

FRIEDBERG'S

FOCUS ON FUTURES

Friedberg Mercantile Group Ltd.



Volume 18, No. 1 February 5, 2015

Cocoa output slumps, but is it enough to keep the bull charging?

Cocoa is one of the few markets that have – for the most part – sidestepped the ravages of the bear market in commodities. While the population of the Ivory Coast was largely unaffected by the Ebola virus, traders attached a fear premium over concerns that the virus – prominent in other West African countries – would hamper production if migrant workers were restricted from entering the country. Thus far, the fears have been unfounded. After spiking to \$3,300 per tonne this past fall, the fear premium has been unraveling, and the market has found direction in supply/demand fundamentals.

For the 2013-14 marketing year that ended in September, Ivorian production reached a record 1.75 million tonnes, roughly 200,000 tonnes higher than the previous record. The International Cocoa Organization (ICCO) estimates that the bumper Ivorian crop resulted in a 53,000-tonne global production/consumption surplus.

The outlook for a continuation of such strong output is less certain, and as a result, prices have bounced off recent lows. As we cross the mid-point of the 2014-15 October-through-November main-crop season, Ivorian arrivals have slumped and are substantially behind last year. As of the most recent report, arrivals stand at 820,000 tonnes, compared with 954,000 tonnes at the same time last year. Farmers rely on periodical rain during the typically dry growing season for healthy plants, but the Harmattan winds that blow in from the Sahara have been harsh this season and have restricted precipitation.

Ghana, the world's second-largest producer, is experiencing the same dry weather patterns and has seen its output fall from last year as well.

It's much too early in the season to write off the West African crops as sub par. Over the years, we have seen weak arrivals pick up steam toward the end of the main crop as weather improves. And often, the post-March mid-crop compensates.

On the demand side, fourth-quarter grind statistics for Europe, North America, and Asia will be released over the next couple of weeks. We anticipate that the data will be weak because product prices have been slipping, which means less

incentive for processors to grind. The butter ratio rose dramatically over the past three years, from as low as one times the London spot price to a high of 2.9 in late 2013, and has recently been quoted at 2.15. Powder prices have been steady, but the fall in butter prices has dragged the combined ratio down to multi-year lows (Chart 2).

Estimates for the new-crop 2014-15 global production/consumption balance are all over the place, ranging from a 50,000-tonne surplus to a 120,000-tonne deficit. The health of the West African crops is still a wildcard, but as illustrated above, we do not see the grind numbers coming in strong.

Commodity funds still hold a formidable net-long position (Chart 3). We do not believe that cocoa prices at these levels are in sync with the other commodity markets in terms of the extraordinary strength of the US dollar, besides which, the cocoa-specific fundamentals do not support a bullish case.

The market remains in backwardation, which would seem to indicate that there is a measure of tightness. The balance of evidence, however, suggests that the market is amply supplied.

Maintain short positions. Lower stops to \$3,100 per tonne, basis March, close only.

[By Sholom Sanik, January 7, 2015]

Inside

Copper: Has the bear arrived?	2
Soybeans: Beans galore.....	4
Corn: Unconvincing bear.....	5

Futures and options trading is speculative and involves risk of loss. Past trading results are not indicative of future profits.

Get Focus by e-mail

Focus on Futures is available by e-mail as an Adobe PDF file. If you prefer to receive your copy of *Focus on Futures* by e-mail, please send us a message at focus@friedberg.ca with your full name, e-mail address, and street address.

Chart 1 – March cocoa

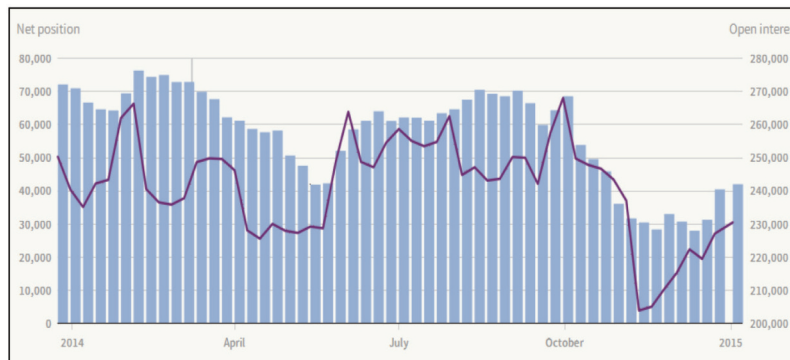


Courtesy Bloomberg LP

Chart 2 – Combined cocoa butter/powder ratio



Chart 3 – Commodity fund net-long position (bar)/open interest (line)



Courtesy CFTC

COPPER

Has the bear arrived?

Copper prices are trading at a five-year low (Chart 4). The market has violated all support levels. The contributing bearish factors: A strong dollar, lower production costs generated by plunging energy costs, and continued skepticism about economic growth in China – consumer of 40% of global copper output.

Warehouse stocks, particularly at the LME, have been

rising. Although they're still considerably below their mid-2013 highs, they stopped falling this past summer and have gained some momentum. Chart 5 shows combined LME, Shanghai, and COMEX stocks curling off the bottom. By all rights, bears should sit back comfortably and enjoy the ride.

A closer study of the apparent copper-specific production and usage fundamentals, however, paints a different picture.

For whatever official Chinese customs data are worth, they continue to show strong import flows. The most recent figures show that imports of refined copper in November were up 4.8% from October and 7.3% higher year-over-year. That was the fourth consecutive monthly increase (Chart 6). Economic data out of China show declining growth, but that does not seem to be affecting appetite for copper. Moreover, fears that the scandal that threatened to make banks more cautious with financing copper imports have also not materialized.

Chilean production has been a disappointment. During the first half of 2014, mine output was growing at a rate of 5.9% per annum and was well on target to reach estimates of 6.03 million tonnes for the year. November's production decline of 7.3% marks the fifth consecutive year-over-year month of falling output. Recent estimates by the Chilean government have been lowered to 5.83 million tonnes, but unless there was an uptick in the December figure, which is released near the end of January, the estimate for the year will be lower still.

There may be a silver lining for copper demand in the otherwise struggling Chinese economy. Recent data show that in 2014, copper used in the power generation and construction industries fell by 9% over 2013. But the government has announced that it is increasing spending on power grid construction by 24% in 2015. One estimate puts the

increase in copper usage that would result from the power-grid spending spree at 8.7%. And perhaps this helps to make some sense out of the stubbornly strong pace of Chinese copper imports. In addition, bonded warehouse stocks have reportedly fallen by 100,000 tonnes just over the past few weeks to 400,000 tonnes. That's down from a peak of 700,000 tonnes about a year ago.

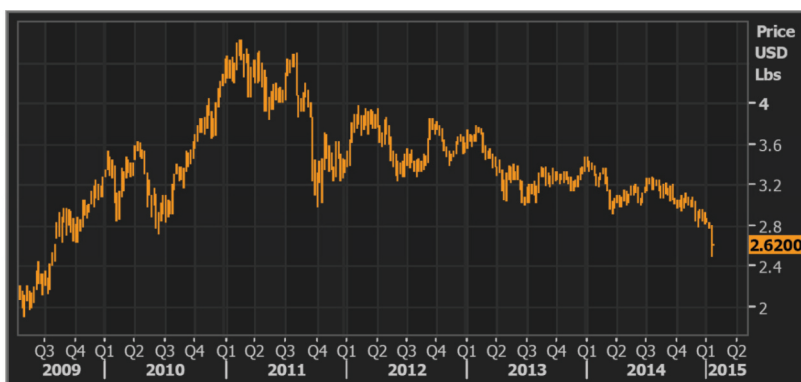
Dated as it may be, the International Copper Study Group's most recent survey puts the global balance for refined copper through the end of the third quarter of 2014 at a deficit of 578,000 tonnes, compared with a 133,000 deficit for the same period in 2013. Given the more current information cited above (surprisingly resilient apparent Chinese consumption data and rather sheepish Chilean output numbers), the global balance is not likely to improve much for the fourth quarter.

For those who live by technical analysis, trying to pick a bottom in a market that has broken down quite the way that copper has would be sacrilegious. Nevertheless, we do not believe the market is quite as weak as the plunge we witnessed would seem to indicate. Rather, the selloff is presenting a buying opportunity.

Buy March copper. Places initial stops at \$2.40 per basis March, close only.

[By Sholom Sanik, January 20, 2015]

Chart 4 – Weekly nearest contract COMEX copper

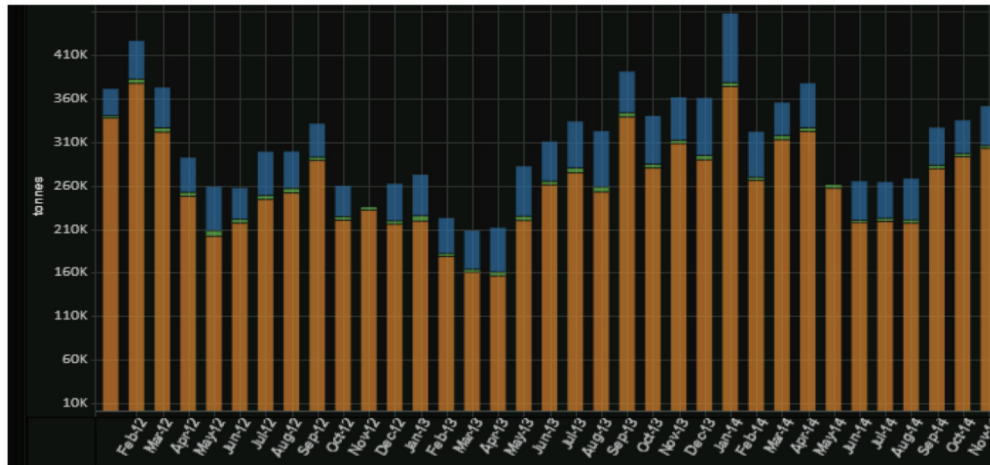


Courtesy Bloomberg LP

Chart 5 – Combined LME, Shanghai and COMEX copper warehouse stocks



Chart 6 – Chinese copper imports



SOYBEANS

Soybeans galore

Soybean prices fell throughout the 2014-15 US growing season as farmers prepared to harvest a record crop. The selling ended abruptly just as the harvest was getting underway. The market rallied, and then spent the next three months in a relatively tight range.

Traders were marking time while South American crops developed. Drought has been an ongoing problem, and there was some doubt as to whether forecasts for record output could be met. But as Brazilian and Argentinean crops head into the home stretch, much needed rains are arriving. Revised forecasts are rising to near the high end of analysts' estimates, and as a result, prices are starting to break down (Chart 7).

With the bumper crop in the US, the soybean balance sheet shifted from the lowest carryout on record (2.6% of consumption) at the end of the 2013-14 marketing year to the largest carryout since 2006-07 (11.2%).

Brazil and Argentina are just beginning to harvest their crops, but if all goes well, Argentinean production will climb to a record 55 million tonnes, just one million tonnes above the previous season. Brazilian output is expected to jump to 95.5 million tonnes, up from 86.7 million tonnes in 2013-14.

Global consumption is estimated to increase by 5%, but will be dwarfed by 10.7% growth in production. Ending stocks are expected to skyrocket to 90.78 million tonnes, or 31.7% of consumption, well above the five-year average of 24.12%.

US soybean exports have been moving at a rapid clip, and normally that would put a bit of a bullish spin on an otherwise very bearish picture. Over the past two months, weekly sales have averaged 695,000, which is quite strong for this point in the season. Shipments have also been quite high. But while sales are still running ahead of last year's pace and typically would be on track to meet the USDA target of 48 million tonnes, this is anything but a typical season.

First, the strengthening US dollar means that many contracts were signed at a much higher cost, and with South American beans slowly becoming available, Chinese cancellations are inevitable. Indeed, those cancellations have begun to appear. Then the flood of South American beans will eventually bring US exports down to a trickle.

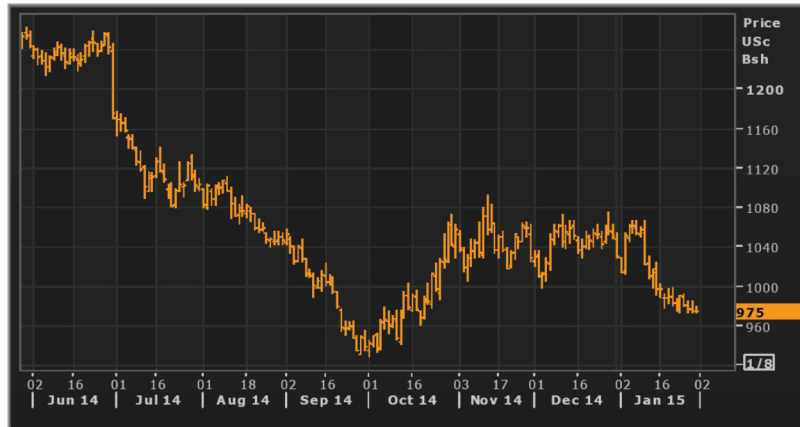
Looking ahead to the 2015-16 season, there does not seem to be much relief from the grip of the bear. The USDA's first estimate for spring planting – just around the corner – will be released on February 20. Early guesstimates are calling for close to 89 million acres, substantially higher than 2014-15 planted area of 83.7 million acres.

Chart 8 shows that commodity funds have been piling onto their net-short position, but it is not a particularly large position when viewed in historical perspective.

We expect continued weakness in the whole soy complex. Remain short as per our July 22 recommendation. Lower buy stops to \$11 per bushel, basis May soybeans.

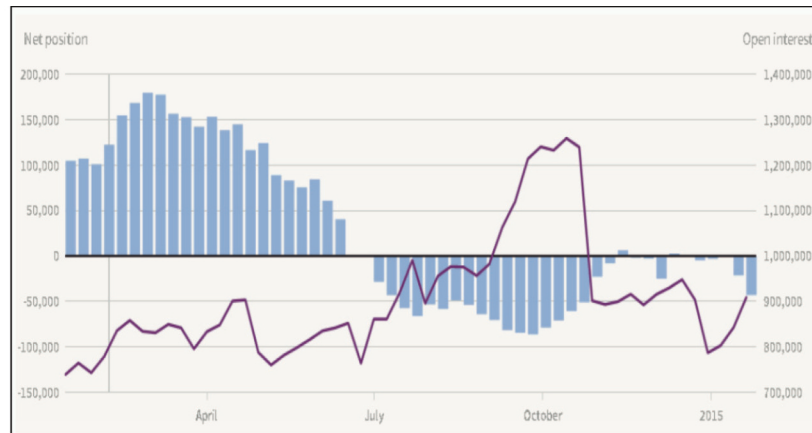
[By Sholom Sanik, January 30, 2015]

Chart 7 – May soybeans



Courtesy Bloomberg LP

Chart 8 – Commodity funds net position



Courtesy CFTC

CORN

Unconvincing bear

Corn prices headed into the January USDA crop report close to the top of a \$1-per-bushel rally. Even bullish news couldn't sustain the rally, though. The revision for arguably the single most important statistic for the global corn market – the average bushel-per-acre (bpa) yield for the US crop – would normally have been considered quite bullish. The yield estimate peaked in October at 174.2 bpa and slipped just a tad as the harvest progressed. The average guesstimate was 173.3 bpa, but the figure came in at 171 bpa. Prices responded briefly to the news, but then continued to erase the post-harvest gains as traders focused on the fact that the crop would still be a record by far (Chart 9).

Global ending stocks for 2015-16 are expected to climb to 189 million tonnes, or 19.5% of consumption. That would be the largest carryover since 2002-03.

Not to be confused with soybeans (see *Focus on Futures*, January 30), the corn market has greater vulnerability. For

starters, on average, South American crops account for about one third of the world corn trade, yet crops in Brazil and Argentina have actually been smaller for two consecutive seasons. Among other major producers of corn, only the EU had a bumper crop in 2014-15, but it does not export much corn. The FSU, traditionally a significant exporter, like its South American counterparts, harvested smaller crops than it did in 2013-14.

US corn ending stocks, like beans, will reach their highest level since they went into free fall in the mid 2000s. But very much unlike beans, the US retains its status as corn supplier of last resort. And the evidence shows up in export flows.

Earlier this marketing year, in keeping with the USDA annual sales target for 2014-15, US corn sales were lagging last year's pace. But as of the most recent weekly export report, sales have caught up to last year's numbers. Shipments are also running neck and neck with last year. The

USDA left its forecast for annual sales unchanged from December at 44.45 million tonnes, down from last year's 48.7 million tonnes, but we're guessing that it will have to revise that figure upwards in the February crop report.

Furthermore, looking ahead to the upcoming spring planting season, early estimates are calling for an increase in soybean plantings to the detriment of corn area. Informa Economics forecasts that US farmers will plant 88.05 million acres of corn, down from 90.5 million acres in 2014-15, while soybean area will jump to 88.78 million acres from 83.7 million acres. If these estimates prove to be accurate, it will be the first time in more than three decades that soybean area will surpass corn area.

To be sure, the corn market is well supplied, at least in

the short term. Demand is strong, though, as illustrated. New-crop prices have outperformed new-crop soybean prices, and in order to shift an appreciable amount of US acres back to corn from soybeans, corn prices will have to rise more *vis-à-vis* soybeans (Chart 10).

With the strong US dollar, internationally-traded commodities, in general, are in a bear mode, so it would be asking for trouble to buy corn. An alternative strategy that could take advantage of the growing disparity between corn and soybeans would be to spread corn against soybeans. Buy December corn and sell November soybeans at a ratio of 7 corn to 3 soybeans. The soybean/corn price ratio is currently trading at about 2.3 soybeans to corn (Chart 10). Place initial stops at a ratio of 2.5. *[By Sholom Sanik, February 5, 2015]*

Chart 9 – March corn



Courtesy Bloomberg LP

Chart 10 – Soybean/corn ratio



Courtesy Bloomberg LP

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. Contents copyright © 2015 by Friedberg Mercantile Group Ltd. All rights reserved. Reproduction in whole or in part without permission is prohibited. Brief extracts may be made with due acknowledgement. Friedberg Commodity Management Inc., an NFA registered CTA, takes full responsibility for the contents of this publication.

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

Futures and options trading is speculative and involves risk of loss. Past trading results are not indicative of future profits. This report is a solicitation for entering into a derivatives transaction. The author of this report may have a position in the underlying derivative securities mentioned in this report.

The information in this report was obtained from sources we believe to be reliable but is not guaranteed by Friedberg Mercantile Group Ltd. or its affiliates. Derivatives are high-risk investments, and there can be no assurances that the securities mentioned or recommended will maintain their value at a constant amount or that the full amount of your investment will be returned to you. Derivatives' values change frequently and past performance may not be repeated.