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Corn: The USDA shocks the street, but will it matter?

The November USDA crop report completely fooled everybody. In August, when corn development was at its most crucial stage and after a season of relatively poor weather, the USDA estimate for the US 2017-18 bushel-per-acre (bpa) yield was below 170 bpa. The crop estimate was 14.153 billion bushels (359.5 million tonnes). That would have been down 6.5% from 2016-17 output.

Throughout the season, analysts consistently missed the USDA yield estimate, looking for a bushel-per-acre yield as low as 165 bpa. Every month the USDA estimate came in higher than analysts' guesstimates.

That was nothing compared with November though. The October estimate was 171.8 bpa, and respecting the trend in USDA field surveys, the average guesstimate leading into the November crop report was 172.4 bpa. And that may have been the biggest miss ever (at least that we can remember).

The USDA came in at 175.4 bpa, a record yield, surpassing last year's record of 174.6 bpa. As a result, output will be 14.578 billion bushels (370.29 million tonnes), down only 3.8% from 2016-17, reflecting just about exactly the drop in planted area. Quite a feat, considering the weather that farmers struggled with.

The market responded in kind with prices dropping for several sessions to break the low of the recent trading range (Chart 1).

While the USDA yield revision certainly had that mega-bearish feel, more US supply did not alter the global balance sheet by very much. Material downward revisions to crops of key Eastern European exporting nations mitigated much of the US increase. Poor weather that ranged from unusually hot weather in September to excessive wet weather as the crop entered its final stages lowered yields. FSU output was revised downwards by 2.3 million tonnes from the October estimate, to 44.25 million tonnes. Ukraine production was down by 2 million tonnes, to 25 million tonnes.

The USDA left South American estimates unchanged from October. For Brazil, all agree that the massive jump in 2016-17 output to 98 million tonnes, from 85 million tonnes in 2014-15 and 67 million tonnes in 2015-16, will not be repeated. The current estimate of 95 million tonnes – the USDA has maintained this estimate since its first look at 2017-18 back in May – is stagnant. Recent estimates put the Brazilian summer crop at 7 million tonnes below last year's.

The 42-million-tonne estimate for Argentina is 1 million tonnes above 2016-17 output and, weather permitting, is probably much more accurate than the Brazilian estimate. Farmers are still coasting on the elimination of the export tax. In addition, the government is trying to pass a bill that would make fertilizer used for corn tax deductible, which furthers a friendly environment for planting corn over soybeans where possible.

Global ending stocks as a percentage of consumption rose to 19.1% from 18.9% in October. That compares with 21.3% in 2016-17 and 22.2% in 2015-16. As illustrated, however, if the Brazilian output estimate is revised downwards, which we're confident it will be, the additional US supplies will have no impact on global inventories. As it is, we're looking at a production/consumption deficit of 22 million tonnes.

One bearish factor is US exports. The USDA forecast for 2017-18 foreign sales is 48.9 million tonnes, down 16% from 2016-17. But the export pace has been sluggish. Commitments to date are 27% behind last year at this time.

It is early in the season, though, and that gap should narrow because South American crops will not be harvested for several months, and particularly since Eastern European

Inside

Coffee: Waking the bull 2
Soybeans: Beans aplenty 4
Cotton: The bull forges ahead 5

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exporting nations will have less to export than previously believed.

In conclusion, the great US crop miracle of 2017-18 has done nothing to bolster global supplies.

Commodity funds hold their largest net-short position since March 2016 (Chart 2). We do not believe that the supply/demand fundamentals are as bearish as the pessimistic posture of fund managers would suggest. We continue to focus on the fact that the world's farmers are struggling to keep up with growing consumption. At the moment, the missing link is US exports, which we believe will snap back.

Remain long March corn, as per our October 4 recommendation. Maintain stops at $3.40 per bushel, close only.

[Sholom Sanik, November 22, 2017]

Chart 1 – March corn

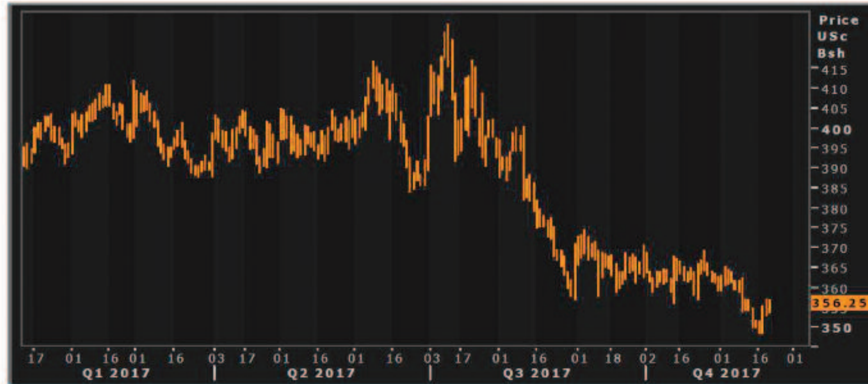

Chart courtesy Reuters

Chart 2 – Corn: CFTC commodity fund net position

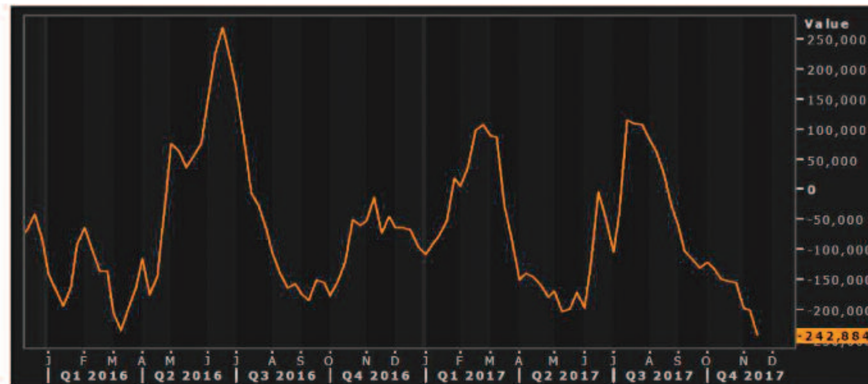

Chart courtesy Reuters

COFFEE

Waking up to the coffee bull

The 2017-18 season was the "off" year in the Brazilian biennial cycle. Brazil grows mostly Arabica beans. In a typical year, roughly 80% of production consists of Arabica beans, while the balance is Robusta. Robusta production was actually up over 2016-17, but output for the two varieties combined was down 12% from 2016-17.

Brazil is by far the world's largest grower of coffee. The number-two producer and the top producer of Robusta, Vietnam, compensated with an 11% increase in output. As a result, total global production was down only marginally, and prices continued to fall to multi-year lows (Chart 3).

Next year's Brazilian crop is expected to rebound, although it is still many months until we will know for sure. In the meantime, commodity funds have profited handsomely from the bear market, and they do not seem in a great rush to declare a bottom. The net-short position is the largest on record (Chart 4).

We believe that the bearish exuberance is overstated. It is impossible to predict what the next crop will look like, but in studying the long-term trends, we find global production is flat, while the long-term trend in consumption is growing materially.

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Global production had a growth spurt in the early 2010s, from 130 million bags to the 160-million-bag level (Chart 5). However, since the 2012-13 marketing year, output has averaged only 157.5 million bags. Consumption, on the other hand, has grown steadily (Chart 6) to the point at which massive production/consumption surpluses have turned into near-balanced markets (Chart 7).

While output is always a variable, it's fair to say that the rate of demand growth should continue to outperform the growth rate in production based on a solid, multi-year trend.

Consumption of coffee in both developed and developing countries has grown steadily. While the volume in countries such as China is still a fraction of that in the US, Europe, and even Brazil, the current growth rate could materialize into something much bigger.

Some anecdotal evidence: A recent report claims that Starbucks is opening a new store in China every 15 hours! Currently, there are more than 3,000 Starbucks stores in China, and the company plans to see that number grow to more than 5,000 locations by 2021.

To be fair, even if these statistics prove to be accurate, total coffee consumption in China will still be about 25% of that in the US. But it does provide some solid evidence that consumption in developing countries is experiencing growth and should contribute to a steady, upward trend in global coffee demand.

Global ending stocks have fallen over the past few years, from close to 30% of usage to below 20% (Chart 8). We consider this a dangerous level, particularly for a commodity for which close to 70% of production is concentrated in four countries _ Brazil, Vietnam, Colombia, and Indonesia. One crop accident in one of these regions could alter the dynamics dramatically.

We believe that this market should be traded from the long side. It's a relatively thin and volatile market. We therefore advise a conservative approach by establishing a moderate-sized position. Buy December coffee, currently trading at about $1.36 per pound. Place initial stops at $1.25, close only.

[By Sholom Sanik, January 8, 2018]

Chart 3 – Weekly nearest ICE coffee

Chart courtesy Reuters

Chart 4 – Coffee: Commodity fund net-short position

Chart courtesy Reuters

Chart 5 – Coffee production (1,000 kg bags)

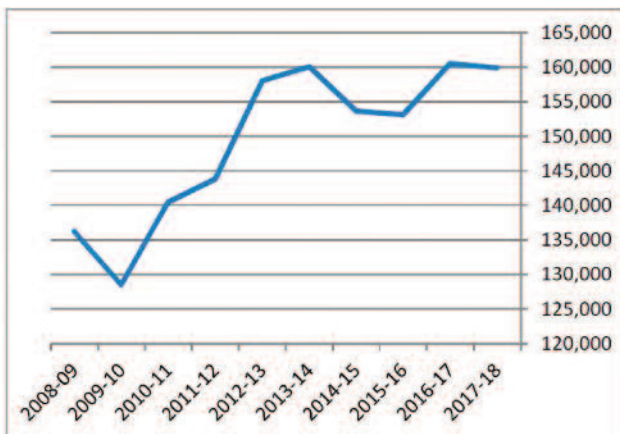

Chart source: USDA

Chart 6 – Coffee consumption (1,000 kg bags)

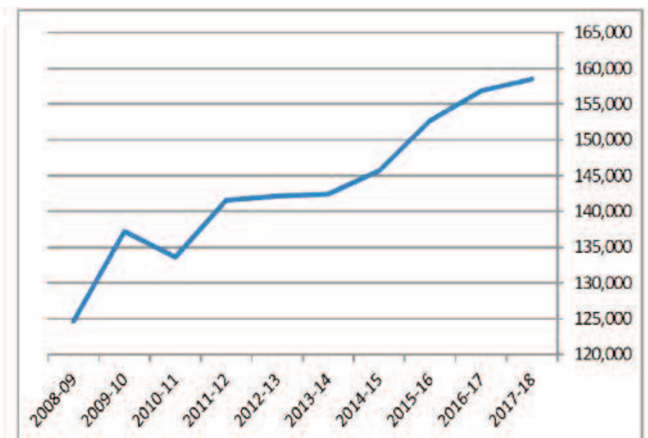

Chart source: USDA

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Chart 7 – Coffee production/consumption balance

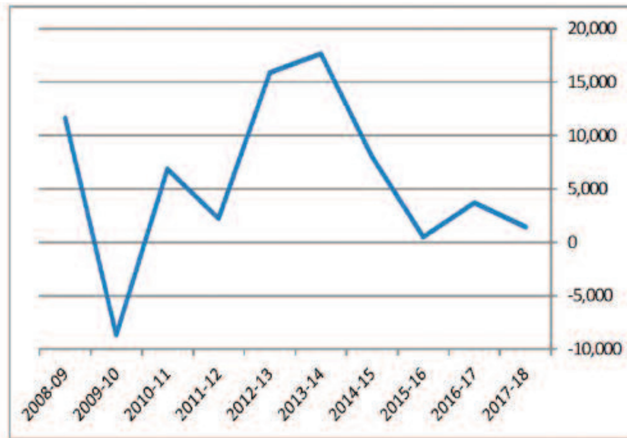

Chart source: USDA

Chart 8 – Coffee global ending stocks as a percentage of use

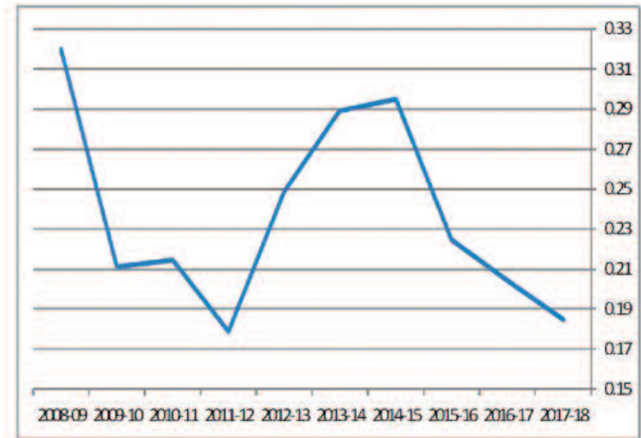

Chart source: USDA

SOYBEANS

Beans aplenty

In the weeks leading up to the January 12 USDA crop report, soybean prices fell to four-month lows. The report inspired some buying that led to an outside day reversal (Chart 9). Was that a pre-holiday short-covering rally or a meaningful turnaround?

There were two bullish items for the US. The coinciding quarterly stocks report showed that December 1 inventories were 3.157 billion bushels (85.92 million tonnes), compared with the average of analysts' guesstimates of 3.181 billion bushels (86.57 million tonnes). But the item that caught the attention of traders was the downward revision to yields. Traders were expecting the bushel-per-acre (bpa) yield to be unchanged from last month, at 49.5 bpa. But the actual figure came in at 49.1 bpa, resulting in a downward revision to the 2017-18 crop of 33 million bushels (898,000 tonnes), to 4.392 billion bushels (119.52 million tonnes).

That was the extent of the bullish news. The balance of the report tilted to the bearish side. While there are many months remaining until the marketing year concludes at the end of August, it is hard to see US exports improving enough to meet the USDA target for 2017-18 foreign sales, particularly as South American supplies become available. There were several weeks of extraordinary sales in December, but then the pace slowed down.

In fact, the USDA slashed its US export estimate by close to 2 million tonnes, to 58.79 million tonnes from 60.56 million tonnes. That estimate is just a whisker below 2016-17 final sales of 59.16 million tonnes and still very optimistic. Export commitments as of the most recent weekly report stand at 41.53 million tonnes, down from 48.32 million tonnes at this time last year, or 14% lower. We should assume there will be further downward revisions to US exports.

Several months ago there were fears that estimates for the late-planted 2017-18 Brazilian crop were too generous, and that it would be a challenge to produce anywhere near the record 114 million tonnes grown in 2016-17 – which was up from 96.5 million tonnes grown in 2015-16. But the crop has fared well, and the USDA raised its January estimate by 2 million tonnes, to 110 million tonnes.

The estimate for global ending stocks for 2017-18 was revised a tad higher, to 28.6% of consumption, which is actually lower than the 2016-17 carryover of 29.2%. Consider, however, that average ending stocks between 2011-12 and 2015-16 were 22.8% of consumption. The jump in production in the US and Brazil from 2015-16 to 2016-17 has set the global inventory position for this market to a new paradigm.

Looking ahead, there does not seem to be any letup on the supply side. Early forecasts for the 2018-19 US crop call for an increase in planted area to 91 million acres, up from the record-by-far 90.1 million acres planted for the 2017-18 crop.

Commodity funds hold a near-record net-short position (Chart 10). Short covering is therefore a risk at any time, regardless of the implications of the bearish long-term supply/demand fundamentals described above. The balance of evidence, however, suggests that prices should move lower over time.

Establish short positions in November soybeans, currently trading at about $9.83 per bushel. Place initial stop at $10.25, close only.

[By Sholom Sanik, January 16, 2018]

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Chart 9 – November soybeans

Chart courtesy Reuters

Chart 10 – Soybeans: CFTC commodity funds net-short position

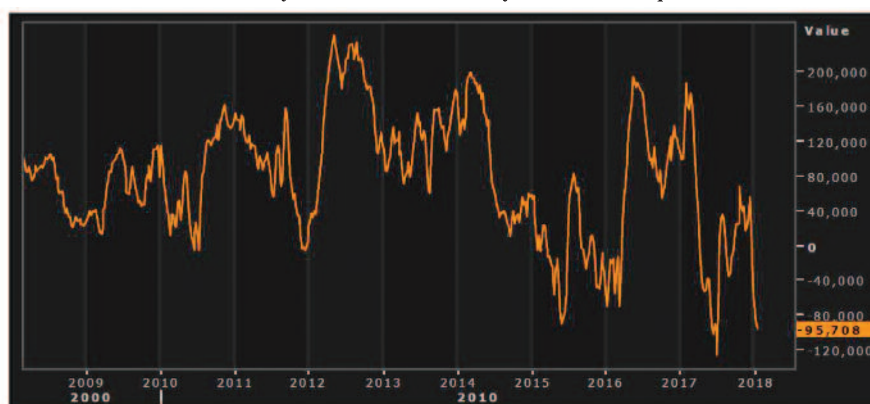

Chart courtesy Reuters

COTTON

The bull forges ahead

To judge by cotton traders' reaction to the January 12 USDA crop report, one would think that there were some terribly bearish, game-changing data contained in the report. March cotton had rallied by more than 25% from its October lows and traded up to yet another new high in the hours before the report was released. The report triggered a selloff that took the market down 3¢ per pound from the morning high. An examination of the report did not reveal any outstanding revisions, however, and the market has since consolidated.

US exports have been very strong this marketing year, which began on August 1, and it is possible that the street was disappointed that the USDA did not raise its forecast for 2017-18 sales from last month's 14.8 million bales. Final sales for 2016-17 were 14.92 million bales, but export commitments indicate that we should do much better by the time the season is over. As of the most recent weekly export report, 2017-18 commitments stand at 11.05 million bales, compared with only 8.61 million bales at this time last year.

One issue mentioned by analysts is the fact that while the level of contracted sales is well above last year, shipments have been lagging. US exporters have shipped 3.518 million bales, compared with 3.975 million bales last year.

Chinese imports were strong in calendar year 2017. A recent government report estimates that imports from *all sources* were up 27% over 2016.

As we've mentioned previously (see *Focus on Futures*, October 27), US exports to China have been running ahead of last year's levels. However, the pace has slowed down. Back in October, US sales to China were ahead by 225%, but are now only 39% higher than year-ago sales.

These are likely the negatives that did not make it to the headlines, but have market participants worried that the rally has overshot.

On the other hand, bulls could argue that if China is buying from *any* exporting country, it could mean that the storied stockpile is useless. Those inventories – if they exist at all – are not suited to meet the quality standards of mills that produce clothing for export. Sooner or later, those needs will

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find their way to US exporters.

In addition, the huge jump in US commitments is therefore attributable to other importers. It is an indication that global demand is very healthy and that the reliance on China to mop up excess US inventories has been diminished.

The demand side certainly helps makes sense of the market's strength despite the fact that we are coming off two consecutive years of extraordinary global output gains. It is too early to know how much area the two top-producing nations – India and China – will devote to cotton planting for 2018-19. We do know, however, that the USDA's early forecast for US planting intentions is down about 10% from 2017-18.

Using some rough arithmetic, assuming that global consumption and production levels in the other producing nations remain about the same as this year, global ending stocks would fall to 70% of usage. On the surface, that's still a frightfully high number.

Considering, however, that at the end of the 2015-16 marketing year we were looking at a carryover that was equal to 100% of usage, the market has made great strides in reducing global inventories. Throw in our theory that Chinese stocks are meaningless, and we're looking at a much more normal global ending stock level that will be vulnerable to supply accidents.

Remain long cotton, as per our October 27 recommendation. Roll March contracts forward to the heavily discounted December contract. Place initial stops at 69¢ per pound, close only.

[By Sholom Sanik, January 18, 2018]

Chart 11 – March cotton

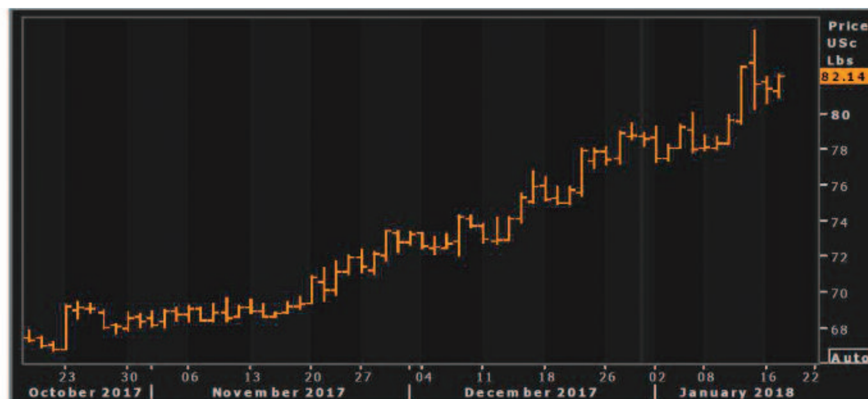

Chart courtesy Reuters

Chart 12 – December cotton

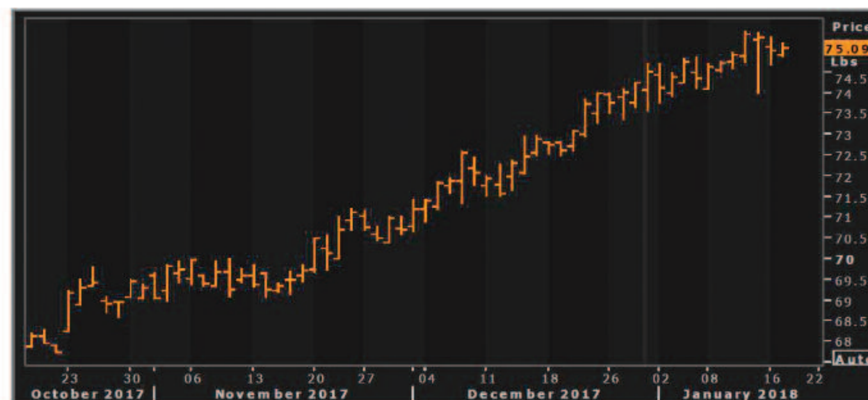

Chart courtesy Reuters

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