FRIEDBERG'S
FOCUS ON FUTURES

Friedberg Mercantile Group Ltd. Volume 18, No. 6 July 17, 2015

Cocoa: Lone wolf

Saying that most commodity markets remain depressed does not do justice to the bear market. A more accurate statement would be that *all* commodity markets are hovering near multi-year lows save for one lone hold-out: cocoa (Chart 1).

We're about half way through the Ivorian mid-crop season. Up until a few weeks ago, port arrivals were running ahead of last year. They've now slipped back below last year's pace at this juncture of the season, by 33,000 tonnes, to 1.493 million tonnes. With two and a half months remaining, we are unlikely to see 2014-15 output match last season's record 1.7 million tonnes. Earlier in the main-crop season, a lack of precipitation was the problem, but rain arrived in time. Now there's been excessive rain, and farmers are concerned about disease affecting their plantations.

The recent surge in price cannot be blamed on the slowdown in arrivals in the Ivory Coast alone. Output has actually exceeded early-season expectations, and while production will fall short of 2013-14, it should still be the second-largest crop on record. But the other West African nations are struggling as well. Most prominent is Ghana, which never recovered from earlier dryness, and the most recent estimates put output at 700,000 tonnes, down about 150,000 from the previous season.

In Nigeria, crop-size estimates differ widely between the official government estimates and those of the International Cocoa Organization estimates (by 100,000 tonnes!). But both sources agree that the mid-crop will be smaller than last year's. Finally, Cameroon will have slightly smaller output than in 2013-14 as well.

As far as we can see, the market's strength comes solely from the supply side. Product prices continue to languish behind bean prices. The butter ratio has fallen to 1.9 times the London spot price, a two-year low. Powder prices have remained steady, but the combined ratio continues to slip (Chart 2).

Over the past few years, grinding capacity has increased in origin countries, but activity remains sluggish there as well. The Ivory Coast, for example, now accounts for close to 15% of global grindings, but 2014-15 grindings are expected to be down by about 10%.

It would seem that butter and powder stocks are ample, and the incentive to chase soaring bean prices does not exist. With the current price structure – an ever widening gap between bean and product prices – the profit motive is compromised.

The International Cocoa Organization recently revised its forecast for the 2014-15 global production/consumption balance to a 38,000-tonne deficit from a 17,000-tonne deficit, because of the poor outlook for West African crops.

Over the past 10 years, the stocks-to-consumption ratio has had a range of 52% to 38% and is currently forecast to come in at the low end of that range. For most commodities, that's pretty high. In the case of cocoa, however, 70% of world output is concentrated in one region. As illustrated above, all the countries of West Africa are affected by the same weather conditions.

In mid-July we get a look at grind results for Europe, North America, and Asia. Judging by the weakness in product prices, it's hard to imagine that the grind will be too strong. Regardless, the market has spoken.

We were mercifully stopped out of our short position at $2,925 per tonne. Remain sidelined.

[By Sholom Sanik, June 18, 2015]

Inside

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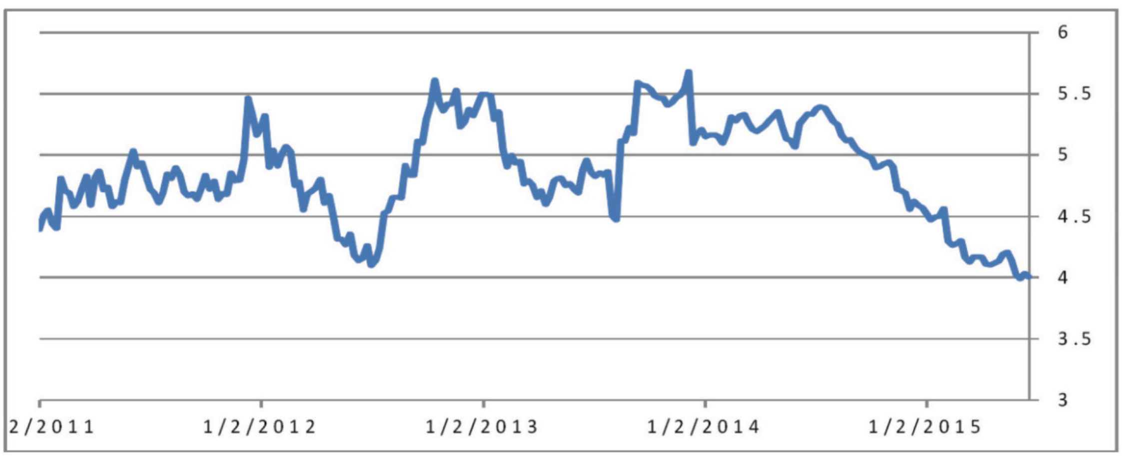
Chart 1 – Weekly nearest contract ICE cocoa

Courtesy Reuters

Chart 2 – Combined cocoa butter/powder ratio



SOYBEANS

Raining on the bear

Planted acreage estimates for the 2015-16 US soybean crop have been on a roller coaster ride this year. It began with a preliminary USDA forecast – long before the season even began – for a sharp increase in planted area to record levels. Then the USDA surprised traders with the March 31 planting intentions report, which showed that planted area would be 1.3 million acres below the average of analysts' guesstimate of 85.92 million acres. Some analysts maintain their original acreage forecasts of close to 87 million acres.

In the early stages of the planting season, all seemed to be going well, and with the backdrop of completed mammoth South American harvests, prices were falling back to last autumn's lows (Chart 3). Then wet weather appeared, delaying planting and washing out some already-planted fields. Fears of significant abandonment have emerged. The market is now braced for another downward revision to planted area. The USDA's early yield estimate for 46 bushels per acre (bpa) is down from 47.8 bpa in 2014-15. Yield estimates are now subject to a downward revision. One recent estimate by a well-regarded analyst puts the yield at 45 bpa.

The weekly crop progress report shows that 90% of the crop has been planted, compared with the five-year average of 95%. That doesn't seem too far behind, but the planting window is closing rapidly, and late-planted crops grow further into the fall when frost risk is greater. The good-to-excellent portion of the crop has fallen to 65% from an early-season high of 69%. That compares with 71% at this time last year. New-crop November soybeans have now rallied by over $1 per bushel off their lows.

It all seems ominous for the crop and bullish for prices. In drawing all this information together, however, we find that US supplies will still be sufficient to meet domestic and export needs. Some rough arithmetic that incorporates the potential for higher-than-typical abandonment and lower yields might shave 100 million bushels off the USDA's output estimate of 3.85 billion bushels (105 million tonnes). That would still leave ending stocks of 375 million bushels, or about 10% of consumption, compared with the average carryout of 4.5% over the past eight years.

The next big event for the grain markets comes on June 30 with the planting and quarterly stock reports. The planting report could actually create more confusion. The acreage surveys for this report are normally concluded in early June. At that point – as we pointed out above – planting progress was running very close to the five-year average, and problems were not anticipated. In fact, there were even expectations that the acreage estimate would be increased. With the delay in soybean planting, this report will be far from accurate. The USDA will likely resurvey the affected areas.

Even if there were a crop failure in the offing for a significant portion of the crop, it would have to be a worst-case scenario to have an appreciable impact on prices. We need to bear in mind that South American crops are now available, and they're so big that they should be able to compensate for lower US supplies. Brazilian output is expected at a record 97 million tonnes, up 2.6% from last year. The Argentinean crop is still being revised upwards. The June USDA estimate is 57 million tonnes, but more recent estimates put the crop above 60 million tonnes, also a record.

Maintain stops on short positions at $9.85 per bushel, basis November, close only.

[By Sholom Sanik, June 26, 2015]

Chart 3 – November soybeans

Courtesy Reuters

CORN

Bear on the run

Corn prices had been falling since the beginning of 2015, and now, in the space of just several trading sessions, all those losses have been wiped out. Heavy rains and strong winds have stymied the developing 2015-16 crop. Then, the release of dual June 30 USDA reports – quarterly stocks and the planted acreage update – added fuel to the bullish fire.

Record precipitation in some key Midwest growing regions flooded fields and is expected to result in lower yields. The USDA's early yield estimate was 166.8 bushels per acre (bpa), the second highest on record, behind the record set in 2014-15 at 171 bpa, but still an excellent performance. It was based on timely planting and good growing conditions.

However, with deteriorating weather, the most recent weekly crop progress report puts the good-to-excellent portion of the crop at 68%. That's down from a season high of 74% and well off the 75% posted last year at this time, so we're looking at a downward revision in the upcoming USDA July crop report.

Quarterly stocks were reported at 4.446 billion bushels, 108 million bushels below the average of analysts' guesstimates. The report was an indication that domestic feed consumption was strong despite fears that bird flu had curtailed demand.

The acreage report surprised traders as well. Planted area was revised downwards from the March intentions of 89.19 million acres, to 88.89 million acres. The street was expecting a slight increase from the March estimate, with the average of analysts' guesstimates at 89.292 million acres. Using the USDA yield estimate and harvested-to-planted ratio of 91.5% (which is optimistic, as illustrated above), the revision amounts to about 50 million bushels less corn available for the 2015-16 marketing year.

Between lower-than-expected stocks and fewer acres, the forecast for US 2015-16 ending stocks would be down to 1.610 billion bushels, or 11.7% of usage, compared with the USDA's June estimate of 1.775 billion bushels, or 12.9% of usage. Last year's final stocks were 13.8% of consumption, a welcome recovery after the previous period. In the four years prior, the average stocks-to-consumption ratio was 8.3%. It's a bit of a throwback to what should have been a second consecutive season of stock rebuilding.

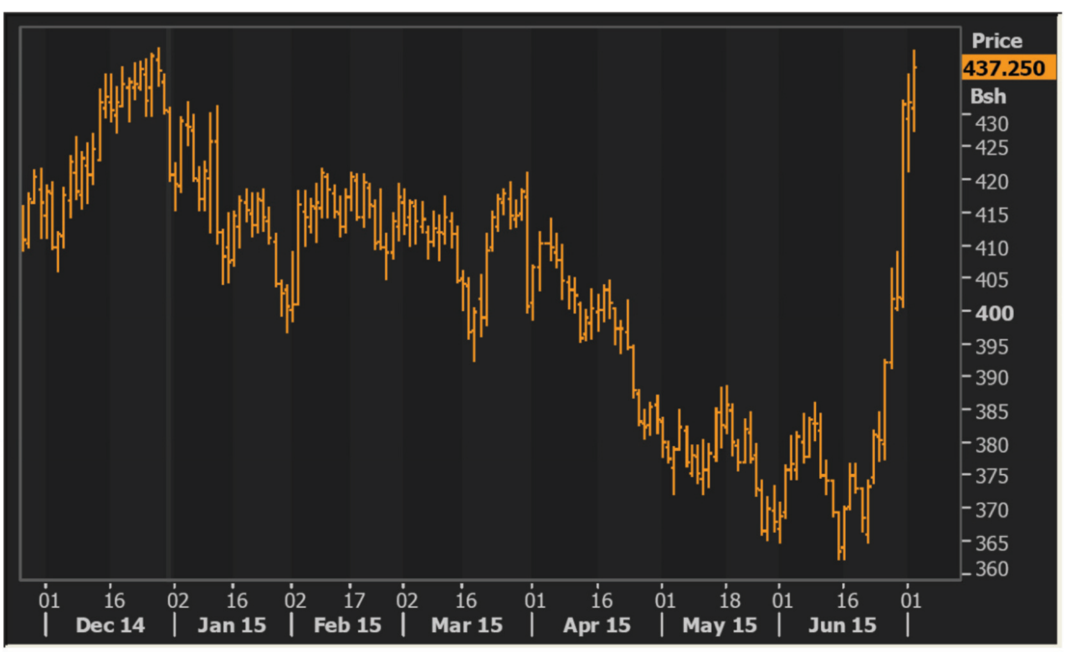
South American farmers have not expanded corn production in recent years the way they have for soybeans. For that matter, all the major corn-exporting nations – the US, Brazil, Argentina, and the Ukraine – maintain more or less the same ratio of global production as they have for many years. With the US being the single largest producer and the seller of last resort, a crop failure could spell the end of the bear market. Still, it is too early to make any assumptions about how the final crop will look.

We were stopped out of our short position at $4.25, basis December, as per our April 16 recommendation.

When judging the power of the recent rally, we need to take into account that the fund short position was the largest in many years. Supported by a strong US dollar, the bear market in this and many other commodities created a strong complacency that prices would continue to drift lower and that counter-trend rallies would be brief and shallow. The quick rally can be attributed to short covering and is not necessarily a reflection of longer-term supply/demand fundamentals at this point. At this time we suggest keeping to the sidelines until we get a better idea of the extent of the crop damage caused in the Midwest.

[By Sholom Sanik, July 6, 2015]

Chart 4 – December corn



Courtesy Reuters

SOYBEANS

Does bad weather in the US still matter?

The USDA's July crop report did not deal with the extremely wet US soybean planting season at all. Although there was a significant drop in the estimate for 2015-16 ending stocks, it had absolutely nothing to do with any new-crop developments, but rather a drop in the final estimate for the 2014-15 marketing year. For that matter, the report used the June 30 acreage report, which revised the March intentions upwards by 500,000 acres. The bushel-per-acre (bpa) yield was maintained at 46 bpa, the second highest on record behind last season's 47.8 bpa.

The crop report is so outdated that even the estimate for the harvested-to-planted ratio was increased slightly from 98.9% to 99.2%. The difference is a relatively small amount – about 10 million bushels – but the point is that the report was largely meaningless because it obviously did not incorporate what the market seems to have deemed to be a major weather event (Chart 5).

In the meantime, the crop is struggling. The good-to-excellent category has slipped to 62%. That compares with a season high of 69%. Last year at this time, 72% of the crop was rated good-to-excellent, humming along on its way to record yields. Most recently the heavy rains have subsided, and general weather conditions have improved. Still, it is noteworthy that traders largely ignored the report and drove prices to seasonal highs.

The late-planted crop leaves a vulnerable situation, which will require optimum weather for the balance of the season.

At least some of the data for the recently completed South American harvests may be a bit stale as well, providing a balance to the bullish US side. As expected, the estimate for Argentinean output was revised upwards by 500,000 tonnes, to 60 million tonnes. Curiously, though, the Brazilian estimate was maintained, at 94.5 million tonnes, even though the consensus among private analysts is that the crop is actually closer to 96 million tonnes.

So while it is quite likely that when the USDA gets around to updating its balance sheets to reflect recent developments, it will lower US output and raise South America, and the revisions will roughly cancel each other out. As it stands now, there is not much reason for soybean prices to embark on another bull run. The only supply-side factor that could change that would be further deterioration in the US crop. The crop was certainly compromised, but current prices reflect the damage that already occurred.

The explosive growth in South American crops insulates the market to a large degree. If the weather situation in the US stabilizes, supplies will be ample. The 2015-16 marketing year will mark the fourth consecutive season of production/consumption surpluses. The July estimate for global ending stocks was 93.22 million tonnes, or 30% of consumption. That's a record high since these statistics were first recorded in the early 1960s. The carryover compares with the average of the previous five years of 24.2%.

We recommend selling short November soybeans at current levels, with a stop at $10.40 per bushel, close only.

[By Sholom Sanik, July 17, 2015]

Chart 5 – November soybeans

Courtesy Reuters

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