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FOCUS ON FUTURES

Friedberg Mercantile Group Ltd. Volume 14, No. 1 February 14, 2011

Corn: disappointing crops and shrinking inventories

The January 12 USDA grain reports were generally very bullish for corn prices. The one exception was an upward revision for the ratio of harvested-to-planted acres for the 2010-11 US crop, from 92.2% to 92.3%. The crop continued to shrink, regardless, because the yield estimate fell rather sharply, from 154.3 bushels per acre (bpa) to 152.8 bpa. The report was a surprise. Average analysts' guesstimate called for a slight drop in yield from last month's 154.3 bpa to 154.2 bpa. The crop estimate was lowered by 93 million bushels from the December estimate, to 12.447 billion bushels.

The quarterly stocks report, which shows inventories as of December 1, came in 27 million bushels below analysts' expectations, at 10.04 billion bushels. Last year's fourth-quarter inventories were 862 million bushels higher. Both old- and new-crop prices have advanced to new highs since the release of the reports (Charts 1 and 2).

The estimate for US ending stocks has fallen to a dangerously low 5.5% of consumption, exceeded only by 1995-96, when stocks fell to 5% of usage.

After the US, Argentina has been the world's second-largest exporter of corn. Responding to the explosive growth in world demand, acreage expanded for the 2010-11 crop, and output was expected to surpass the previous record of 22.9 million tonnes. Up until a couple of months ago, production was forecast at 25 million tonnes, which would have allowed for record exports of 18.5 million tonnes. A devastating drought has shelved any hopes for a bumper crop, however, and the estimates keep dropping. In the January crop report, the USDA lowered its estimate by 1.5 million tonnes, to 23.5 million tonnes. That estimate is ancient history, though. On January 20 the Buenos Aires Grain Exchange cut its estimate to 19.5 million tonnes, down from its previous estimate of 20.35 million tonnes.

Not that it was any great surprise, but China made its first purchase of 500,000 of Australian feed wheat. Australia is saddled with an enormous amount of wheat, which was intended to be milling quality, but was spoiled by the heavy flooding that has devastated crops. The Chinese purchase in itself is not that significant, but several million tonnes of the inferior grade wheat will be up for sale by the time the harvest is complete in February. In 2009-10 China made its first purchases of US corn in many years. With the cheaper Australian feed wheat available, it is unlikely that China will be a customer for US corn in the foreseeable future.

In any case, in 2009-10 China ran a production/consumption deficit. This season it is expected to grow a 6-million tonne surplus. Imports from the US thus far in 2010-11 have been only 313,000 tonnes, so any effect from reduced Chinese interest on total US exports will be negligible.

Bulls breathed a sigh of relief when Congress extended the ethanol credits for another year. It is almost a certainty that ethanol consumption would drop off to some degree without the government subsidies.

In the meantime, until such time that the handouts are quashed, supply-side developments for corn have been fairly pathetic. The US now uses almost as much corn for ethanol as it does for animal feed. US ethanol usage in 2009-10 grew by 23% over the previous marketing year. For 2010-11, consumption is forecast to grow an additional 7%, to the corn equivalent of 4.9 billion bushels. Feed usage has grown modestly each year. The size of the US crop, however, is smaller

Inside

Unless otherwise indicated, all articles have been written by Sholom Sanik (E-mail: *ssanik@friedberg.ca*).

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this year than it was in two out of the past three seasons.

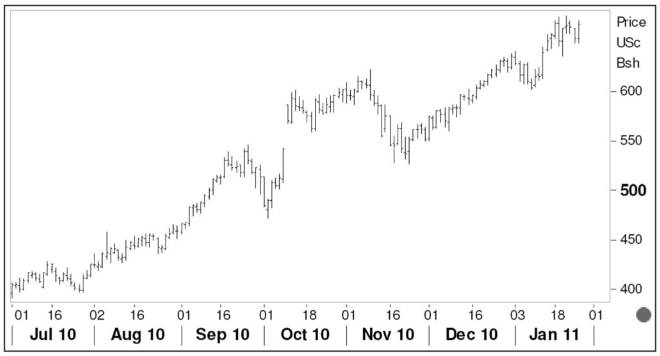
With this month's revisions, the estimate for global ending stocks is revised down to 15.2% of usage, very close to the 15% level we dropped to at the end of the 2006-07 marketing year, which ultimately saw prices run to $7.40 per bushel.

What's in store for the future? In the coming months we'll see acreage estimates for US 2011-12 crops. Informa Economics weighed in with a forecast of 90.93 million acres, up from its previous estimate of 90.755 million acres. That'll be up from 88.2 million acres in 2010-11, but still shy of the record 93.527 million acres planted in 2007-08. Competition from wheat, soybeans, and cotton will be stiff, so the acreage estimates will fluctuate.

Although the market is trading right near its highs, we feel very comfortable following the trend. Remain long. Place sell stops at $6.35, basis May, close only.

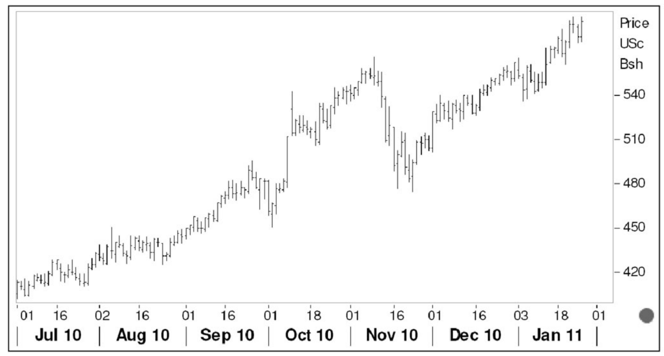
[January 27, 2011]

Chart 1 – May corn



Courtesy Reuters

Chart 2 – December corn



Courtesy Reuters

SOYBEANS

Argentinean estimates wither

With the revisions contained in the January USDA crop report, the estimate for US ending stocks for soybeans will sink to a record low. The harvested-to-planted ratio improved slightly, from 98.88% to 98.96%, but that's where the bearish news ended. The improved harvest ratio was compromised by a drop in the yield estimate. The guesstimate was calling for a slight increase in the average bushel-per-acre (bpa) yield, but it actually fell from the 43.95-bpa December estimate, to 43.5 bpa. As a result, the 2010-11 crop estimate fell by 46 million bushels from the December estimate, to 3.329 billion bushels. The average guesstimate was for just a small downtick, to 3.373 billion bushels, so the report took traders by surprise. Ending stocks will fall to 140 million bushels, or 4% of consumption, down from last month's 165 million bushels.

The quarterly stocks report released concurrently with the crop report showed December 1 soybean stocks at 2.277 billion bushels, down from 2.339 billion bushels a year earlier, but far more significantly, below analysts' expectations for 2.345 billion bushels.

The primary news that has been driving prices higher has been Argentina. The largest revision contained in the January crop report was a drop in the estimate for Argentinean output. Drought has plagued this year's crop, and the USDA lowered its forecast by 1.5 million tonnes, to 50.5 million tonnes. Although the weather has stabilized, with cooler temperatures and some precipitation, the USDA estimate is probably still too high. The most recent private estimate puts production at 48 million tonnes.

Sticker shock has not been a deterrent for foreign buyers of US soybeans. Weekly export commitments continue at a clip that is still above the historical norm. The USDA estimates that 2010-11 exports will reach a record 1.59 billion bushels, but weekly commitment data suggest an even higher figure.

The Chinese delegation visiting the US signed agreements to buy old- and new-crop soybeans in what amounts to about 15% of this year's US crop. It was more of a ceremonial showcase and headline grabber than actual bullish news, because the deal represents just a fraction of what China buys from the US. Thus far, Chinese commitments for 2010-11 represent about 66% of all US sales.

While Asian consumption has been the principal driver of the demand side, the US crush has been improving from recessionary levels. The most recent Census Bureau data show that 153 million bushels were crushed in December, down from 173.1 million bushels crushed in December 2009. The total crush since the start of the marketing year is still smaller than last season at this time. The USDA actually revised the US domestic 2010-11 crush down by

10 million bushels in the crop report. The pace indicated by year-to-date crush figures, however, looks higher than the revised forecast for the bean equivalent of 1.655 million bushels. We'll probably see that figure move back up in the February crop report.

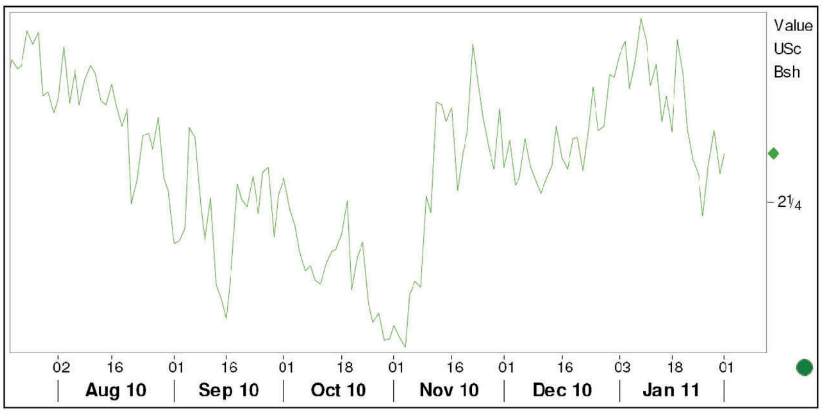
In 2009-10, US farmers planted 77.4 million acres to soybeans. With anticipation of the tightest carryover in history and high prices, you'd think that soybean plantings would expand. That is not the way it looks – at this time anyway. Informa Economics lowered its estimate for US soybean area to 76.654 million acres, down from its previous estimate of 77.655 million acres.

As we head into the crucial decision-making period of what to plant – where the choice exists – competing crops have inched out in front of soybeans. Charts 3 and 4 show that over the past few weeks, both new-crop corn and especially cotton prices have been much stronger than soybeans. Of course, there is time for the pendulum to swing back in favor of soybeans.

Back in the fall, as we headed into the US harvest, 2010-11 global ending stocks were estimated at over 25% of consumption. Many things have changed since then, though. The US crop is down 4%, US exports are up about 8%, and Argentinean output estimates are still falling. The revised estimate for the carryover is now 22.8% of usage. After accounting for more current Argentinean output estimates, that figure is closer to 22%. That should still be sufficient to meet global needs, but inventory levels have become far more vulnerable.

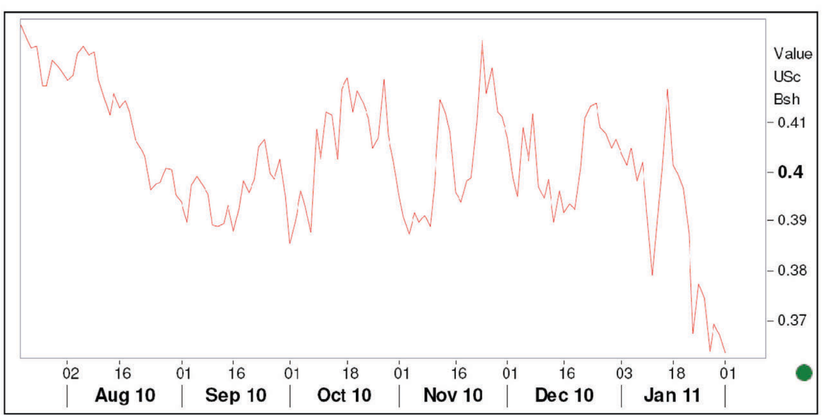
Remain long March soybeans and soybean meal. Place protective sell stops at $13.50 per bushel and $360 per tonne, respectively, close only. *[February 1, 2011]*

Chart 3 – November soybean/December corn ratio



Courtesy Reuters

Chart 4 – November soybeans/December cotton ratio



Courtesy Reuters

WHEAT

Global wheat inventories slipping back to bull market levels

On January 26, March wheat traded through the $8.41-per-bushel inter-day high set on August 9. While our trading strategies are guided almost exclusively by fundamental analysis, this double-top violation was a key milestone for wheat.

Wheat prices rallied this past summer because of drought in the FSU. Production estimates have since been revised downwards consistently. The January USDA crop report slashed an additional 1.3 million tonnes off Kazakhstani output, leaving the estimate for total 2010-11 FSU output at 81.33 million tonnes, down from the pre-drought estimate of 108 million tonnes. In 2009-10 the FSU harvested 113 million tonnes of wheat and exported 36.73 million tonnes. This year exports are estimated at 16.7 million tonnes.

The January crop report revised FSU exports down by 1 million tonnes, but until this month's crop report was released, the 16.7 million-tonne export estimate has remained the same since November. So although the estimates for output kept dropping – after assessing the damage in late-summer/early fall – the street had already determined the extent of the impact of the FSU wheat crisis. This explains the spike in prices in August, but it also explains the subsequent $2-per-bushel dive. Years of rising global production had insulated the pool of wheat available to feed world trade, despite the magnitude of the hit that the FSU took in both quantity and quality.

Not much has changed in statistical terms. Global ending stocks in September were 26.8% of consumption – and despite all the turmoil, that figure has barely moved. According to the January crop report, the carryover is 26.75% of usage.

The recent events that propelled prices past the August highs, however, have altered the landscape. First, weather problems in Australia devastated the wheat crop. Early acreage-based forecasts called for a record crop of close to 27 million tonnes. The January USDA crop report lowered its estimate to 25 million tonnes, from the December 25.5-million-tonne estimate. With the harvest complete, more current estimates put output as low as 22.7 million tonnes.

Even this lower Australian estimate does not tell the story, though. Excessive rains reduced a huge amount of the crop to feed grade, which further exhausts the supply of the food-grade wheat traded at the Chicago Board of Trade and the Kansas City Board of Trade. Recent data show that 38% of harvested wheat stocks in Australia are feed-grade, compared with 14% last year.

The major Northern Hemisphere winter wheat crops – currently in their dormancy stage and to be harvested in the spring and early summer – have come under some pressure as well. The two principal growing regions in China have been very dry, with no significant rain forecast for the next few weeks. About 15% of total Chinese wheat crop grows in the affected areas.

China has been running production/consumption surpluses in recent years. It has not been a player in the export market, which likely has padded its reserves. According to the USDA, using data supplied by the Chinese Ministry, inventories are equal to more than 50% of consumption. This figure is likely bloated, but unlike many other commodities, China does not seem to have any wheat shortages.

The acreage estimate for 2010-11 which was released concurrent with the January crop report, showed that US farmers planted 40.99 million acres for the winter wheat crop this past fall, 3.655 million acres more than in 2009-10 and in line with expectations. However, the huge jump in acreage could be compromised by a bitterly cold winter storm that has swept across the US plains and that could freeze the dormant plants.

Both the US and Chinese weather situations are not necessarily devastating. We get weather scares every year, for every crop and for every region.

The ending-stocks figure is deceptive, though. It has not fully accounted for the Australian drought-reduced crop. In addition, estimates for the US and China have thus far been based on acreage, and as illustrated above, the potential for downward revisions has become a reality. Moreover, the balance sheet does not discern between bread-quality and feed wheat. A higher percentage of global inventories than is typical in feed wheat. The crisis in North Africa and the likelihood that importing developing nations will be making liberal purchasing decisions in the coming months have sparked fears that we'll be seeing estimates for global inventories dropping.

Remain long March wheat. Place sell stops at $7.50 per bushel, close only. *[February 7, 2011]*

Chart 5 – March CBOT wheat

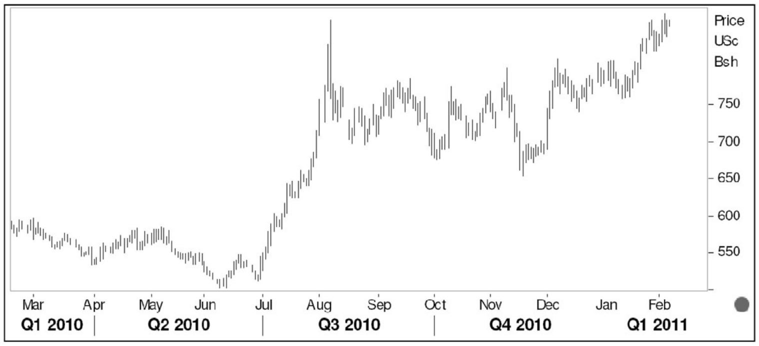


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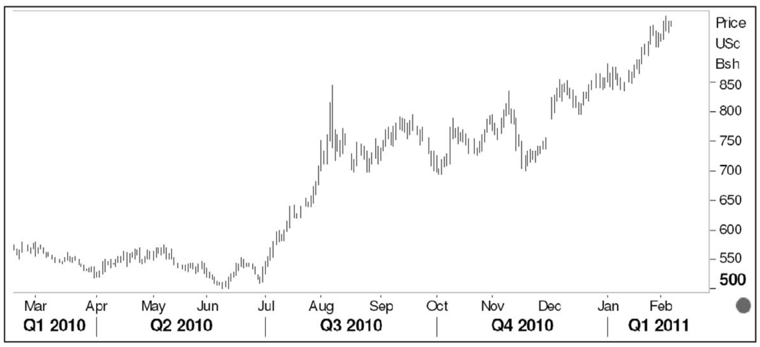
Chart 6 – March KCBT wheat



Courtesy Reuters

COCOA

Ivorian export ban: more than meets the eye

The political turmoil in the Ivory Coast has seen cocoa prices spike to fresh recovery highs and to a whisker shy of the December 2009 $3,510-per-tonne peak.

Just a brief primer to understand what has transpired: Incumbent president Laurent Gbagbo lost the November 28 presidential election to Alassane Ouattara. The UN thinks so, but Mr. Gbagbo does not. First, the EU and the US imposed sanctions, which did not allow ships flying its flags to load Ivorian cocoa. Shortly afterwards, Mr. Ouattara ordered a one-month ban on all cocoa exports out of the country, which was respected by exporters. The purpose of the ban was to starve the coffers of Mr. Gbagbo of the lucrative taxes collected from exporters. Mr. Ouattara declared that the tax will be collected again from violators of the ban when – and if – he succeeds in taking the presidential office. At present, there is talk that the export ban will be expanded when it expires on February 23.

Analysts have generally made light of the effect of the ban on global supplies. After all – similar to strikes – the beans exist and it is just a matter of time before the supplies hit the market. It is easy to explain the backwardation that has developed in terms of short-term tightness. Press reports claim that European processors are well supplied, and there is no danger of the pipeline running dry. In fact, port arrivals, last reported on February 7, were 919,000 tonnes, 12.5% ahead of last year at this time. The market should be able to handle the export ban.

There are several issues, though. One problem is that storage facilities are inadequate. Normally the beans are harvested, dried, and off to the ports for shipment to Europe. Farmers are reporting that some beans have begun to rot.

The damage from one month of export restrictions can perhaps be mitigated by the excellent arrival rate before the ban began. A second month of no exports, however, would wipe out any gains from the larger crop and then some, at least in the short term. Last year, arrivals from January 23 through March 23 were about 115,000 tonnes. Of course, the bulk of the beans – even after accounting for rotting – will eventually come to market, but in the short term, a squeeze could materialize.

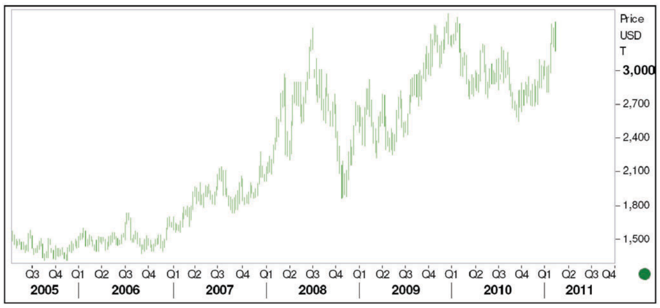
Butter supplies are said to be low in Europe. With the butter/bean ratio still hovering just above multi-year lows (Chart 8), the incentive to make butter has been weak and will now manifest itself in tight butter supplies, which sooner or later will push processors to ramp up bean purchases.

We believe the most important issue is the long-term implications of the political uncertainty in the Ivory Coast. Up until now, as we've pointed out many times, there has never been a serious supply disruption that was directly related to the internal conflicts that are a fixture in the Ivory Coast. All that has changed. By imposing the export ban, the candidate supported by the international community has shot the Ivory Coast in the foot, in a manner of speaking, by jeopardizing the industry without which the country's economy would surely slip into further chaos. The size of the fear premium attached to the price of cocoa should rightfully expand.

While open interest has increased by about 50,000 contracts, or 40%, over the past few months, it is not a crowded trade. Chart 9 shows that the size of the net-long position held by commodity funds is not extraordinary by historical levels. The exuberance displayed for long cocoa seemed to be much richer in 2007.

Remain long cocoa and do not be afraid to put on new positions at these levels. We expect dramatically higher prices. *[February 11, 2011]*

Chart 7 – Weekly nearest contract cocoa



Courtesy Reuters

Chart 8 – European butter ratio

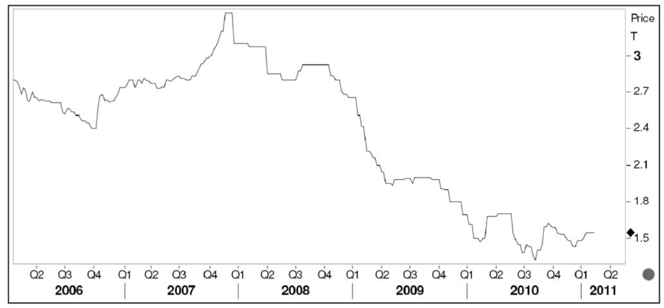


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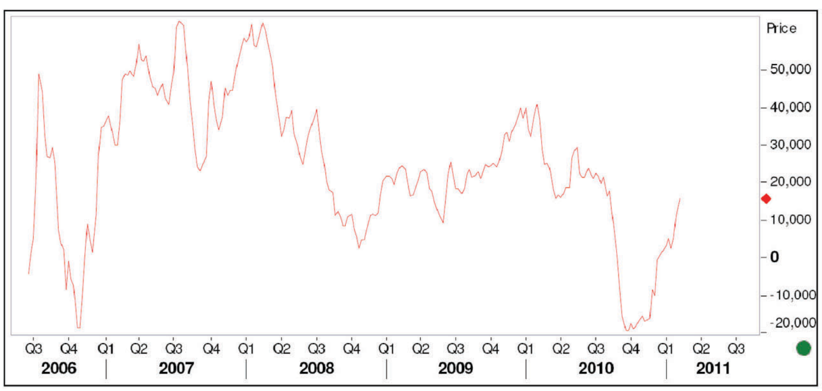
Chart 9 – Fund net-long position



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Subscription Enquiries for
Friedberg's Focus on Futures
Suite 250
181 Bay Street
Toronto, Ontario, Canada
M5J 2T3
416-364-1171

All enquiries concerning trading accounts should be directed to:

In Canada
Friedberg Mercantile Group Ltd.
Suite 250
181 Bay Street
Toronto, Ontario M5J 2T3
416-350-2903
Attn: Sholom Sanik

For U.S. Persons
Friedberg Mercantile Group, Inc.
Suite 250
181 Bay Street
Toronto, Ontario, Canada M5J 2T3
1-800-461-2700