FRIEDBERG'S
FOCUS ON FUTURES
Friedberg Commodity Management Inc.
Volume 5, No. 6 July 2, 2002

The anticipated recovery in global wheat production is in jeopardy

This month's USDA supply/demand situation report inspired a robust, 20¢-per-bushel rally in wheat futures. July wheat tested chart resistance by tying the March high of $2.98 per bushel, but has since backed off, erasing about half the gains. Déjà vu?

US

Highlights of the report include a 1.7-million-tonne drop in US output, mostly because of deteriorating conditions in the winter wheat belt and a poor start to the spring wheat crop. This was reinforced Monday afternoon with the weekly crop progress report. The good-to-excellent portion of the winter wheat crop fell yet again, to 28% from 29% last week and 43% last year at this time. For spring wheat, the good-to-excellent portion dropped to 56% from 59% the previous week and 69% last year.

Long-standing bears argue that it will be difficult ever to generate a serious bull run in wheat – or any crop grown in the US for that matter. Low world prices are not an effective disincentive to farmers when the federal government guarantees a price floor for their crops. While this makes perfect sense in analysts' reports, it is not what is happening out in the fields. US farmers planted 59 million acres of wheat this season, the smallest acreage planted since the 1973-74 season.

Mother nature has complicated matters with drought. The USDA estimates the winter wheat crop at 33.8 million tonnes (1.24 billion bushels), 9% below last year's 37 million tonnes (1.36 billion bushels). As the crop is being harvested, though, it has become apparent that weather has done enough damage to render even these forecasts optimistic. Well-regarded agronomist William Tierney of Kansas State University shaved his estimate by about 1 million tonnes, to 32.8 million tonnes (1.204 billion bushels).

Global picture

World wheat production has declined each year since the 1998-99 season. The 2002-03 season is expected to reverse this trend. While still above last year's figure, it was disappointing for bears to see the USDA revise downwards its estimate for global production by 6 million tonnes, or 1%, to 589.78 million tonnes. Production for 2001-02 was also lowered by close to 1 million tonnes. Combined, these revisions resulted in a 7-million-tonne drop in the forecast for 2002-03 global ending stocks, to 156.07 million tonnes, or 26% of consumption, compared with 27.2% last month. Definitely more bullish than last month, but no dramatic shakeup in the overall picture. Until we look at recent developments, that is.

First of all, there's the 1-million-tonne reduction in the US we mentioned earlier. Not included in the USDA report were updates by Australian and Canadian grain agencies that lowered significantly those countries' (the world's second and third largest exporters) output forecasts for 2002-03.

Australia's ABARE chopped its previous, 24-million-tonne, forecast dramatically to 20.5 million. AWB, the coun-

In this issue

2 **Cocoa** A chink in the armor, but the bull charges on
4 **Sugar** Big crops, weak prices
5 **Corn** Wet spring has a limited effect on acreage, but the market holds its own
6 **Hotline Update**

Unless otherwise indicated, all articles have been written by Sholom Sanik (E-mail: ssanik@friedberg.com).

try's national exporter put the crop at 22 million tonnes. This compares with the USDA's 23-million-tonne estimate.

The USDA estimated Canadian production at 24 million tonnes, assuming a return to normal yields after the dismal 2001-02 crop of 21.3 million tonnes. The Canadian Wheat Board, however, reported on June 12 that drought will trim the western Canadian crop to 19.65 million tonnes, from 19.9 million tonnes last season. After adding the balance of Canadian output of roughly 1.5 million tonnes, the total amounts to only 21.15 million tonnes, nearly 3 million tonnes below the USDA estimate.

With these changes in US, Canadian, and Australian output projections, we can trim about 5 million tonnes off the USDA's global production forecast, putting production closer to 585 million tonnes rather than the USDA's 589.78 million tonnes. As a result, ending stocks would be drawn down to 151 million tonnes, or 25.3% of consumption. This pushes carryover stocks well below the average 29% stocks-to-consumption level of the past few years.

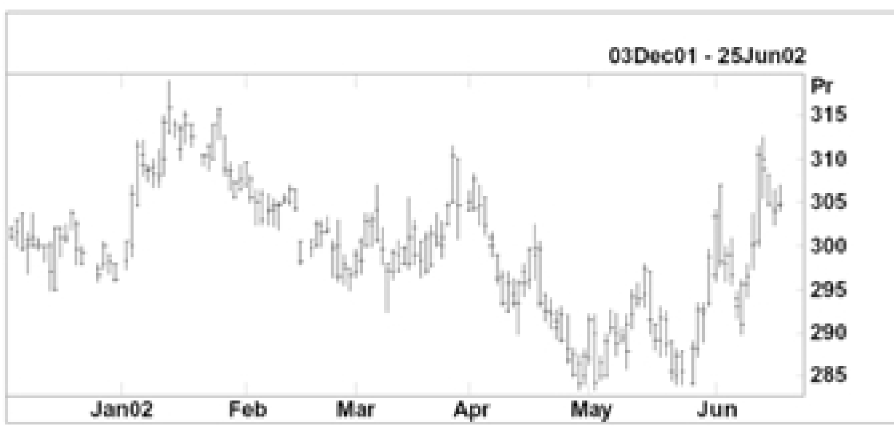
The supply side, as illustrated, is bullish. On the demand side, the estimate for total global consumption is forecast to increase by about 9 million tonnes to 596 million tonnes, but the world trade portion is expected to fall by 1.5 million tonnes. In using the US – still the world's largest exporter – as a proxy for projecting the direction of world trade, we find exports have been falling since the 1999-00 season. This month's USDA report revised projections for 2002-03 US exports upwards by 700,000 tonnes from last month, but still leaving the annual figure more than 1.5 million tonnes below last year.

One very significant factor that could bolster demand for US wheat, however, is the broad decline of the US dollar we are witnessing. Some evidence of this may have appeared in recent export data. Export commitments for the new marketing year are running about 4% ahead of last year's pace. Still, it is far too early to tell if the trend will hold.

In conclusion, the supply/demand balance at current levels, with global stocks at 25.3% of consumption, does it for us. We're long and expecting the market to clear the $3-per-bushel level decisively. *[June 19, 2002]*

STRATEGY: *Remain long December wheat as per Flash Update of June 13. Maintain stops at 285, close only.*

Chart 1 – December wheat



Courtesy Reuters

COCOA

A chink in the armor, but the bull charges on

On June 10, cocoa prices took a spectacular, $100-per-tonne plunge. Even more spectacular, though, was the timely $170-per-tonne recovery. Bulls did not have to endure discomfort for very long. The market spent very little time near the bottom and then snapped back to record yet another new contract high only nine sessions later (Chart 2).

Both the selloff and the subsequent recovery occurred amidst a dearth of any fresh, published data. In West Africa, we are in the middle of the mid-crop season and between main crop seasons. The most recent Ivorian main-crop data show that arrivals stand at 1.06 million tonnes. It is generally accepted that the Ivorian mid-crop will come in at about 150,000 tonnes. This puts the total crop at 1.21 million tonnes, in line with E.D.&F. Man's late-April estimate. Its next estimate is expected any time now.

It is far too early for analysts to take a stab at forecasting the size of the coming 2002-03 crop. Generally, the weather has been favorable for the early development stages.

While the action is the stuff of a classic commodity bull market, one red flag is being raised, and bulls should take note. The strength of this market has been associated almost entirely with the supply side, the primary issue being the end of the era of crop-size growth in the Ivory Coast. Prices rose despite soggy grinding statistics over the past four quarters. We rationalized that actual bean purchases by processors must have been stronger than grind statistics indicated, because the market was in such a steep backwardation. Actual grinding levels were weak because of poor processing margins.

And now there's a fly in that ointment. The backwardation began to unravel back in mid-April (Chart 3). The 1-year spread peaked at $256 per tonne and is now just about flat. The spreads improved a bit during the recent rally, but have begun to erode again even as the market continues to register yet another round of contract highs. The action in the spreads demands careful monitoring.

On the brighter side, well-regarded softs analysts Judith Ganes-Chase tells us that while the butter market is in ample supply, there is tightness in the powder market. The reluctance of processors to grind because of poor processing margins is catching up with them on the powder side of the balance sheet. Eventually, grindings will have to increase to meet powder demand.

The commitment data support the bull case. The behavior of commodity funds – never big believers in the bull case – has been rather confusing. Several weeks ago they seemed to be finally getting on board the long side, building a net long position of 16,028 contracts. Now, they've turned around completely and are heavily short. As of this Monday's CFTC report, they were *net short* 10,958 contracts, certainly an oddity.

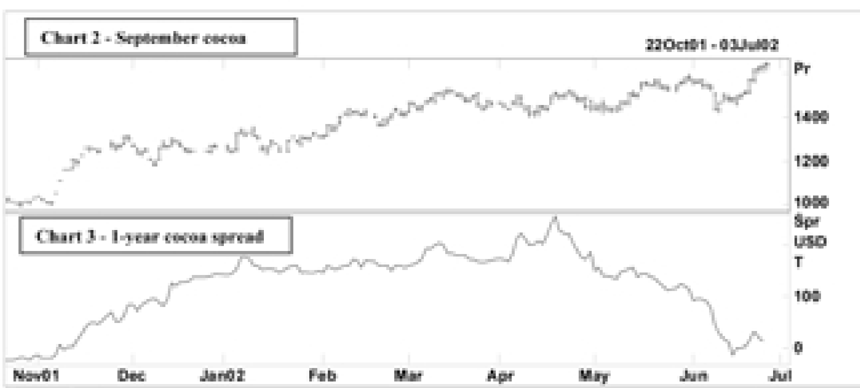
Typically, commodity funds follow the trend and there is little question about which direction that has been. Chart 4 shows the rather erratic pattern of the commodity funds' trading. Even small speculators have never participated much in this move. They are net long only 1,455 contracts. Now that the funds are short, there is the possibility of short-covering overhanging the market, particularly in light of the daily multi-year highs we are registering.

Sentiment readings confirm the lackluster approach speculators have taken to this bull market. The service that we subscribe to shows bullish sentiment at only 36%, much closer to the 52-week low than it is to the 52-week high. Our contrarian spirit finds comfort in this.

There will be a number of reports to look for in the coming weeks, most notably, second-quarter grind data and the June E.D.&F. Man report, which will give us a better idea of the size of the mid-crop and the coming main-crop in the Ivory Coast.

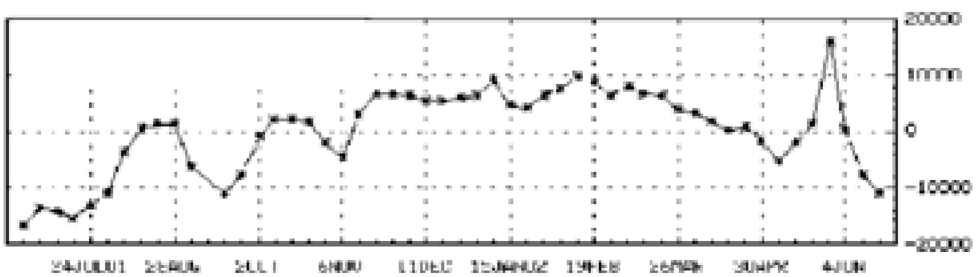
In conclusion, we are in a bit of a dilemma, because we are concerned about the erosion of the spreads, but we are hesitant to raise our very liberal, 1425 stop, because we have to expect volatility, and we do not want to lose this position. We will be on the lookout for other indications that bullish fundamentals have abated, but until then we will remain resolutely long and look for the market to challenge the 1998 high of $1,758 per tonne. *[June 27, 2002]*

STRATEGY: *Remain long September cocoa. Maintain stops at 1425, close only.*



Courtesy Reuters

Chart 4 – Net position of commodity funds



Courtesy Bloomberg

SUGAR

Big crops, weak prices

Sugar prices are hovering at two-year lows and are not all that far from three-year lows. It is quite a challenge to build even a weak bullish case given the apparent fundamentals. According to sugar statistician F.O. Licht, world sugar production for 2002-03 will increase by 2 million tonnes, to 138.3 million tonnes. Consumption is forecast to grow by 3 million tonnes, to 135 million tonnes, but this would still leave a 3-million-tonne production/consumption surplus. Global carryover stocks at the end of 2002-03 should stand at 66.3 million tonnes, or 49.1% of consumption, up from an already burdensome 47.7% of consumption at the end of 2001-02.

In taking a closer look at the crops of the important exporting and importing regions individually, you won't find a bullish fundamental in sight. Top gun Brazil is expected to harvest a record 23 million tonnes, close to 3 million tonnes more than last season. The EU will produce 17.6 million tonnes, an increase of 1.3 million tonnes over last year. Chinese farmers are estimated to have grown a record crop of 8.9 million tonnes, surpassing the previous record set in the 1998-99 season.

There are a few, meager bullish notes. The increase in Brazilian production is not as overwhelming as it seems. It will probably not have quite the availability for exports that is being forecast, because the government is likely to keep increasing the required alcohol/gas ratio from the current 24%, with the specific intention of restricting sugar exports to boost prices. Each percentage point rise in the ratio represents about 500,000 tonnes of sugar.

One of the bearish factors overhanging the market over the past couple of years was the possibility of India becoming an important exporter. The country's stocks soared to 12 million tonnes from 7 million between 1998 and 2002. Although the government has been liberalizing the industry to boost exports, it is unlikely that the country will become a threatening force on the world market for a number of reasons, but primarily because the quality of its product is inferior, and it cannot compete with European sugar. Besides, production is expected to drop by 800,000 tonnes this season, while consumption is estimated to increase by 600,000 tonnes, drawing stocks back down to a somewhat less cumbersome 10.6 million tonnes.

In March 2000, sugar prices were in the same neighborhood that they're in now when a series of production shortfalls appeared, causing a production/consumption deficit that at one point was thought to be as high as 5 million tonnes. Prices more than doubled. With bountiful crops being harvested in most Southern Hemisphere growing regions and healthy crops expected from expanded acreage in Northern Hemisphere regions, it does not seem that the supply side will come to the rescue of depressed prices this time around.

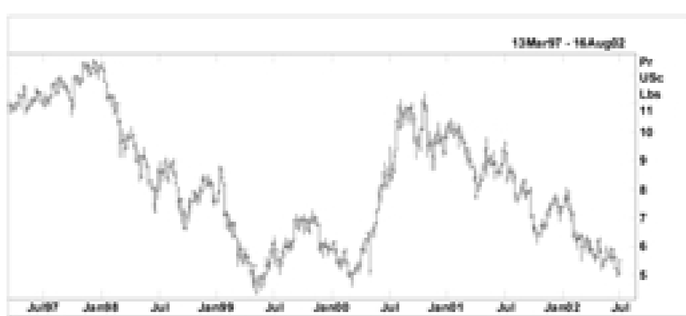
There are several factors, however, that would make us be on the lookout for bottoming action. China is expected to import 1.7 million tonnes of sugar as part of its agreement in joining the World Trade Organization. Analysts are divided over whether this is going to happen. Still, the country's stocks were drawn down in the inclement-weather-reduced 2001-02 season while consumption continued to grow steadily. Although 2002-03 will be the second consecutive season of bumper crops, domestic consumption has been greater than production in each of the past four years. Chinese imports remain a wildcard.

A price of 5¢ per pound is very, very cheap, the significance of which is that for farmers in countries without government subsidies, these price levels are below their cost of production. In the near term this manifests itself in reduced usage of pesticides, which lowers yields. In the longer term, farmers switch to more profitable crops. Elementary commodity economics.

Summing it all up, there is no bullish case (that we know of). The reason to keep on eye on this market, however, is found in a lesson learned in other markets. Cotton in particular. When cotton prices slipped below 30¢ per pound in November 2001, hard as you might have tried, you couldn't concoct a bullish fundamental. No self-respecting analyst would dare suggest that such low prices were unsustainable. Certainly, there was nobody who predicted that within six months of touching the bottom, prices would rally 50% – which they did. But, again, simple commodity economics tells us that low prices entice demand and discourage production, exactly the scenario that played out in cotton. We cannot see any reason for the global sugar balance to tighten at this time. But as illustrated, bear markets beget bull markets. As such, we continue to watch the sugar hot-spots for changes in supply and demand patterns. *[June 27, 2002]*

STRATEGY: *Remain sidelined.*

Chart 5 – Nearest contract sugar



Courtesy Reuters

CORN

Wet spring has a limited effect on acreage, but the market holds its own

Forecasts for hot, dry weather in the US corn belt fueled a sharp rally in corn prices this week. It is not merely coincidence that the last time spot prices reached these levels was one year ago, also during the weather-scare season (Chart 6). For that matter, it is difficult to find any year in which there wasn't a weather-related rally at some point of the planting or growing season. How real are this year's weather-related problems?

The drought-fear the market is currently trading on is the second weather problem of the season. In the spring, excessively wet weather restricted planting progress. This morning's USDA planting report, however, shows that the problem was not as significant as traders had imagined. The average trade estimate for corn acreage was 77.73 million acres, but the figure came in at 78.9 million acres. This is higher than the USDA's previous estimate of 78 million acres and significantly higher than last year's 75.8 million acres, certainly a disappointment for bulls. The notes accompanying the USDA report explained that while traders focused on the wet planting conditions in the eastern corn belt, farmers in the western corn belt enjoyed ideal weather conditions and planted more acres than they had intended to.

Using a yield of 136 bushels per acre (somewhere between the USDA and analysts' estimates) and the average harvested-to-planted-acre ratio of the past 3 years, this would tack on 111 million bushels (2.8 million tonnes) to the USDA's June 2002-03 crop estimate of 9.65 billion bushels (245 million tonnes).

Tempering that bearish item slightly, the USDA also reported quarterly grain stocks on June 1 were 3.594 billion bushels (91 million tonnes), 14 million bushels (355,000 tonnes) lower than analysts' expectations.

Between the two, US ending stocks for 2002-03 would rise from the June estimate of 1.301 billion bushels (33 million tonnes), or 13% of consumption, to 1.398 billion bushels (35.5 million tonnes), or 14% of consumption. All in all, it was not a great morning for bulls.

Another bearish item appeared today. A report out of China said that Chinese exports would reach 8 million tonnes this year, 2 million tonnes higher than the June USDA estimate.

The market still has other issues to worry about, though, for both the supply and demand sides. Soil moisture levels in the US Midwest are low and are in need of precipitation during the upcoming, critical pollination period. Forecasts are calling for a continuation of above-normal temperatures.

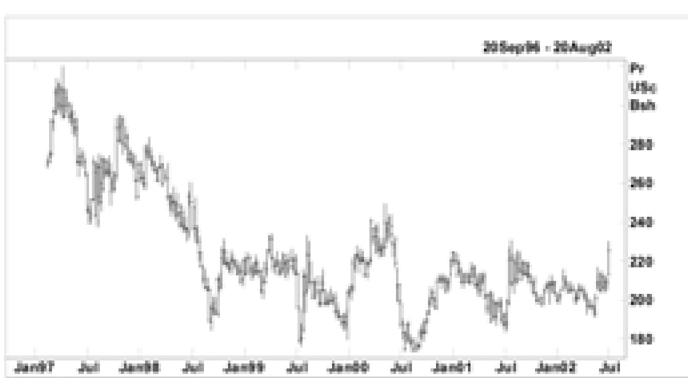
US exports have been very strong. Net new sales of old crop corn were 925,000 tonnes this week, bringing total commitments for the year to 44.26 million tonnes. The USDA forecast for 2001-02 exports is 48.9 million tonnes. At this point we can expect sales to shift to new crop. But with 10 weeks left in the old crop marketing year, US exporters will have to sell an average of only 464,000 million tonnes weekly to reach the target, well below the 940,000-tonne average old crop sales of the past 4 weeks. The USDA is very optimistic about the prospects for 2002-03, forecasting a 4.5-million-tonne jump in exports.

Plugging all these number into the global balance sheet, we find that this morning's rather bearish report does not alter the generally bullish scenario. Ending stocks for 2002-03 would increase by 2.445 million tonnes to 105.1 million tonnes, or 16.7% of consumption, compared with the USDA June estimate of 16.4% of consumption, and still well below 2001-02 ending stocks, which stood at 19.9% of consumption.

December corn closed only 1¢-per-bushel lower today, an extremely resilient performance, considering that traders – including us – were genuinely surprised that acreage was not reduced and considering we are coming off a strong rally. Global balances remain tight, and – as illustrated – that didn't change very much. The weather is a serious issue and makes US supplies vulnerable to yield losses that could easily compensate for the tonnage we added in today's reports. *[June 28, 2002]*

STRATEGY: *Remain long December corn. Maintain stops at 2.15, close only.*

Chart 6 – Nearest contract corn



Courtesy Reuters

HOTLINE UPDATE

***Flash Update* – Monday, June 3, 2002:**
Good afternoon for Monday, June 3, 1:35 pm. This is a Flash Update. We have liquidated our long July copper position at 77.50.

Friday, June 7, 2002:
Good afternoon for Friday June 7, 4:50 pm. The following is a recap of our current open position recommendations, and our latest stop levels. We are short June mini S&P, with our stop at 1135; long July cocoa, with our stop at 1380; long December corn with our stop at 215; and long August gold, with our stop at 306, good anytime. All other stops are close only.

***Flash Update* – Thursday, June 13, 2002:**
Good morning for Thursday June 13, 10:50 am. This is a Flash Update. We have purchased December wheat at 300.25, placing our initial stop at 285, close only.

Friday, June 14, 2002:
Good afternoon for Friday June 14, 4:50 pm. The following is a recap of our current open position recommendations, and our latest stop levels. We are short September mini S&P, with our stop revised to 1110; long September cocoa, with our stop at 1380; long December corn, with our stop at 215; long December wheat, with our initial stop at 285; and long August gold, with our stop at 306, good anytime. All other stops are close only.

Friday, June 21, 2002
Good afternoon for Friday June 21, 4:50 pm. The following is a recap of our current open position recommendations, and our latest stop levels. We are short September mini S&P, with our stop at 1110; long September cocoa, with our stop revised to 1425; long December corn, with our stop at 215; long December wheat, with our stop at 285; and long August gold, with our stop at 306. All stops are close only.

Friday, June 28, 2002:
Good afternoon for Friday June 28, 3:30 pm. The following is a recap of our current open position recommendations, and our latest stop levels. We are short September mini S&P, with our stop at 1110, long September cocoa, with our stop at 1425; long December corn, with our stop at 215; long December wheat, with our stop at 285; and long August gold, with our stop at 306. All stops are close only.

Subscription Enquiries for
Friedberg's Focus on Futures
Suite 250, BCE Place
181 Bay Street
Toronto, Ontario, Canada
M5J 2T3
416-364-1171

All enquiries concerning trading accounts should be directed to:

In Canada
Friedberg Mercantile Group
Suite 250, BCE Place
181 Bay Street
Toronto, Ontario M5J 2T3
416-350-2903
Attn: Sholom Sanik

For U.S. Persons
Friedberg Mercantile Group, Inc.
Suite 250, BCE Place
181 Bay Street
Toronto, Ontario, Canada M5J 2T3
1-800-461-2700