FRIEDBERG'S
FOCUS ON FUTURES
Friedberg Mercantile Group Ltd.
Volume 19, No. 1 February 29, 2016

# Coffee: is the bear tiring?

After hitting $2.25 per pound in mid-2014, coffee prices tumbled precipitously through this past summer. The market has tried to crack $1.10-per-pound several times in the interim, but support emerged, and prices pushed back into a fairly tight trading range (Chart 1).

Crops in the world's two largest producing and exporting nations – Brazil and Vietnam – grew to record levels in 2012-13 and 2013-14, but demand was flatlining. In 2014-15, and based on early forecasts for 2015-16, the roles have reversed.

In 2014-15 global consumption grew by close to 3 million (60 kg) bags, to 145.5 million bags, but prices continued to fall because there was an overhang of stocks from the years of bountiful harvests. In December, the USDA revised its estimate for 2015-16 usage upwards by over 500,000 bags from its initial estimate in June, to 148.3 million bags. That is an increase of additional 3 million bags over 2014-15.

Global production, on the other hand, has been sliding. The USDA revised its 2015-16 output forecast downwards by 2.5 million bags in its December estimate, to 150.1 million bags. That will be 600,000 bags more than in 2014-15, but 5.5 million bags less than the record achieved in 2013-14.

In the five years prior to this year's harvest, there were hefty global production/consumption surpluses. The average surplus was 7.4 million bags. According to the USDA's December estimate for the 2015-16 marketing year, there will still be a surplus, but of only 1.8 million bags.

Ending stocks held in the major producing and consuming nations for 2015-16 are set to fall to 25% of usage. This compares with 29% in 2013-14 and 2014-15. Stocks in Brazil in particular are near record lows, which means that favorable weather over the next few months is imperative.

The weather has been dry in the key growing regions in Brazil and Colombia. El Niño may be waning, but its effects are still being felt.

There are two recognizable trends developing. The most prominent is the jump in global demand over the past two years, as seen quite clearly in the USDA balance sheet cited above. Of course there is always a concern that the slowing economic growth rates in China could affect demand for coffee, as it may for any commodity. But on the whole, demand is on the rise in both developed and developing countries. The International Coffee Organization tracks traditional and emerging markets separately, and both sectors have seen demand grow steadily since 2011.

Then there is the uncertainty surrounding the coming crops among the major producers. We've already seen a downtick with last year's crops, and as illustrated, forecasters are not looking for any improvement this year.

Open interest is near record levels, and speculative funds still own a massive short position (Chart 2). Any hint of crop problems will unleash a short-covering rally.

It would be premature to talk about a deficit, however. With prices having fallen so far and supply/demand fundamentals traveling in a bullish direction, the market is vulnerable.

We recommend establishing long positions in May coffee, currently trading at about $1.22 per pound. Place initial stop at $1.15, close only.

*[Sholom Sanik, February 3, 2016]*

## Inside



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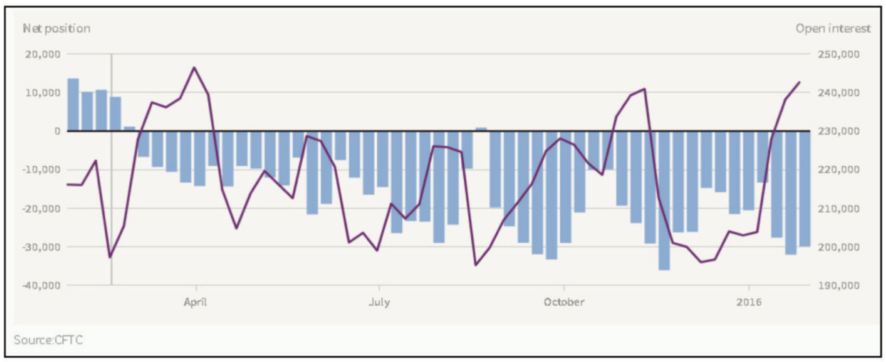
**Chart 1 – May ICE coffee**


*Courtesy Reuters*

**Chart 2 – Open interest (line), Fund net-short position (bar)**




*Courtesy CFTC*

## COPPER

# Faux bearish fundamentals?

The *anticipation* of weaker copper demand sparked a sharp selloff in copper prices over the past few months. In particular, the devaluation of the Chinese yuan back in August triggered fears that the world's second largest economy was in trouble and that we would see a drop in commodity imports. Chart 3 shows a fairly close cor-relation between the fall in the yuan and copper prices. Even before the devaluation, analysts were bewildered by the staying power of Chinese copper imports and predicted that in the fourth quarter of 2015, we would see the long-awaited drop in Chinese overseas buying.

Well, to the extent that Chinese customs statistics published by the government are anywhere near accurate, the collapse of imports has not materialized (Chart 4). At 530,000 tonnes, December imports of refined copper were just shy of the monthly record set in January 2014. In the three previous months, imports were also well above the average recorded throughout 2014 and 2015. Chinese imports of refined copper in 2015 rose by 2.5%, to a record 3.68 million tonnes.

The seemingly insatiable appetite for copper is also intriguing in light of government-imposed restrictions on copper used for collateral after the Qingdao port scandal was uncovered. Activity in the sector has reportedly dropped materially.

While many will continue to question the reliability of the customs data, it would be harder to explain why Chilean data show that 2015 shipments to China are at least as large as they were in 2014.

Another indicator that has not been commensurate with falling prices is warehouse stock levels. Combined inventories at LME, Shanghai, and COMEX hovered near 500,000 tonnes for most of 2015, still down sharply from their near-double peak in 2013 (Chart 5). And according to the International Copper Study's most recent report, Chinese off-exchange bonded warehouse stocks declined by 160,000 tonnes from January through October 2015.

Regardless of whether demand fundamentals have warranted the bear run in copper, falling copper prices have had a material impact on production. Early-2015 forecasts saw global copper mine production rising by about 6%, but that figure is much closer to 1.5% growth.

Mine capacity has been expanding, but that has not resulted in increased production – quite to the contrary. A closer look at the world's largest producer shows clearly that miners are not eager to crank up production when the gap between copper prices and production costs has narrowed significantly. During the second half of 2015, Chilean mine output was actually 2.17% below the same period of 2014. Output for the year was about unchanged, but even that was only on account of the anomalous January 2015 bubble that saw output for the month jump 13.2%. Otherwise, mining activity was in a slump for the balance of the year.

The slowdown in China and the weak recoveries in other regions may very well push the copper market into surplus one day. At the moment, however, there is no evidence in the apparent fundamentals, i.e., Chinese import demand, that demand has slackened. Output has nevertheless been affected by falling prices.

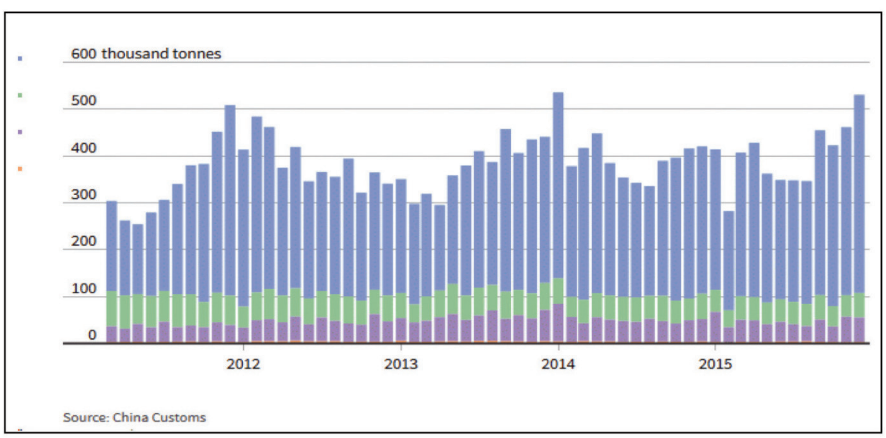
COMEX open interest is at an all-time high (Chart 6), and commodity funds are heavily net short. When the market decides to focus on the fact that the fundamentals are actually bullish, a powerful short-covering rally will ensue.

We recommend establishing long positions in May copper, currently trading at about $2.10 per pound. Place initial stops at $1.95, close only. Should the market close above $2.15 (the December high), raise sell stops to $2.02, close only. *[By Sholom Sanik, February 5, 2016]*

**Chart 3 – March copper (bar), March Chinese renminbi (line)**


*Courtesy Reuters*

**Chart 4 – Chinese copper imports**




*Courtesy China Customs*

**Chart 5 – Global exchange warehouse stocks**

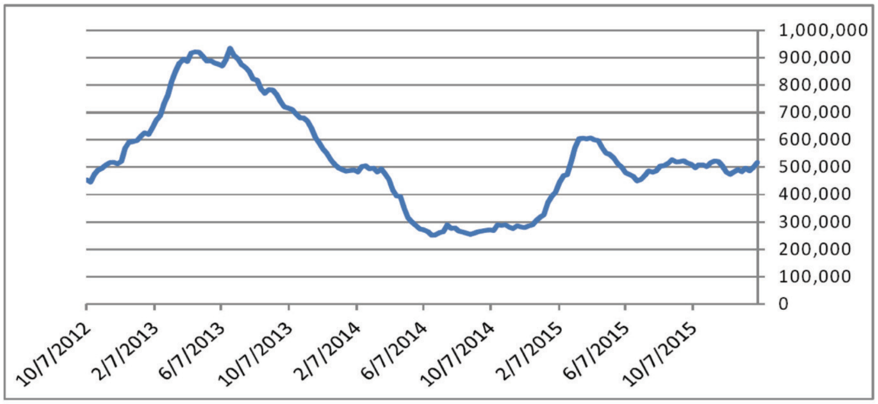
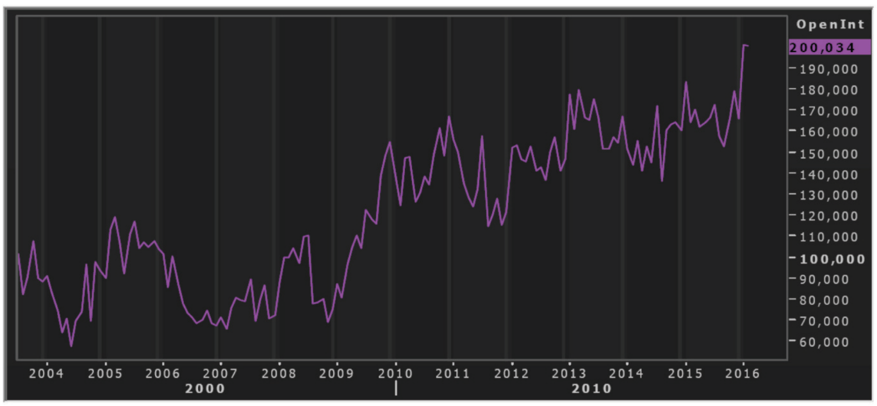



**Chart 6 – COMEX open interest**




*Courtesy Reuters*

## SUGAR

# The harsh reality of a global sugar deficit sets in

Sugar prices responded dramatically (Chart 7) to an International Sugar Organization (ISO) report that increased its estimate for a global deficit for the 2015-16 marketing year by 1.5 million tonnes, to 5 million tonnes.

The larger deficit is a result of revisions to output estimates for the two largest Asian producers. Thailand is the world's second-largest exporter behind Brazil, selling about 90% of its output abroad. El Niño brought drought, and as the cane crop is being processed, yield estimates have been dropping.

Although analysts have been ratcheting down the prospects for 2015-16 Indian output, the estimates remained stubbornly high, at no lower than 26 millions tonnes. Over the past few months we've been skeptical about these estimates after significant drought damage was reported in Maharashta State (see *Focus on Futures* December 18 and January 26). Concrete estimates for India have yet to emerge, but you can bet that they are materially below 26 million tonnes. The crushing season is expected to end early because of a lack of viable cane. Thus far, 33 mills in the state have ceased operations for the season, compared with only 11 at the same time last year.

India is not and has never been an exporter of great importance. But over the past several years, bumper crops created surpluses, and exports of several million tonnes became the norm, with the objective of stabilizing rising domestic prices. This season the government enacted legislation that strongly encouraged exports. Depending on how production turns out, this may have been an ill-advised strategy.

Indian domestic sugar consumption is the highest in the world. Sugar is relied upon by state planners as an inexpensive carbohydrate, and they do not want to see inventories run low. Thus far we have no idea just how badly the drought has affected yields, but we are quite certain that – sooner or later – legislative action will reverse the accommodative export rules. Any exports India contributed to the pool that helped balance the looming global deficit can no longer be counted on.

In its report, the ISO revised its output estimates down by 650,000 tonnes for India and 500,000 tonnes for Thailand. It's harder to gauge activity in Thailand, but we feel confident that the losses in India are larger than the ISO estimate.

The ISO deficit estimate is actually the most conservative of the lot. Other private forecasters have weighed in with deficit estimates that run as high as 8 million tonnes.

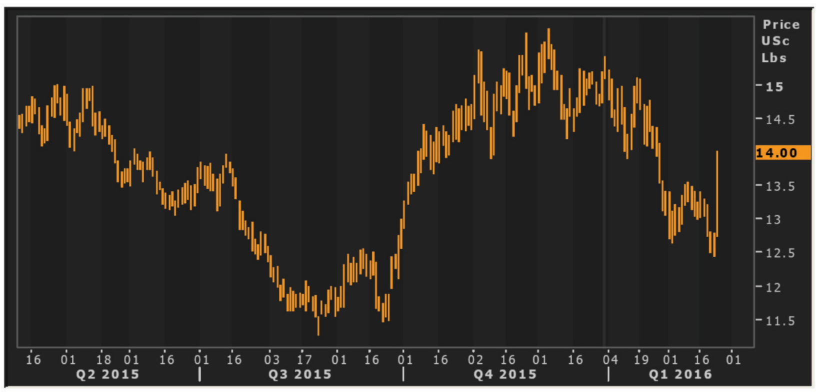
Over the past three years, global stocks as a percentage of consumption averaged about 25%. Even when using the ISO's conservative estimate of a 5-million-tonne deficit, that figure will fall to 20% of usage (Chart 8).

With the expiry of the March contract around the corner, there has been a mass exodus of speculative longs. Over the past few weeks open interest fell by close to 90,000 contracts, or by about 10%. The net-long fund position dropped from a peak of 167,000 contracts to 21,000 contracts (Chart 9). We believe the correction has run its course. Confirmation from the ISO that we are headed for a deficit seems to have startled the market.

Remain long call options.

*[By Sholom Sanik, February 24, 2016]*

**Chart 7 – March ICE sugar**




*Courtesy Reuters*

**Chart 8 – Global sugar ending stocks as a percentage of usage**

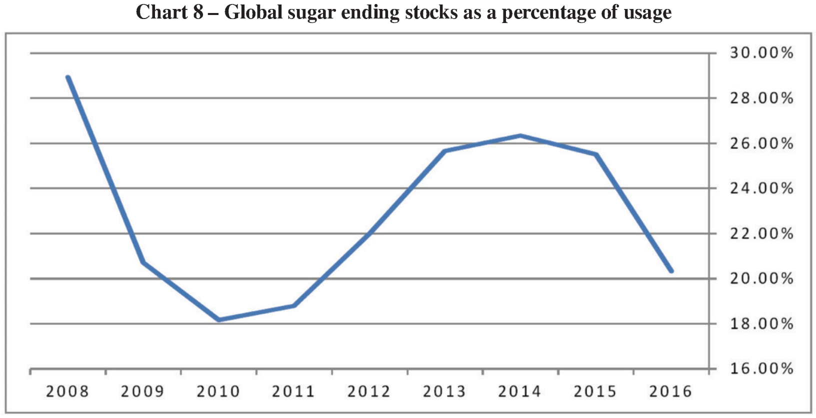
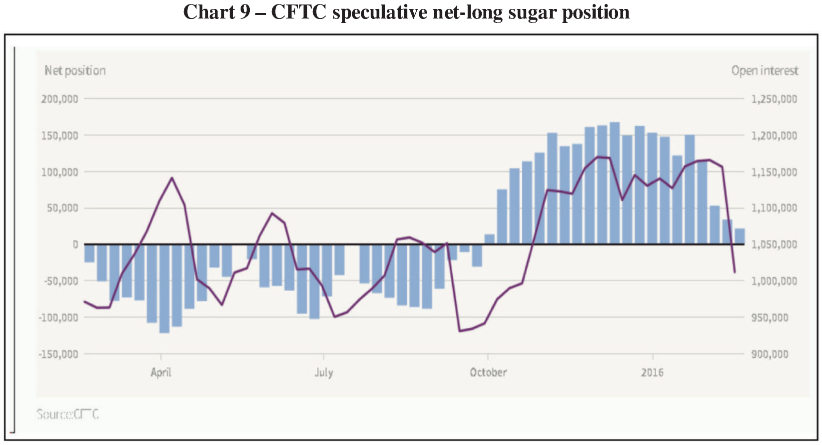



**Chart 9 – CFTC speculative net-long sugar position**




*Courtesy CFTC*

**CORN**

# South American producers edging in on the US

Corn prices have been stuck in a fairly narrow range since the completion of the 2014-15 US harvest last fall (Chart 10).

The change in government in Argentina late last year was the most significant piece of news to be introduced into this market. The elimination of the export tax and a *de facto* devaluation of the peso had the expected bearish effect. Farmers jumped at the opportunity to plant more corn before the January window closed, and inventory that was held back in anticipation of higher prices (in local currency) has been finding its way to market.

A recent government estimate revised planted area up by 3.3% from its January forecast. In its February crop report, the USDA increased the Argentinean output estimate by 1.4 million tonnes from the previous month, to 27 million tonnes. That will mark the fourth consecutive year of bumper crops.

The estimate for Brazilian production was increased as well, by 2.5 million tonnes, to 84 million tonnes. That's just shy of last year's record, but Brazilian output has jumped dramatically over the past few years. Average output since 2012 has been 82.6 million tonnes. In the five-year period before that, average output was 59 million tonnes.

While still dwarfed by US production, Brazil is becoming a competitive force in the global export market. The USDA revised its export estimate upwards by 2.4 million tonnes, to 28 million tonnes. In 2014-15, exports reached a record 33 million tonnes, compared with US exports of 47 million tonnes. Until 2012 Brazil was exporting about 10 million tonnes. As output expanded, exports have more than doubled.

With the USDA's upwardly-revised South American forecasts, global ending stocks will tick up a notch to 21.62% of consumption. That will be the highest carryover since 2001-02.

At its annual Agricultural Outlook Forum, the USDA announced its 2016-17 acreage projections for major US crops. As a whole, farm acreage is expected to fall due to low prices. The lone holdout is corn. The early forecast calls for 90 million acres planted to corn, slightly higher than the street's guesstimates, and 2 million acres more than in 2015-16. A more accurate estimate based on comprehensive farmer surveys will be announced at the end of March.

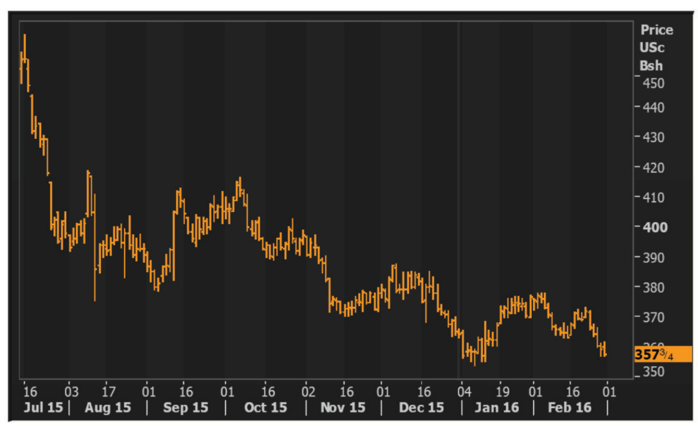
On the demand side, earlier this marketing year the USDA was forecasting that US exports for 2015-16 would be just slightly below the previous year. As the season progressed, however, and we moved closer to availability from the South American harvests, the USDA keeps trimming its estimate. The February crop report reduced the export estimate by 1.3 million, to 41.9 million tonnes.

That is still an optimistic forecast, though. According to commitment data, exports are 24% behind last year at this time, compared with the USDA forecast that we will end the season down only 11%.

The fundamentals of this market are bearish, as illustrated, and we recommend maintaining short positions. The market should continue to drift lower. Nevertheless, there have been several instances over the past decade in which wet weather had a serious enough impact on US spring plantings to result in substantial rallies. Lower protective buy stops to $3.70 per bushel, close only.

*[By Sholom Sanik, February 29, 2016]*

**Chart 10 – May corn**




*Courtesy Reuters*

Friedberg's Focus on Futures is published by Friedberg Mercantile Group Ltd., P.O. Box 866, Suite 250, 181 Bay Street, Toronto, Ontario, M5J 2T3.


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