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Argentinean corn set free

Corn prices have been drifting lower (Chart 1). In its December crop report, the USDA lowered the US export estimate for the 2015-16 marketing year by 1.3 million tonnes, to 44.45 million tonnes. Average commitments over the past four weeks have been only 585,000 tonnes, far below the average needed to meet even the USDA's downwardly-revised target. The recent slump in itself is not that alarming, because December is always a slow period for export sales. However, accumulated commitments are 25% behind last year at this time, compared with the USDA's forecast for annual sales to fall only 9% below last year's.

It's not just a US phenomenon. Importers seem to be well stocked. Overall sales from exporting nations are estimated to fall to 117.7 million tonnes in 2015-16, down from 131.1 million tonnes and 136.8 million tonnes in 2013-14 and 2014-15, respectively.

Global consumption actually remains quite strong. The USDA estimates total usage at 970 million tonnes, only 0.05% below last year's record usage. But after three consecutive years of strong global output, inventories are robust. Global ending stocks are forecast at 21.8% of consumption, their highest level since 2001-02.

As we pointed out in the November 19 issue of *Focus on Futures*, the Argentinean presidential election presented a bit of a wild card and was resolved to the bearish side. The victor, Mauricio Macri, promised and subsequently delivered reforms. He allowed the peso to float, which resulted in a 30% devaluation. In addition, he eliminated the 20% export tax on corn.

These reforms triggered a wave of corn sales – as well as sales of other commodities – which farmers were holding back in anticipation of pocketing more pesos for their goods. Moreover, the planting window for corn extends through December and into early January. It is estimated that planted area would increase by 10% as farmers rushed to take advantage of the new government's enactments.

In response to the implications of the economic reforms in Argentina, Informa Economics raised its estimate for

2015-16 output by 1 million tonnes. And this does not include the sales of corn that were being held back as farmers waited for the election results.

Looking ahead, over the past few months new-crop soybean prices have rallied *vis-à-vis* new-crop corn prices (Chart 2). When viewed in a longer-term historical perspective, however, soybean prices are still in a slump relative to corn (Chart 3). As a result, the USDA's early forecast for acreage for the 2016-17 US crop that will be planted this spring favors corn over soybeans. Corn area is estimated to jump to 90.5 million acres, up from 88.4 million acres in 2015-16. Soybean area is forecast at 82 million acres, down from 83.2 million. Only a meaningful improvement in the soybean/corn price ratio would shift some acres back to soybeans.

The bearish supply/demand fundamentals are not a well kept secret. Commodity funds are heavily short corn – as well as the other grains (Chart 4). The inevitable bullish weather news from South America is bound to spark the occasional rally, so expect some volatility. But with increased global supplies and the absence of any notable demand growth, we expect this market to work its way back to the 2014 lows near \$3 per bushel.

Remain short, lower stops from \$4.15 per bushel, basis March, to \$3.90, close only.

[Sholom Sanik, January 8, 2016]

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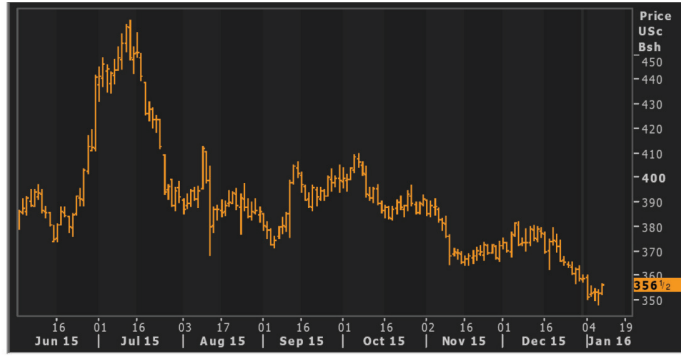
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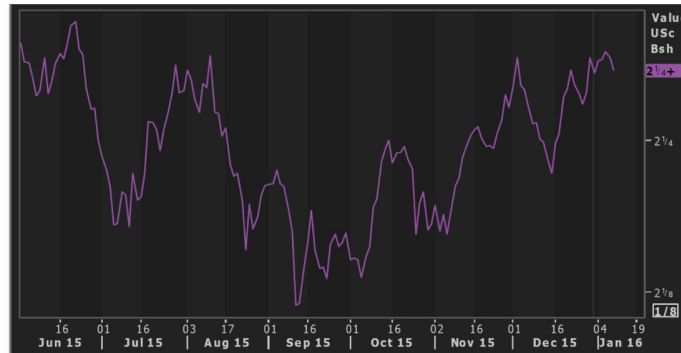
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Chart 1 – March corn



Courtesy Reuters

Chart 2 – November soybeans/December corn ratio



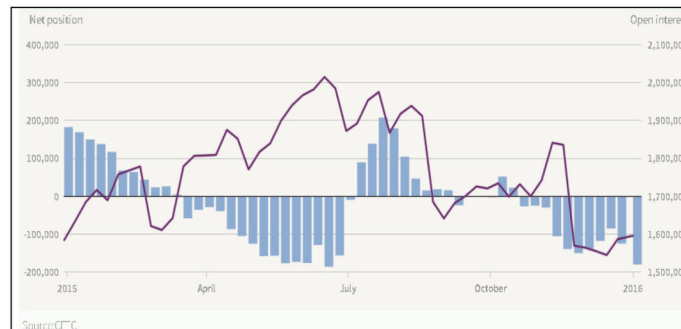
Courtesy Reuters

Chart 3 – Weekly nearest contract soybeans/corn ratio



Courtesy Reuters

Chart 4 – Commodity fund net short position



Courtesy CFTC

SOYBEANS**Downward revisions to major soybean crops won't ward off the bear**

Soybean prices have been stuck in a fairly narrow range since mid-summer (Chart 5). Most recently, the market bounced off the lows because of unexpected bullish revisions contained in the January 12 USDA crop report. Most analysts were content that the December estimate for the 2015-16 US crop was final, or very close to it. If anything, some were looking for a higher number. The average guesstimates for bushel-per-acre yield (bpa) and crop size were virtually the same as the USDA December estimates. So traders were surprised with the bullish results of the report. Harvested area was cut by 629,000 acres, to 81.8 million acres, and yields were lowered to 48 bpa, from 48.3 bpa. All of which resulted in a 50-million-bushel drop in the size of the crop, to 3.93 billion bushels (106.96 million tonnes).

It certainly was a bullish development. However, the crop retains its status as the largest on record. More importantly, the bull market may be over, but it did its job. Even with steadily growing demand, output has grown enough to create surpluses. While ending stocks dropped to 11.9% of consumption, from 12.4% in December, they are still much higher than they've been in recent years. Over the past eight years, US ending stocks averaged only 5% of usage.

December was drier than normal in Brazil. The very optimistic forecasts for a 103-million-tonne crop have faded. The range of estimates is now between 98 million tonnes and 100 million tonnes, which would still beat the 2014-15 record of 96.2 million tonnes.

The weather in Argentina was favorable during the same period, and output estimates have not changed very much. Still, the USDA balance sheet is likely behind with its Argentinean estimate of 57 million tonnes. Most private analysts are forecasting a crop of closer to 60 million tonnes.

Soybeans are probably the only commodity that China is expected to buy more of in the current marketing year than it did in the previous year. The USDA estimates Chinese imports at 80.5 million tonnes, up from 78.35 million tonnes in 2014-15.

It's no great enigma, however. Chinese farmers grow only about 15% of domestic consumption needs, and the rest is imported. Slower economic growth has caused a stir in the financial markets. However, the population continues to grow, and the culture is Westernizing, which means more pork consumption. Hence, demand for protein feed is growing at a faster rate than the underlying economy.

Despite the aggressive forecast, total US sales to China for 2015-16 – shipped and unshipped – stand at 24.1 million tonnes, down from 27.8 million tonnes at the same time last year. Furthermore, from here on in, as the South American harvest progresses, large purchases typically shift to Brazilian and Argentinean origins.

Looking ahead, on January 19 Informa Economics published its acreage estimate for the soon-to-be planted US 2016-17 crop. It raised its December estimate by about 700,000 acres, to 85.23 million acres, up from 2015-16 area of 82.7 million acres.

This is in sharp contrast to the early USDA estimate, which is calling for US soybean area to fall to 82 million acres. The only possible explanation for Informa's sharp upward revision is that new-crop soybeans have outperformed corn prices over the past couple of months (Chart 6), whereas the USDA survey was done before soybean prices firmed *vis-à-vis* corn.

After adjusting for the USDA's conservative Argentina estimate, global ending stocks will be at their highest level since the 2010-11 marketing year. And that's even after accounting for the downward revision for the US.

Commodity funds are heavily short soybeans as they are the other US agriculture markets (Chart 7). Bullish news will inspire countertrend short covering, but does not change the overwhelming bearish case that stems primarily from the rapid increase in South American crops.

Remain short. Maintain stops at \$9.25 per bushel, basis March, close only, as per our December 18 recommendation.

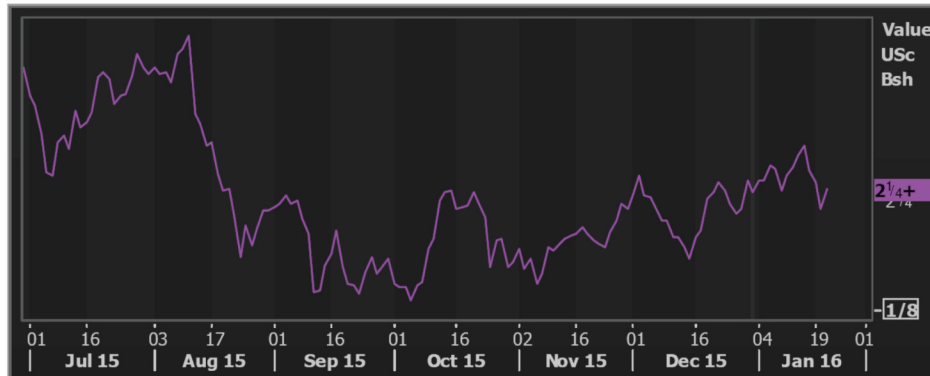
[By Sholom Sanik, January 22, 2016]

Chart 5 – March soybeans



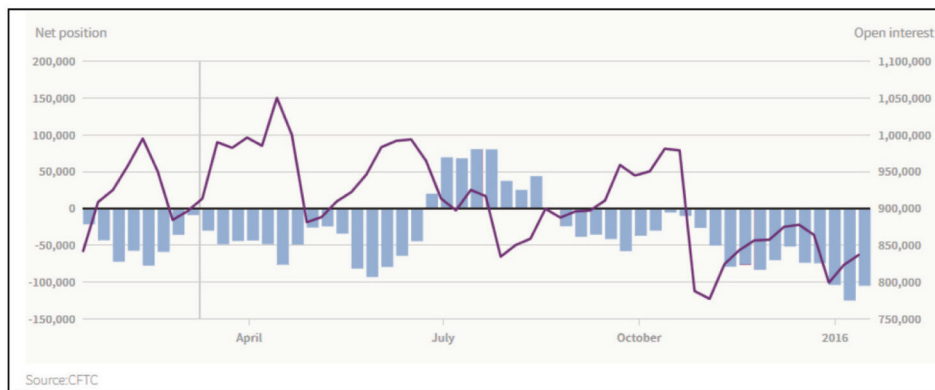
Courtesy Reuters

Chart 6 – November soybeans/December corn ratio



Courtesy Reuters

Chart 7 – Commodity fund net short position - soybeans



Courtesy CFTC

COCOA

Weak output and improved demand cannot save cocoa from the bear

It's been a fairly dry growing season for West African cocoa-producing nations. With the main crops near completion, however, the results have not been too bad. The mid-crops remain vulnerable.

In 2014-15, the Ivory Coast produced 1.8 million tonnes of cocoa beans. That was its second consecutive record crop. Output for the current 2015-16 marketing year has fallen behind last year's pace. Port arrivals stand at 1.014 tonnes, down 2.9% from the same time last year.

Ghanaian output fell to 700,000 tonnes in 2014-15, down about 20% from the previous season, because of unfavorable weather conditions. There was much concern regarding what recovery, if any, there would be in 2015-16. So it is a welcome relief to find that the government pur-

chasing board had already bought 590,000 tonnes from farmers by mid-January, near the tail end of the main-crop and with the mid-crop yet to come. Analysts do not believe that output will reach the previous bumper-crop levels that were as high as 800,000-850,000 tonnes, but it is still a reasonable recovery.

This season's hardest hit West African country, though, is Nigeria, the world's fourth-largest producer. The mid-crop accounts for roughly a third of total output and is expected to be less than half its normal size. We estimate the total loss at roughly 30,000 tonnes, which should leave output at no more than 200,000 tonnes.

On the demand side, fourth-quarter grinding results were bullish for the most part. The European grind was 6% higher

year-over-year, and the Asian grind was up 14%. North American grinding, however, was down 3.25%.

Product prices rose in 2015, so it was not a great surprise to see greater volumes of beans being processed. The price of cocoa butter, the principal product of cocoa beans and the main ingredient used to make chocolate, rose by 25% over the course of the past year, to 2.4 times the spot price of London cocoa. Powder prices spiked as well.

Overall, it was the strongest quarter we've seen in some time. The problem is that the incentive of high product prices, which encouraged processors to buy more beans because of greater profitability, may have been short lived. The butter ratio has already slipped back to 2.10. So at this point, we would view the robust demand indications from the fourth quarter grind as nothing more than an anomaly. Until we see back-to-back quarters of positive results, at the very least, we

are not impressed.

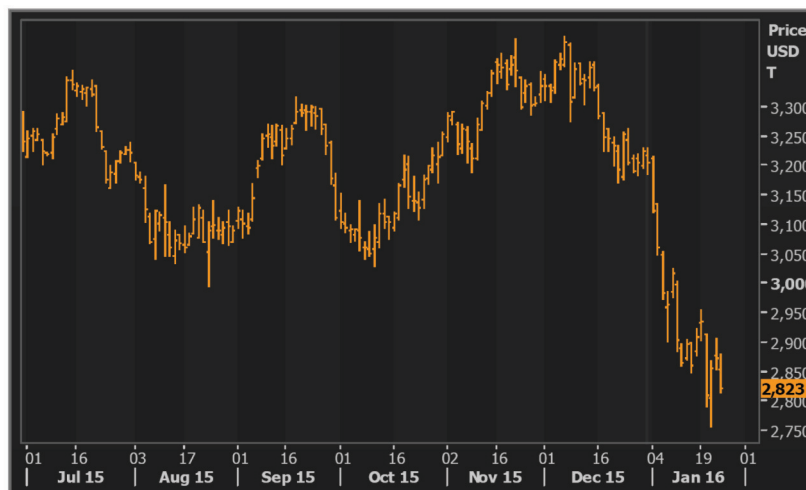
And the proof is in the market. Funds had begun to liquidate their massive net-long position before the release of the fourth-quarter grind results. The European and Asian numbers sparked a bit of a rally, albeit an uninspired one. Now that traders have absorbed the fresh grind data, the selling has continued (Chart 8).

West African output, as illustrated above, has not been spectacular, and probably will just muddle through. But as global stocks continue to hover near 40% of consumption, we would need demand to be unequivocally strong across the board for the market to find some support. Certainly the North American results disappointed in that regard.

Remain short as per our December 8 recommendation. Lower stops to \$3,200 per tonne, basis May close only.

[By Sholom Sanik, January 25, 2016]

Chart 8 – May ICE cocoa



Courtesy CFTC

SUGAR

The bull takes a break

El Niño affected both of the world's largest sugar producers, but in opposite fashion. India was plagued by severe drought, while Brazil received too much rain.

At the moment, sugar prices have been selling off, at least in part because of optimism regarding the 2016-17 Brazilian crop. While wet weather during the crush season may have lowered sugar content in the cane crop, the subsoil moisture that will have accumulated is expected to boost yields for the coming harvest, which begins in April.

Quite different in India. Not only has the dry weather forced analysts to lower their estimates for sugar output from the current crush, the outlook for the 2016-17 crop is absolutely dismal. One analyst is talking about a greater than

30% drop in planted acreage. Sugar cane is a water-intensive crop, and the lack of subsoil moisture will lower yields enough to squeeze farmers' profits.

For the current marketing year, early-season forecasts put output at close to a record 30 million tonnes, but the estimates are now at 26 million tonnes. For next year, it's impossible to put a figure on it at this juncture, but one thing is for certain: Output would be less than domestic consumption, and there would be a stock drawdown to meet local demand.

To be sure, state planning has ensured ample supplies. Ending stocks for 2015-16 are estimated at nine million tonnes. However, the drought challenges the wisdom of the government's export incentives.

Another factor pressuring prices is the possibility of a shift in the Brazilian ethanol/sugar ratio. One analyst is forecasting that as long as the real remains depressed, 43.5% of the cane crop will be turned into sugar for the 2016-17 crushing season. That compares with only 41.8% this season. Ethanol is mostly a domestic market. Most of the sugar produced in Brazil, however, is exported for dollars, leaving sugar production more profitable.

For a while, it seemed as though world sugar prices would rise enough to alleviate some of the larger problems that plague the industry. But for the moment, with the rally ground to a halt, mills in Brazil and India are back to square one in that prices have not risen enough to cover the cost of purchasing cane from farmers. Thus the state of the milling industries, where bankruptcy looms, has not improved.

Predictions that China would become the world's largest importer materialized. Chinese imports for 2015 were close to five million tonnes. The pace will slacken, though, because the government has imposed import restrictions. In addition, there's no telling at this point if the

Chinese crop will bounce back after a disastrous season that prompted the need for imports.

All these bearish tidbits have bulls worried. The massive net-long position held by commodity funds leaves the market vulnerable to liquidation.

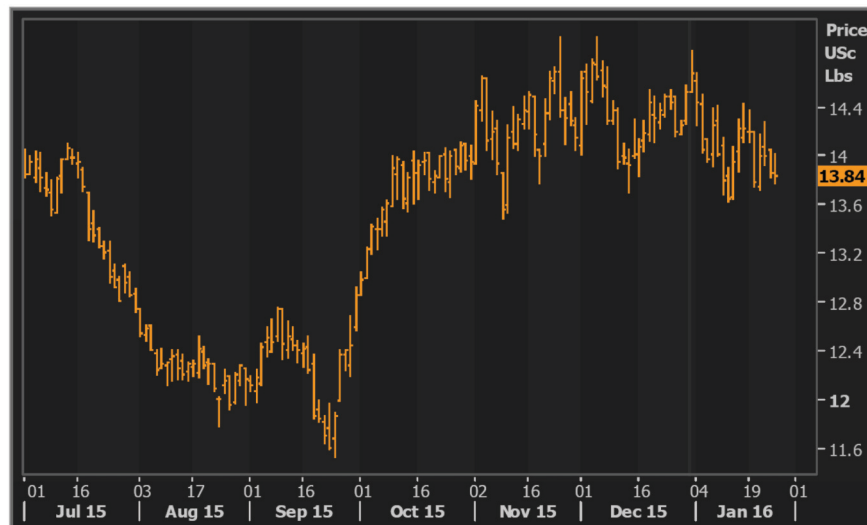
We believe that it doesn't matter at all. The precipitous bear market has come full circle in that it has discouraged production. At first, we anticipated reduced mill activity as profits kept shrinking. But with a little help from the weather, as illustrated above, we are looking at smaller crops in India. It pays to bear in mind that the bull market that drove sugar prices to 35¢ per pound in 2011 was strictly on account of drought in India. And we are looking at a possible repeat of that era. There is little appetite for farmers or producers to increase output.

With a looming global deficit for 2015-16 and the probability of another in 2016-17, we are quite comfortable with our long-term bullish view on this market.

Remain long calls. Buy October 16 calls, currently trading at about 60 ticks.

[By Sholom Sanik, January 26, 2016]

Chart 9 – October ICE sugar



Courtesy CFTC

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