

# FRIEDBERG'S

## FOCUS ON FUTURES

Friedberg Commodity Management Inc.



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## Wheat: emerging from dormancy

In last month's discussion of wheat, we pondered what was then a mini-rally and posed the question: "Are we looking at a temporary reprieve before traders start bashing it again, or can it be the bottom?" We concluded that available data did not paint a very bullish picture, but given historical comparisons between nominal prices and carryover stocks, the market was underpricing wheat.

The data released by the USDA on January 12 goes a long way to answering our question. First, let's look at supply-side issues. The first estimate of seedings for the US winter wheat crop that was planted last autumn totalled 42.916 million acres. This was only 1% below last year but almost 8% below 1998 seedings. The market's perception of abundance reflected in multi-decade lows in price is being challenged. Significantly, the estimate was below the low end of analysts' expectations.

The quarterly stocks report was very bullish as well. The previous quarterly stocks report shocked the market to the bearish side by about 100 million bushels. This time, however, it was the other way around. Stocks on December 1 stood at 1.878 billion bushels, slightly lower than at the same time the previous year. This figure was also below the low end of analysts' estimates. Again, this dispels any notion that a state of overwhelming abundance exists.

Stocks in the US are still large, though. With the new USDA figures, they drop to 40% of consumption from last month's 44%. While this certainly represents an improvement, from an historical perspective we still need both domestic and export demand to continue at a healthy pace to make a dent in the rather burdensome stockpiles. At the end of the 1997-98 season carryover stocks stood at 31% of consumption.

How is demand? An increase in feed use accounted for a drop in projected ending stocks of 55 million bushels. The export sector is vital, however, and is the one fly in the ointment. Towards the end of last year, the pace of export commitments had picked up steam. The first two reporting periods of this year have been quite limp,

with commitments at 133,000 tonnes this week and 162,000 last week. This compares with the average of the previous four reporting periods of about 600,000 tonnes per week. At this time it would be acceptable to blame it on the slow holiday period, but we'd like to see much better numbers next week. Commitments had been running ahead of last year's pace until now, but have fallen behind with these two poor readings. Indeed, the USDA was not moved by the healthy readings we saw before the New Year and kept its projection for exports steady at 1.075 billion bushels for the year.

It was very impressive, then, to see the market ignore the weak export statistics. The seeding and stocks reports were released on Wednesday and were greeted with a 5¢ rally. Despite Thursday morning's disappointing export numbers, the market built on the rally, tacking on an additional 5¢ cents.

There were bullish developments on the global scene, as well. The estimate for production was raised by 300,000 tonnes, while there was a more significant, 2-million-tonne hike in the estimate for consumption. The resulting drop in ending stocks lowered stocks as percentage of consumption to 21.8% from 22.2% in last month's report.

We feel confident that we have seen the bottom of this market. The current level of stocks can rightfully

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allow participants to feel complacent, for the moment. Nevertheless, the drawdown we saw in the USDA report indicates that there is fresh demand in the market. The acreage reduction completes the picture of a bear market that has come full circle. The strong rally has wiped out the deep discount prices. From here on in, the market will

not tolerate any surprises, and bullish news will take the market higher still. This is no temporary reprieve.

[January 17, 2000]

**STRATEGY:** Remain long July wheat as per Flash Update of December 21, raising stops to 269.

Chart 1 – July Wheat



## GRAINS & OILSEEDS

### How about corn and beans?

This month's USDA supply/demand situation report provided the first concrete indication that the bear market in US crops may be over. There is rarely any single factor that will determine the price of a commodity, but at times, a single, critical milestone might appear, which signifies a turning point. We believe that such a milestone was contained in this month's report – the estimate of seedings of the winter wheat crop. Farmers planted the smallest number of acres since 1972. This is so important, because a bear market cannot end until prices have been pushed low enough to discourage the overproduction that facilitated the bear market in the first place. It is a bit early to talk about specific estimates of corn and soybean acreage. There are variables such as government incentive programs that can still come in to play. But it is not completely illogical to assume that unattractive prices will put farmers in a conservative mood when deciding how much corn and beans they plant. Is this a reasonable assumption? What are the fundamentals?

#### Corn

As the release of the USDA report approached, most analysts were in agreement that there would be bullish revisions to the supply/demand situation of corn. This was mostly on account of robust feedlot demand for cheap grain. Clearly, the

USDA would be forced to raise the estimate for domestic consumption. Still, the report held a number of surprises.

Production of the 1999-00 crop – typically on the books by now – was lowered by 100 million bushels from last month's estimate to 9.437 billion bushels. Although a downward revision was expected, analysts really missed the boat. The average trade estimate was 9.544, with the lowest trade estimate at 9.5 billion bushels.

Feed usage was raised by 100 million bushels. Together with upward revisions for other categories of consumption, domestic usage was raised by 120 million tonnes.

Then there are exports. Export commitments for the past three weeks have been weak, averaging only 439,000 tonnes per week. This compares with the weekly average of the previous four periods of 976,000 tonnes. We can attribute this to the slow holiday period, which is apparently what the USDA did, because it revised exports for the marketing year up by 50 million bushels to 1.975 billion bushels. Despite the dropoff these past few weeks, export commitments for the year are still running ahead of the same time last year by about 50 million bushels.

China is a net importer of just about all commodities. In this, corn stands out. Starting with the 1998-99 marketing year, China not only became self-sufficient in corn, but also became a net exporter. This season, China's corn crop will be

128 million tonnes. The USDA estimates that China will consume 120 million tonnes domestically and export about 5 million tonnes. Although the US is still by far the largest exporter – accounting for 64% of world trade this season – the Chinese will pose a formidable challenge to demand for US exports as they move towards permanent self-sufficiency in corn.

Having invoked this cautionary note, we return to the USDA report. The average trade estimate for quarterly grain stocks as of December 1 was 8.214 billion bushels. The estimates came in almost 200 million bushels lower, at 8.02 billion bushels, and below the low end of analysts' estimates.

All the revisions to production and consumption along with the new data had a significant impact on ending stocks both in the US and on the global level. US ending stocks will drop by 280 million bushels from last month's estimate, to 1.714 billion bushels, or 18% of consumption, down from 21% last month.

World production was lowered by 2 million tonnes, and consumption was raised by 3 million tonnes. Ending stocks were revised down by close to 6 million tonnes to 109.5 million tonnes, or 18% of consumption, compared with last month's figure of 19.5% of consumption. This does not represent a dramatic change from ending stocks at the end of the 1998-99 season, which stood at 18.5% of consumption. It does, however, present evidence that the extended period of low prices has inspired demand out of its slump and discouraged the overproduction we've seen the last few years. True, the numbers do not indicate that any tightness exists at present. On the other hand they also show that the street's perception was off with regard to where we stood in both production and consumption trends. The multi-year lows in prices were a result of these misperceptions. The bear market in corn is over.

## Soybeans

The USDA report had a few surprises for soybean traders, but none quite as dramatic as those in the corn and wheat market. Then again, soybean prices didn't need the kind of boost that corn and wheat prices did. Soybean prices seem to have ended their bear market back in July when they crash-landed just a smidgen shy of \$4 per bushel. Soybeans hadn't seen such low prices since 1972. Since the mid-summer bottom, prices have been as high as \$5.15 per bushel and have now consolidated comfortably at \$4.9 per bushel.

The soybean picture has been improving ever since the USDA began releasing monthly estimates of the 1999-00 crop. To illustrate, consider that back in July, US ending stocks were estimated at 595 million bushels. A steady string of downward revisions brought them all the way down to this month's figure of 365 million bushels. So, while the USDA

did lower stocks from last month's estimate by 30 million bushels, this is something that has been developing over the past six months. This is reflected in the sustained, sharp rally off the \$4-per-bushel level.

The only significant change in this month's US numbers was a 30 million bushel reduction of the 1999-00 crop, which resulted in the drop in ending stocks from December's numbers. But we see a stark contrast in comparing the early-season estimates of ending stocks with the current ones. Carryover stocks as percentage of consumption back in July would have been 23%; with this month's report they stand at 14%.

The trend, clearly, is bullish. Nevertheless, we must realize that this market, along with most other commodities, is coming off an era of abundance. A 14% carryout may seem alluring compared with the early season estimate. It even seems to spell the beginning of tightening of supplies when compared with last year's ending stocks, which stood at of 14.5% of consumption. But when seen in the context of the average carryover of the previous four seasons of 9% of consumption, the bullish tone is somewhat tempered.

To achieve the kind of numbers that would make the current \$5-per-bushel level seem cheap, the trend in consumption would have to continue. A healthy flow of exports from the US is vital. The holiday season was much kinder to soybean exports than it was to corn and wheat exports which dried up almost completely. The average commitments of the past four weeks were 517,000 tonnes compared with the average of the previous four weeks of 575,000 tonnes. Total commitments for the season are ahead of last year's pace by 8.5%. The products have not fared nearly as well. Meal exports are down 10% over last year, and beanoil exports are only one third of what they were at the same time last year.

The market has spent much energy worrying about the Brazilian crop. Rightfully so. Brazil is the world's second biggest player in the soybean market behind the US. It produces 20% of the world's crop and accounts for 22% of world trade. Lack of precipitation in South America has wreaked havoc with agriculture this season and threatens to reduce bean yields. The USDA held steady, keeping the estimate for the crop unchanged from last month's estimate at 31 million tonnes.

To make us interested enough to take a long position, we would need to see the following: A continuation of bean exports at the current pace, a dramatic improvement in product exports, and to round out the picture, smaller acreage in the upcoming planting intentions report. Problems with the Brazilian crop would hasten the process. [January 21, 2000]

**STRATEGY:** *For now, we prefer to remain long wheat. The corn and soybean picture has probably changed enough to be a buyer on dips. Stay tuned.*

Chart 2 – July Corn



Chart 3 – July Soybeans



## GOLD

### Why gold? Why now?

Last September we witnessed what we believed to be the single most important event to take place in the gold market in recent years. It was an announcement by 15 European Central Banks (ECB) that the divestment of their gold reserves would become transparent. These central banks agreed to sell a maximum of 400 tonnes per year for the next 5 years. Until then, central bank gold sales were carried out in a clandestine fashion, and the market was apprised of a sale only after a central bank had dumped the bullion onto the open market. A discount was built into the price to protect against sudden shocks, which accentuated the bear market.

Although central banks around the globe will continue to unload their gold reserves until they are almost depleted, the bearish effect of their sales will become subdued. Rather, the

psychological, “headline” effect of titans (the central banks) selling gold by the tonne kept prices down. The market is now free to roam and to price an ounce of gold so that it represents the pure supply/demand fundamentals.

Having said that, what are the fundamentals? Knowing that the veil of secrecy has been lifted from central bank sales tells us only that one, long-standing bearish aspect is no longer a factor. Are there other factors that should make prices rise?

To be sure, there are a number of negatives. First and foremost is the market’s perception of inflation, or more accurately, disinflation. The fuel that fired bull markets in gold in the 1970s and 1980s was prices that had gone out of control. Whether the spark was oil prices or easy money, buying gold was viewed as protection against rising prices.

Speculation then fed on itself, and precious metals exploded. Both of these sparks are very prominent in today's economy. Still, consumer price indexes the world over show inflation to be quite stable. This is what economists and traders watch, and their arguments are quite strong. The giant leaps in productivity have brought costs down right across the economy – from high-tech planting, mining, and manufacturing to retail buying on the Internet that is slowly cutting out the middleman.

The disinflationary mindset will remain a big drag on the market. While gold is still viewed as a store of value in the East, the West has changed its attitude completely. Following the lead of central banks, Westerners have adopted the view that yieldless gold is no longer an intelligent investment.

The ECB pact does not preclude other central banks from selling gold. Indeed, back on November 25 Jordan announced that they had sold 300 tonnes.

Production costs have fallen consistently over the years and are roughly an average of \$200 per ounce. This of course is bearish, because it allows producers to continue mining at a profit even though prices are weak. Producers can hedge their output liberally on any rally.

There is, however, a problem with the disinflation scenario. True, prices of goods and services have been tame. How about assets? Is it possible that the appreciation in values of equities and real estate we saw in the 1990s will never translate into consumer inflation? The bond market doesn't think so. Even after the recent rally in bonds, the yield on the long bond sits at 6.5% which has built in an expectation for inflation of 2.3%, up from under 1% a year ago.

The market also had the luxury of falling commodity prices these past few years. That may be over. The Bridge/Commodity Research Bureau Index of commodity prices is 15% off its low. While it is also 20% off its high, the fundamentals of many commodities have slowly been turning bullish, both from the demand and supply sides. The near-term picture for commodity prices certainly looks bright.

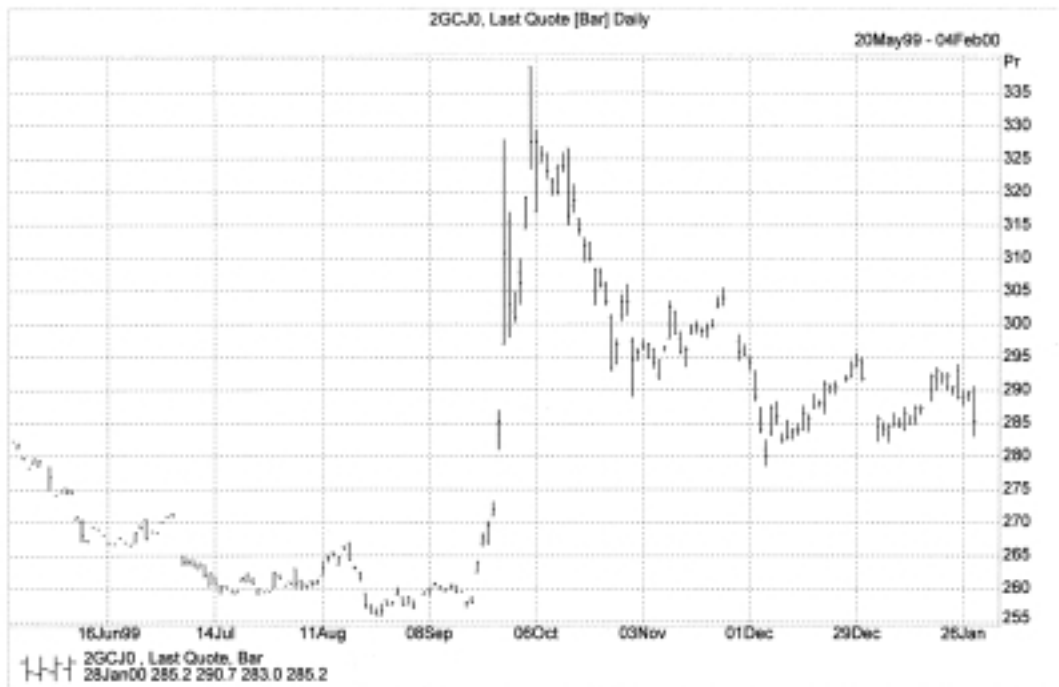
As for timing, the gold market – along with many other markets – should be concerned. They should be concerned with issues such as the overextended credit of individuals, corporations, and countries. They should be worried about what will happen to prices when those who are smiling along with the asset bubble start cashing in their chips. But everyone is happy. Complacency is the order of the day. Open interest in gold has fallen dramatically, indicating that both the small speculator and commodity funds have no interest in this market.

In its Man of the Century issue, *Time* magazine has a feature in which it compares various aspects of selected centuries of the past millennium to those in a model of what the 21st century might look like. In the "most important commodities" section of this feature, gold is obviously featured prominently for each century, including the one just past. For the 21st century, however, gold was dropped from the list and replaced with microchips and airplanes. The contrarian hounds smell blood.

[January 28, 2000]

**STRATEGY:** Remain long April gold as per Flash Update of January 20, maintaining stops at 279.50, close only.

Chart 4 – April Gold



## HOTLINE UPDATE

**Flash Update: Tuesday, January 4, 2000:**

Good afternoon, for Tuesday January 4, 5:15pm. This is a Flash Update. We have sold short March S&P at 1411.50, placing our initial stop at 1464.50, close only.

**Flash Update: Wednesday, January 5, 2000:**

Good morning, for Wednesday January 5, 9:00am. This is a Flash Update. We have liquidated our long March Japanese yen position at 97.53.

**Wednesday, January 5, 2000:**

Good afternoon, for Wednesday January 5, 2:20 pm. We have liquidated our long March silver position at 5.16. We repeat our Flash Update from earlier today, where we liquidated our long March Japanese yen position at 97.53.

**Flash Update: Thursday, January 6, 2000:**

Good morning, for Thursday January 6, 10:30 am. This is a Flash Update. We have liquidated our long February crude oil position at 24.58.

**Flash Update: Friday, January 7, 2000:**

Good afternoon, for Friday, January 7, 9:00 am. This is a Flash Update. We have sold short March crude oil at 24.20, placing our initial stop at 25.20, close only.

**Friday, January 7, 2000:**

Good afternoon, for Friday, January 7, 5:00 pm. The following is a recap of our current open position recommendations, and our latest stop levels.

- Long March Canadian dollar, with a stop at 66.85.
- Long July wheat, with a stop at 2.61.
- Short March S&P, with a stop at 1467.50.
- Long April platinum, with at stop at 387.
- Short March crude oil, with a stop at 25.20.
- Long February CRB Index, with a stop at 198.50.

All stops are close only.

**Flash Update: Monday, January 10, 2000:**

Good morning for January 10, 9:00 am. This is a Flash Update. We have covered our short March S&P position at 1474.50.

**Flash Update: Tuesday, January 11, 2000:**

Good morning, for Tuesday January 11, 9:00 am. This is a Flash Update. We have purchased March T-bonds at 90-18, placing our initial stop at 89-10, close only.

**Flash Update: Wednesday, January 12, 2000:**

Good morning for Wednesday, January 12, 9:05 am. This is a Flash Update. We have liquidated our long March T-bond position at 89-10.

**Flash Update: Wednesday, January 12, 2000:**

Good morning for Wednesday, January 12, 10:30 am. This is a Flash Update. We have covered our short March crude oil position at 25.23. We repeat our Flash Update from earlier today where we liquidated long March T-bonds at 89-10.

**Friday, January 14, 2000:**

Good afternoon for Friday, January 14, 4:45 pm. The following is a recap of our current open position recommendations, and our latest stop levels.

- Long March Canadian dollar, with our stop adjusted to 67.50.
  - Long July wheat, with our stop at 2.61.
  - Long April platinum, with our stop at 387.
  - Long February CRB Index, with our stop adjusted to 201.
- All stops are close only.

**Flash Update: Thursday, January 12, 2000:**

Good morning for Thursday, January 20, 8:50 am. This is a Flash Update. We have purchased April gold at 292.90, placing our initial stop at 279.50, close only.

**Friday, January 21, 2000:**

Good afternoon for Friday, January 21, 4:45 pm. On January 27, 1999, we recommended the sale of Hong Kong dollar 1-year forward. As this trade is coming due, we recommend covering short Hong Kong dollar positions. The following is a recap of our current open position recommendations, and our latest stop levels.

- Long March Canadian dollar, with our stop revised to 68.10.
- Long July wheat, with our stop at 2.61.
- Long April platinum, with our stop at 387.
- Long February CRB Index, with our stop at 201.
- Long April gold, with our stop at 279.50.

All stops are close only.

**Friday, January 28, 2000:**

Good afternoon for Friday, January 28, 4:45 pm. The following is a recap of our current open position recommendations, and our latest stop levels.

- Long March Canadian dollar, with our stop revised to 68.60.
- Long July wheat, with our stop revised to 2.69.
- Long April platinum, with our stop revised to 397.
- Long February CRB Index, with our stop at 201.
- Long April gold, with our stop at 279.50.

All stops are close only.

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