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Smaller wheat acreage no deterrent for the bear

Wheat prices have moved in a relatively tight range since the beginning of this year (Chart 1). The market was focused on 2015-16 Northern Hemisphere crops – planted in the fall of 2014 and to be harvested this spring. For the most part, planted area was expected to shrink in major producing nations – the US, the FSU, the EU, and India.

Particular attention was directed to US acreage. The March 31 planting intentions report put winter wheat 1.65 million acres, or close to 4%, below 2014-15. After a harsh winter, the usual weather scares abounded. As the crop began to emerge, however, ratings were quite favorable, and fears of a disastrous crop abated. The most recent weekly USDA progress report shows that the crop is developing at a faster-than-average rate. In addition, 45% of the crop is in the good-to-excellent category, compared with only 30% at this time last year.

As a result, the May USDA crop report estimated that the harvested-to-planted ratio will be close to 87%, compared with only 81% for the two previous seasons. So despite an estimate for yields of 43.5 bushels per acre, a bit smaller than last year, the forecast of 56.81 million tonnes for the combined winter- and spring-wheat crops is actually *larger* than last year's 55.13 million tonnes.

The wheat-producing countries of the FSU, Russia, the Ukraine, and Kazakhstan, collectively are the world's largest exporters of wheat. They all planted smaller crops for 2015-16. The USDA estimates that total output will be 103.38 million tonnes, down from 112.73 million tonnes in 2014-15. Total exports are estimated to fall by 3 million tonnes, to 36.5 million tonnes.

The fall in FSU output will therefore contribute to a drop in global wheat production to 719 million tonnes, down from 726 million tonnes in 2014-15. Nevertheless, 2015-16 is expected to be the third consecutive year of global production/consumption surpluses. This year's surplus will be the smallest, but global inventories have been rebuilt. Ending stocks as a percentage of usage will climb slightly to 28.4%, and will still be at their highest level since 2010-11.

The USDA production data may be a bit dated, though, and in all probability ending-stock estimates over the next couple of months will be updated to reflect better-than-expected output results in some regions.

First of all, estimates for the already-harvested 2014-15 South American crops have been creeping up. The Argentinean agriculture ministry, for example, recently raised its output estimate to 13.9 million tonnes, compared with the USDA estimate of 12.5 million tonnes. Similarly, estimates for new-crop Russian and Ukrainian crops have been revised upwards as well.

Finally, there have been some weather problems with the soon-to-be-harvested US winter wheat crop in the form of excessive rain. So, although the development of the crop is ahead of schedule, the USDA has estimated the bushel-per-acre yield at 43.5, slightly below last year, as mentioned above. In the meantime, analysts are saying that the damage was not as severe as originally believed. Given the general excellent condition of the crop, it is also likely that we will see the USDA raise the yield estimate.

Establish short positions in December wheat, currently trading at about $5.10 per bushel. Place initial stops above the recent highs, at $5.55, close only.

[By Sholom Sanik, May 29, 2015]

Inside

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Chart 1 – December wheat

Courtesy Reuters

SUGAR

A bull market delayed

Fresh six-year lows for sugar prices – few, if any, commodities on the board can lay claim to that dubious distinction.

India and Thailand are wrapping up their 2014-15 harvests, and output results are slightly better than originally anticipated. Brazil is beginning its 2015-16 marketing year, and production forecasts are calling for better results than had been forecast as well.

The International Sugar Organization (ISO) recently revised its estimate for 2014-15, to a 2.2-million-tonne surplus from a 620,000-tonne surplus. One analyst puts its revised surplus estimate as high as 3.4 million tonnes. Forecasts for a massive 2015-16 global deficit of 5 million tonnes that we saw a few months ago have also been tempered. The average estimate is now closer to 2 million tonnes.

There are approximately 300 sugar mills in Brazil. A recent report by an industry group says that 67% of the mills are operating under bankruptcy protection.

We don't have statistics on the Indian situation, but it cannot be much different. There is ongoing strife between processors and the government. The cost of cane has not fallen at the rapid pace of world sugar prices, and the mills struggle to make payments to cane farmers. The government responds with subsidies, but the problem will not go away if sugar prices remain as depressed as they are.

As the 2015-16 Indian growing season begins, a new wrinkle has surfaced in the sugar market. About 60% of Indian agriculture relies on rain for irrigation. About 70% of the rainfall is expected to come from the June-through-September monsoon. El Niño has appeared this year and has already started wreaking havoc with global weather patterns: Too much rain in some regions, too little in others. Rainfall of between 96% and 104% of the 50-year average is considered normal. Below 96%, but above 90%, is below normal. Anything below 90% is classified as deficient. At present, meteorologists estimate that the monsoon is between 88% and 93% of normal.

Last year the monsoon rains were light in the early part of the season as well, but improved as the season wore on, and the crop muddled through in fine fashion. And that could be the case this year. It is, however, the introduction of a potential powerful bullish factor. The Indian drought in 2009 triggered a bull market that drove sugar prices up to 35¢ per pound.

The Agriculture Ministry has certainly taken threats of a weak monsoon seriously. It has contacted farmers with instructions on how to maximize irrigation and ensure the use of the correct variety of seeds.

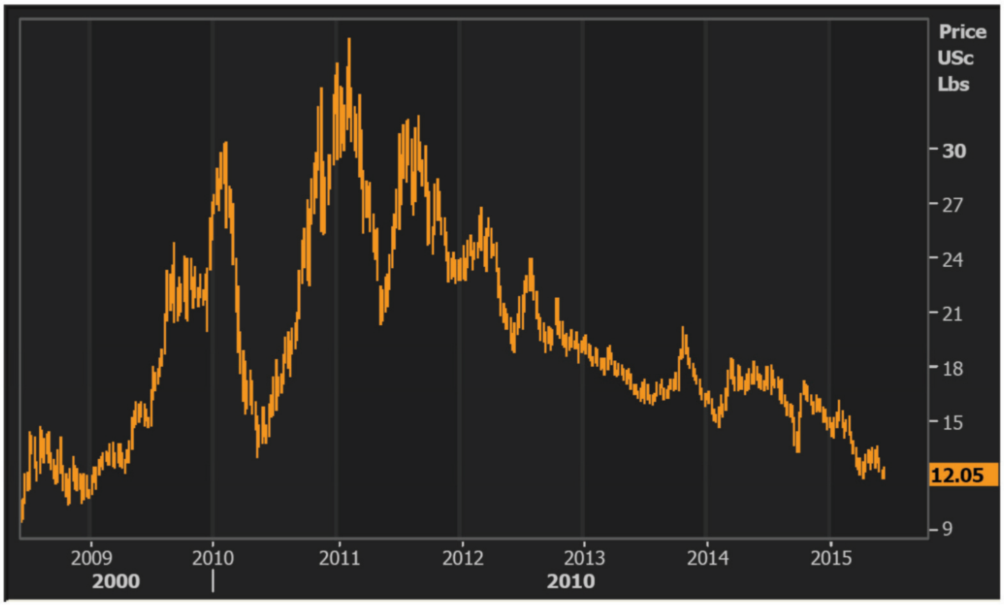
With estimates for more comfortable global inventories and the charts boasting what is probably the single most bearish technical picture of any security we know of, commodity funds are piling on the shorts.

The upwardly revised estimates for Brazilian and Indian output, however, have served only to delay the inevitable. The financial infrastructure of production facilities in both countries is broken, and it is only a matter of time before we see mill shutdowns and lower output. The problem could only be exacerbated by a crop failure in India, if the monsoon rains do not arrive in time.

We maintain our stance. Buy and hold long-term out-of-the-money call options.

[By Sholom Sanik, June 4, 2015]

Chart 2 – Weekly nearest-contract ICE sugar



Courtesy Reuters

SOYBEAN OIL

El Niño and the vegetable oil market

Further to our discussion on the possible effects of El Niño on the Indian monsoon (*Focus on Futures*, May 5), another vulnerable region is Southeast Asia. Palm oil (palm and palm kernel) production comprises about 40% of the world's vegetable oil production. Indonesia and Malaysia produce about 85% of the world's palm oil. A crop failure would therefore have dramatic repercussions, not only for the price of palm oil, but on all other vegetable oils as well.

While there is a tradeable contract for palm oil on the Kuala Lumpur Exchange, there are two issues with trading that market. First, it is closed during the North American trading day. That problem is surmountable, but it is denominated in Malaysian ringgits, which leaves the risk of adverse currency fluctuations. So in terms of trading, our focus is on soybean oil. Production of soybean oil represents about 27% of the world's vegetable oil output.

During the last significant El Niño-induced Asian drought in 2009, vegetable oil prices rose substantially. Not too much inference can be drawn from that period as to what effect a Southeast Asian drought would have on other oils, because we were still in the throes of a broad-based commodity bull market then. In the current environment, inventories of most commodities have been rebuilt and only a *bona fide* shortage could drive prices higher.

Although there has been some dry weather in Indonesia and Malaysia, it is still very early to draw any conclusions about how the palm crops will perform. However, there has been some stirring in the soybean oil market. While soybean and the other US grain prices have languished in a multi-month range, soybean oil prices have sprinted to six-month highs (Chart 3). Chart 4 shows clearly how soybean oil has outperformed the underlying soybeans.

The world is awash in soybeans. Record South American crops have been harvested and are ready for export. Regardless of what happens in Southeast Asia, soybean prices are likely to remain depressed. But the possibility of a vegetable oil bull market independent of a soybean shortage has some historical precedent. As indicated by Chart 5, there have been incidents in which soybean oil has outperformed soybeans by a wide margin.

The bullish case for vegetable oils received an unexpected boost earlier this month when a wide swath of the rapeseed growing region in the Canadian province of Manitoba was hit by a freeze. Many farms saw the entire crop wiped out. Canola oil is made from rapeseed, the world's third-largest vegetable oilseed crop. Roughly 27% of global vegetable oil output is canola oil, 10% of which is produced in Canada. There is a replanting window, but that closes in mid-June.

As it is, according to the USDA, 2014-15 global ending stocks for all vegetable oils touched an 18-year low of 9.9% of consumption. The early estimate for 2015-16 calls for record low inventories of 8.8% of usage, partly because many countries have been creating incentives for processors to bolster vegetable-oil biodiesel programs. These estimates have not accounted for any crop failures.

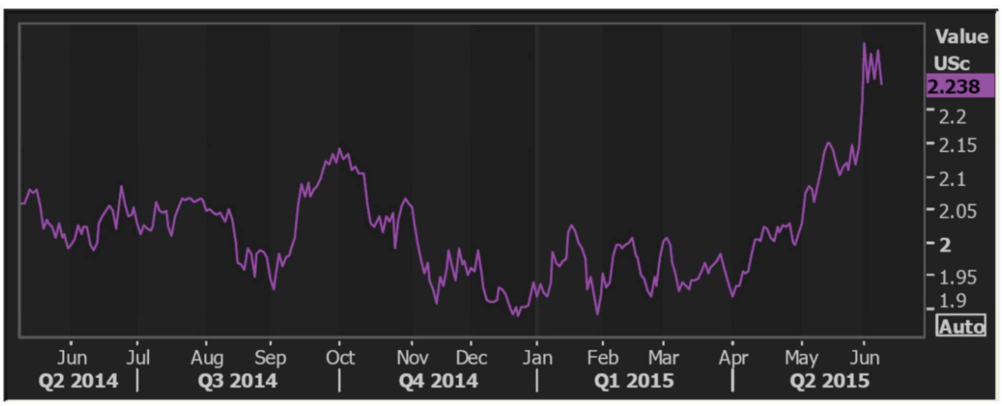
We are not predicting a weather catastrophe. Rather, we are introducing the idea that if El Niño does turn out to be a serious concern, one area of vulnerability will the palm crops in Indonesia and Malaysia, which should have a strong ripple effect on the other oils.

We recommend buying December soybean oil on pull-backs of between $0.0050 and $0.0075 per pound, presently trading around $0.34 per pound. Place initial sell stops at $0.31 per pound. *[By Sholom Sanik, June 9, 2015]*

Chart 3 – December soybean oil

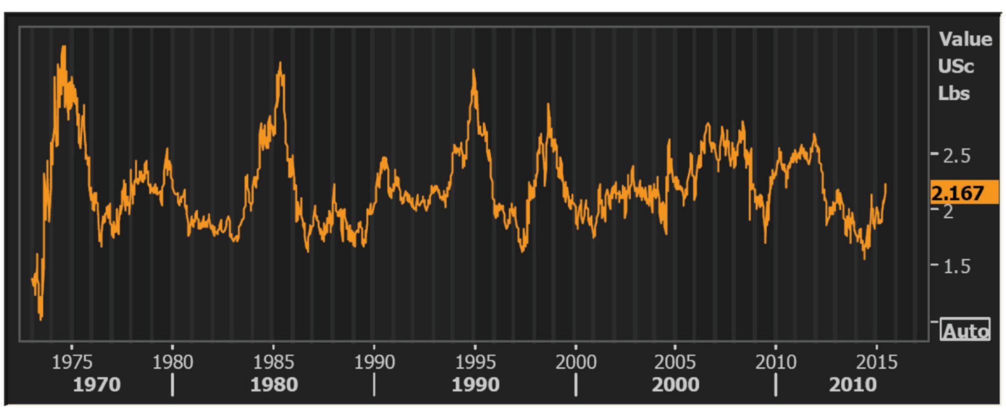
Courtesy Reuters

Chart 4 – December soybean oil/November soybean ratio



Courtesy Reuters

Chart 5 – Weekly nearest contract soybean oil/soybean ratio



Courtesy Reuters

COTTON

Taking a tiny bite out of inventories

Cotton prices continue to wander aimlessly in a narrow range (Chart 6). Global inventories remain stubbornly high. The changes are subtle, but early estimates for the upcoming 2015-16 marketing year, which begins on August 1, show a bit of a drawdown. Ending stocks are forecast at 106.08 million bales, or 92% of usage, down from 98.7% in 2014-15.

Lower stocks are the result primarily of two factors. Global output is estimated to be 6.5% below 2014-15. In addition, Chinese inventories account for about 60% of the global overhang, but the government program to eat into those massive stocks by reducing imports has lowered its carryover by close to 5% from last year.

To illustrate, consider that in 2013-14, Chinese domestic mill usage was 34.50 million bales, and imports were 14 million bales. For 2015-16, the USDA estimates mill usage at 36 million bales, with imports at a scant six million bales.

Back to the production side – with cotton prices near five-year lows, all major producing nations, including, China, India, Pakistan, and the US have planted smaller crops. These four countries account for more than 70% of global cotton output, so any important changes are crucial to world supply levels. The June 10 USDA crop report did not revise any of its output estimates from the May estimates for these producers.

For China, the estimate is 27 million bales, three million bales below 2014-15, and commensurate with estimates for a drop in planted area. The USDA typically takes a conservative approach when there is no clarity. But with regard to India, the USDA has not made any adjustments from last year's output estimate, and it would seem highly improbable that status quo will be maintained. Indian production for 2014-15 was 29.5 million bales, and the USDA estimate calls for the same for 2015-16. However, the Indian trade group, the Cotton Association of India, is forecasting that farmers were planting 7% less cotton than in 2014-15.

With comparable yields, that would shave about two million bales off the USDA estimate. While it is still early in the monsoon season, the most current forecasts put the vital rains at only 88% of normal, still a problematic level. Optimum yields are therefore a long shot, and final production totals could well be even smaller.

US farmers planted 13.5% fewer acres than in 2014-15. As of the most recent crop progress report, 81% of the crop has been planted, compared with 87% last year, and the five-year average of 89%. The smaller area and slow-planting progress issues have been in the market for some time and are reflected in current estimates. Output is forecast at 14.5 million bales, down from 16.32 million bales in 2014-15.

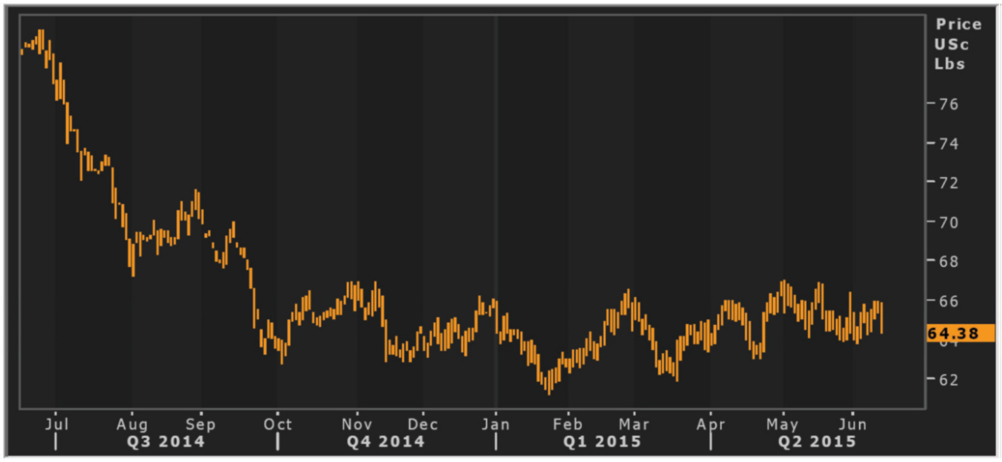
Global consumption is forecast at 115.3 million bales, up from 111.3 million bales in 2014-15, leaving the first production/consumption deficit since 2009-10. In a normal environment this would be a bullish configuration. The pending drawdown in global stocks would certainly be ample cause to consider being long a market that is hovering just above five-year lows. At present, however, the cotton market is anything but normal. With overseas purchases by the world's largest importer having shriveled to a shadow of what they were while it works off its own stockpiles, it is hard to expect much upside price action from this market.

By the same token, we don't see the market falling to new lows either. As illustrated, the process of eating into China's formidable carryover has begun, but it will be a lengthy process. Barring any crop "accidents," we believe prices will remain range-bound.

Stand aside.

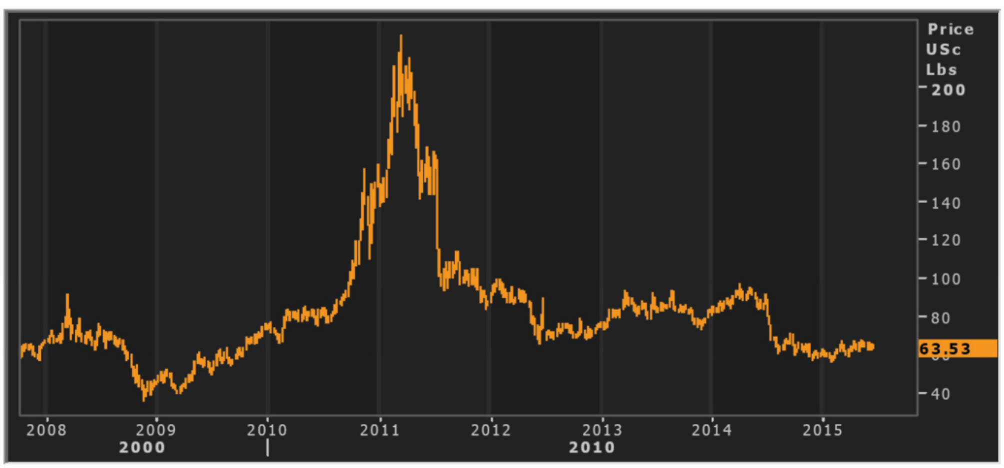
[By Sholom Sanik, June 12, 2015]

Chart 6 – December ICE cotton



Courtesy Reuters

Chart 7 – Weekly nearest contract ICE cotton



Courtesy Reuters

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