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Global ending stocks of corn are dwindling

The "traders' reaction" item, carried on news wires immediately after the June USDA supply/demand situation report flashed across the screen on June 11, indicated that new information provided in the monthly report was bearish for corn prices. Initially, analysts focused on the US portion of the report, which showed that old-crop (2002-03) ending stocks were revised upwards from the May report by 640,000 tonnes. They ignored more significant changes to estimates of the global supply/demand balances.

The market opened weak, but after a second look at the numbers, traders drove the market to solid gains by the close. Judging by the action since, however, participants seem to have harked back to their initial impressions of the report (Chart 1). Where are we headed?

First, a little history. Last summer, the market ran up to $2.85 per bushel, its highest level since 1998. The powerful, $1-per-bushel rally was caused primarily by fears of a drought-reduced US crop. The USDA began the 2002-03 marketing year with an estimate for a very healthy, near-record 252-million-tonne crop. By early fall, analysts were looking at a crop size closer to 220 million tonnes. A late-season spurt of favorable weather stabilized the situation, resulting in a decent crop of 229 million tonnes. Fears of a disastrous crop subsided, and the bull run ended.

Export demand provided no assistance. Here, too, the USDA forecast varied widely throughout the season. Early in the season, sales for 2002-03 were estimated at 50 million tonnes, in line with the 49-million-tonne average of the previous four years. The most recent estimate has fallen to 40 million tonnes.

Consequently, while the outlook for prices has indeed been rather soggy, the fresh data for the new-crop marketing year change the picture considerably.

We view the bearish part of the report, the increase in US ending stocks, as tentative. The USDA is once again looking for a robust, 255-million-tonne US crop, which would beat the record crop grown in the 1994-95 season by a hair. It would be frivolous to warm up to the bull side merely by anticipating volatile weather. On the other hand, when we begin with such optimism, we would have to invoke the good-news-is-already-in-the-market factor.

With prices much closer to the low of the past year's range this early in the growing season, the outlook for a good crop at this time is not *yet* a bearish factor.

This past season's decline in US exports was not the result of a general drop in global demand. Consumption actually increased slightly from 2001-02. Rather, the problem was that China decided to increase its exports, taking a chunk of business away from the US. Chinese corn exports grew to a record 13.5 million tonnes, displacing Argentina as the world's second biggest exporter after the US.

This is where the bullish case takes over. China cannot repeat its pace of export activity. For starters, low corn prices have encouraged farmers to switch 3% of corn acreage to more profitable commodities such as oilseeds. The USDA estimates 2003-04 Chinese output at 118 million tonnes, a 4-million-tonne downward revision from last month and down from 121 million tonnes last year. Dryness has been an issue in most corn growing regions, prompting local analysts to lower their forecasts further, to 114 million tonnes. In addition, Chinese consumption was revised up by 2 million tonnes from the May report.

China's entry into the export business has drawn its inventories down to their lowest levels since the 1970s. Up until the end of the 1990s, stocks hovered around 80% of consumption. With the new figures for 2003- 04,

Inside

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stocks of 27 million tonnes will have plunged to 21% of consumption!

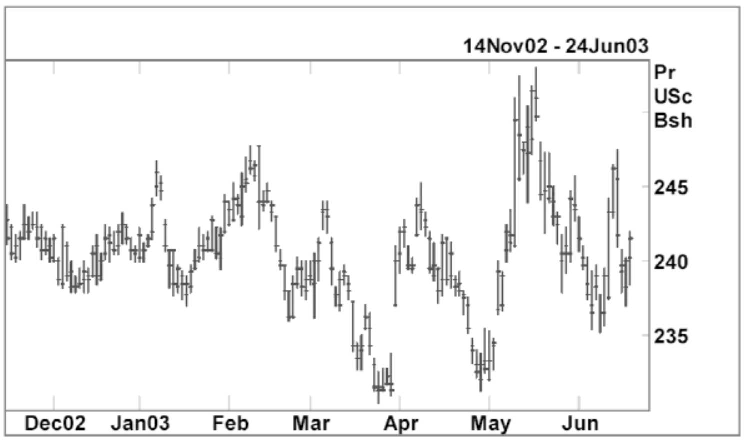
The bullish revisions to the Chinese scene were responsible for a very significant shift in the global supply/demand balance. Global ending stocks are forecast to fall to 83 million tonnes, or 13% of consumption, 8.5 million tonnes below last month's estimate. That compares with last year's ending stocks of 96 million tonnes, or 15% of consumption, and 128 million tonnes at the end of 2001-02, or 21% of consumption.

The growth in demand for meat by Asian consumers has fueled a bull market in soybeans. Corn should be similarly affected. The corn market may have lagged owing to the availability of cheap feed wheat after last year's unprecedented bumper crops in Eastern Europe and the FSU. Those crops are expected to return to normal yields this season, which will almost certainly show up in the form of increased demand for corn.

We believe the market is cheap and should be traded from the long side. *[June 19, 2003]*

CURRENT STRATEGY: *Liquidated long December corn as per Flash Update of June 26.*

Chart 1 – December corn



Courtesy Reuters

COCOA

The bear stalls, but only to catch its breath

After experiencing a wicked $500-per-tonne slide since the beginning of May, cocoa prices seem to have found some support. The action this past week was particularly volatile, with wild swings between $1,500 and $1,600 per tonne.

Prices are now 35% below the $2,400-per-tonne peak reached last fall. The operative bearish fundamental – the near-record 2002-03 Ivorian crop that befuddled observers across the spectrum – was highlighted this week with fresh estimates for the mid-crop. The Coffee and Cocoa Bourse reported on Thursday that the mid-crop, which is currently being harvested, would reach 300,000 tonnes, exceeding even the most optimistic forecasts. The news was released during Thursday's New York trading session, which promptly put a lid on a rally that was about to take the market through the $1,600-per-tonne level. Prices snapped back in the following session and finished the week on a firm note, near the high end of the recent range (Chart 2).

In April, E.D.&F. Man estimated the 2002-03 Ivorian crop at 1.3 million tonnes. Arrivals now stand at 1.13 million tonnes, part of which is the beginning of the mid-crop. This should bring the total crop to about 1.4 million tonnes, equal to the record crop harvested in the 1999-00 season. Tacking on 100,000 tonnes to the 23-million-tonne global surplus forecast in Man's April report changes everything. In the space of a few months, we've moved from estimates for a deficit of well over 100,000 tonnes to estimates for a surplus of a similar amount.

As a result of these changes, global ending stocks should rise to about 1.2 million tonnes, or 40% of consumption, compared with 37% of consumption that we discussed in our April issue. And for cocoa, that figure is bear market country. The market lived with the completely erroneous assumption of the potentially devastating effects that the civil war would have on Ivorian output. Clearly, the market must now adjust for this.

A bearish supply side picture is rounded out with the number 2 and 3 producers, Indonesia (485,000 tonnes) and Ghana (450,000 tonnes). Both countries are looking to harvest crops that will meet or exceed early season forecasts.

The issue now is just how much of the price adjustment we have already seen. After all, as pointed out above, there's been quite a drop in prices over the past two months. Although we are definitely bearish for the long run and would like to trade from the short side, we may be dealing with several bullish factors in the short run.

First, aside from the large crop in the Ivory Coast, another bearish factor responsible for the steep fall in prices was the collapse of product ratios. Prices of products (butter and powder) fell relative to bean prices, which made it unprofitable for processors to grind more beans than they have immediate requirements for. This in turn slowed demand for beans. Over the past few weeks, however, butter ratios have been firming. The ratio has fluctuated between about 1.5 and 2 times the price of beans on LIFFE and is currently quoted at 1.97 for spot delivery. It would be interesting to see if this will show up in grinding figures, but we don't get third quarter grinding results until mid-July.

Another important consideration, at least for the short term, is the large short position held by commodity funds. At one point, just 2 weeks ago, out of a total open interest of 100,000 contracts, the group held a record-sized net short position of 29,000 contracts. The funds have begun to cover. As of this past week's CFTC data, the net-short position has been reduced to 13,000 contracts. Typically, a short-covering rally is not expected to end until the entire position has been covered. If the fundamentals are indeed as bearish as we think they might be, the short covering phase could be accomplished with minimal upside movement in price as commercials reposition themselves on the short side.

In summary, while we have to be wary of a bubbling demand side, this bull market, strong as it may have been, was to a significant degree based on the anticipation of a decline in supply. With such fears now known to be unfounded we believe that the entire bull run will ultimately be unwound. We remain sidelined, but eager observers.

[June 24, 2003]

STRATEGY: *Stay closely tuned.*

Chart 2 – SEPTEMBER COCOA

Courtesy Reuters

COPPER

The copper market moves into deficit

In industrialized countries whose economic health is closely tied to copper usage, economic data released over the past couple of weeks have been mostly constructive, but not exclusively positive. Obviously, demand for copper and all industrial commodities will ultimately be determined by economic strength or weakness. For the purposes of short- or intermediate-term price forecasting, however, the constant stream of data released by government agencies is not very useful in an environment in which there is no very clear direction.

Owing to their particular sensitivity to industrial production, base metals are tricky because their price movements tend to track the stock market rather closely (see Chart 3). Thus, even in an environment in which the movement of stock prices doesn't necessarily reflect economic realities, market participants seem to extend their stock market bias to a bias for the base metal markets.

Having said that, regardless of whether economic conditions around the globe appear to be bullish for copper prices or not, we find that the realities of the copper market are quite bullish.

While mine output continues to grow, usage is growing faster. According to the latest data from the International Copper Study Group (ICSG), global mine production for the first quarter of this year totaled 3.342 million tonnes, an 84,000-tonne increase, or 2.6%, over the same period last year. Usage for the period grew as well, but by 219,000 tonnes, or 6%, to 3.852 million tonnes. Even after adding in secondary production, total supply for the period was 3.778 million tonnes, leaving a deficit of 74,000 tonnes for the period, something we have not seen in some time. This compares with a surplus of 240,000 tonnes at the end of 2002, and a surplus of 213,000 tonnes at this time last year. ICSG expects the current trends to ease somewhat and estimates that 2003 will end the year in a balanced position.

More current data indicate that production increases are very strong. In Chile – the world's largest copper miner – output rose by 7.3% between January and April of this year over the same period last year. Expansion at Escondida – the world's largest mine – is in full swing, with output for May up 14%. The market has sold off from the highs by about 2¢ per pound since the beginning of the month, which may partially reflect the output gains.

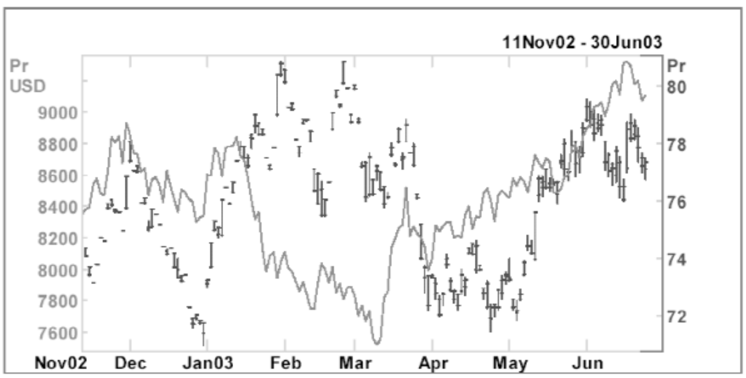
The supply side may be quite strong, but all indications point to a continuation of a well-balanced demand side as well. ICSG data show that while usage in some important regions – namely the US – remains sluggish, other regions are picking up the slack. Looking at the first quarter for the four most important regions, US usage was down 1.9% over last year, but Japanese usage was up 14%, and EU was 2% higher. China, which has now overtaken the US as the world's largest consumer of copper, saw usage rise 21%.

Warehouse stocks continue to drop. LME stocks have now fallen by 330,000 tonnes, or more than 30%, to 670,000 tonnes, over the past year. Shanghai stocks have stopped falling and have stabilized at around 60,000 tonnes after reaching a peak of 248,000 tonnes. Even NYMEX inventories, which remained strong while LME and Shaghai stocks were falling, have dipped significantly to 320,000 tonnes, after touching 400,000 tonnes at the beginning of the year.

We've been developing a bullish appetite for this market for some time now, but frankly, we've kept missing opportunities to enter the long side. For the moment, we will continue to watch from the sidelines. *[June 26, 2003]*

STRATEGY: *Stay tuned.*

Chart 3 – September copper (bar), Dow Jones Industrial Average (line)



Courtesy Reuters

SOYBEANS

Weather clouds the big picture

Soybean prices dipped sharply yesterday in response to forecasts for favorable crop weather. The setback takes the market back to the low of the recent $5.50- to $5.80-per-bushel range (and for our purposes, dangerously close to our stop).

The market's pessimism might be slightly shortsighted. Prices did not rise because of bad weather, or for that matter, not even in anticipation of bad weather. The most recent USDA crop progress report was released on Monday, and it showed that the crop was doing just fine in all categories. The report showed that 94% of the crop had been planted, up from 89% the previous week, and compared with the five-year average of 96%. Even more important, crop conditions had improved. The good-to-excellent category rose 2 percentage points from the previous week, to 70%, and significantly above the 5-year average of 62%. The market's strength was the result of long-term fundamental factors, which won't disappear because of slightly better yields.

On the whole, the June USDA supply/demand situation report was not very bullish. The most prominent revision was yet another 1-million- tonne uptick in the estimate for Brazilian production, to 52 million tonnes. Global ending stocks for 2002-03 are now forecast at 31.84 million tonnes, an 880,000-tonne upwards revision from the May report. Along with a 270,000-tonne downtick in the forecast for usage, stocks as a percentage of consumption will rise to 16.4%, up from May's 15.9%.

We're still in a tight environment, though. Inventories have been shrinking for several years now, with last year's stocks at 17.4% of consumption, and 17.8% for 2000-01. This trend doesn't seem dramatic on the surface. But the magnitude of the growth in consumption can be appreciated more fully when considering that even with the boom in South American output, inventories were able to decline at all. In the space of only 2 years we've gone from combined Brazilian and Argentinean output of 67 million tonnes in 2000-01, to 87 million tonnes this year. Global output during this period grew only 19 million tonnes, while consumption increased by 22.5 million tonnes.

Prices have increased substantially during this period, however, and it is therefore understandable for the market to be sensitive to bearish developments. Still, we believe that the balance of evidence indicates that we are still in a bull market.

China, the world's biggest importer of soybeans, has seen its domestic needs increase by 24% over the past 2 years, to 33.15 million tonnes. More so than any of the other large US crops that we trade – such as wheat, corn, and, cotton whose price fortunes often depend heavily on Chinese purchasing patterns – the Chinese are heavily reliant on imports of soybeans. The country grows only 50% of its needs, compared with 79% for cotton, 83% for wheat, and 92% for corn. So while domestic soybean consumption has increased by over 6 million tonnes since 2000-01, production has grown by only 1 million tonnes.

The USDA is still maintaining its estimate for annual US exports at 27.49 million tonnes, below the current commitment-to-date figure of 28.68 million tonnes. Commitments have been slowing, and the possibility exists that cancellations will begin to appear. Commitments over the past 4 weeks have slowed down to a trickle, averaging only 262,000 tonnes of combined old- and new-crop sales. Which is why this week's US export commitment report was a complete surprise. Combined old-crop and new-crop sales were 810,000 tonnes, well above the high end of analysts' estimates of 550,000 tonnes, with China taking 55,000 tonnes old crop and 226,000 tonnes new crop beans.

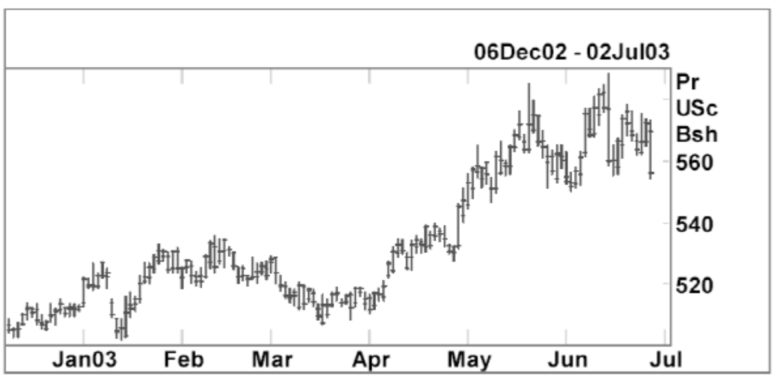
The bearish case that even bulls have fretted about is the arrival of the South American harvest. Strangely, there is little evidence that there has been any impact. As illustrated, US exporters are still doing a bustling business. Although we have no accurate information, there is anecdotal evidence that the shipping infrastructure in Brazil is backed up. Of course, this means that it is only a matter of time until competition makes a serious dent in US sales.

In conclusion, the weather makes the headlines and motivates traders. If the fundamentals are truly bullish, the market will find support and resume the uptrend. Commodity funds hold a net-long position of 19,000 contracts, but that position has already been whittled down from 70,000 contracts over the past 3 months, quite a feat, considering that the liquidation took place without any major selloffs below the range.

At the moment we're clinging to the position by a thread, but regardless of whether we manage to hold on or not, we maintain a strong bullish bias. *[June 27, 2003]*

STRATEGY: *Remain long November soybeans. Maintain stops at 5.50, close only.*

Chart 4 – November soybeans



Courtesy Reuters

HOTLINE UPDATE

Flash Update **– Tuesday, May 27, 2003:**
Good afternoon for Tuesday, May 27, 12:45. This is a Flash Update. We have liquidated our long July coffee position at 61.20.

Flash Update **– Thursday, May 29, 2003:**
Good afternoon for Thursday, May 29, 12:10 pm. This is a Flash Update. We have rolled over our long June gold positions into August at 1.10 August over.

Flash Update **– Friday, May 30, 2003:**
Good morning for Friday, May 30, 11:45 am. This is a Flash Update. We have purchased July wheat at 323.25, placing our initial stop at 315, close only.

Friday, May 30, 2003:
Good afternoon for Friday, May 30, 4:50 pm. The following is a recap of this last week's trade recommendation history, and our latest recommendations and stop levels: On May 27 we liquidated our long July coffee position at 61.20; on May 29 we rolled over our long June gold position into August at 1.10 August over; on May 30 we purchased July wheat at 323.25; we are currently long August gold at 362.10, with our stop at 330; long November soybeans at 530.50, with our stop revised to 550; long July cotton at 53.27, with our stop at 49.75; and long July wheat at 323.25, with our initial stop at 315. All stops are close only.

Flash Update **– Monday, June 2, 2003:**
Good morning for Monday, June 2, 11:00 am. This is a Flash Update. We have liquidated our long August gold position at 361.60

Flash Update **– Tuesday, June 3, 2003:**
Good morning for Tuesday, June 3, 9:50 am. This is a Flash Update.

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We have purchased September euro currency at 1.1727, placing our initial stop at 1.1550, close only.

Flash Update **– Tuesday, June 3, 2003:**
Good afternoon for Tuesday, June 3, 3:40 pm. This is a Flash Update. We have liquidated our long July cotton position at 48.61. We repeat our Flash Update of this morning, where we purchased September euro at 1.1727, placing our initial stop at 1.1550, close only.

Flash Update **– Wednesday, June 4, 2003:**
Good afternoon for Wednesday, June 4, 2:40 pm. This is a Flash Update. We have liquidated our long July wheat position at 313.

Flash Update **– Friday, June 6, 2003:**
Good afternoon for Friday, June 6, 3:30 pm. This is a Flash Update. We have liquidated our long September euro position at 1.1672.

Friday, June 6, 2003:
Good afternoon for Friday, June 6, 4:20 pm. The following is a recap of this last week's trade recommendation history, and our latest recommendations and stop levels: On June 2 we liquidated our long August gold position at 361.60; on June 3 we purchased September euro at 1.1727, and liquidated our long July cotton position at 48.61; on June 4 we liquidated our long July wheat position at 313; on June 6, we liquidated our long September euro position at 1.1672; we are currently long November soybeans at 530.50, with our stop at 550. All stops are close only.

Flash Update **– Monday, June 9, 2003:**
Good afternoon for Monday, June 9, 1:30 pm. This is a Flash Update. We have purchased December cotton at 54.25, placing our initial stop at 52.50, close only.

Flash Update **– Friday, June 13, 2003:**
Good morning for Friday, June 13, 11:50 am. This is a Flash Update. We have purchased September coffee at 62.30, placing our initial stop at 59.00, close only.

Friday, June 13, 2003:
Good afternoon for Friday, June 13, 4:55 pm. The following is a recap of this last week's trade recommendation history, and our latest recommendations and stop levels: On June 9 we purchased December cotton at 54.25; on June 13 we purchased September coffee at 62.30; we are currently long November soybeans at 530.50, with our stop at 550; long December cotton at 54.25, with our stop revised to 57.50; and long September coffee at 62.30, with our initial stop at 59.00. All stops are close only.

Flash Update **– Tuesday, June 17, 2003:**
Good morning for Tuesday, June 17, 11:05 am. This is a Flash Update. We have purchased August gold at 363.60, placing our initial stop at 348, close only.

Flash Update **– Wednesday, June 18, 2003:**
Good morning for Wednesday, June 18, 11:10 am. This is a Flash Update. We have purchased December corn at 239.75, placing our initial stop at 230, close only.

Flash Update **– Thursday, June 19, 2003:**
Good morning for Thursday, June 19, 10:50 am. This is a Flash Update. We have liquidated our long September coffee position at 59.95.

Friday, June 20, 2003:
Good afternoon for Friday, June 20, 4:45 pm. The following is a recap of this last week's trade recommendation history, and our latest recommendations and stop levels: On June 17 we purchased August gold at 363.60; on June 18 we purchased December corn at 239.75; on June 19 we liquidated our long September coffee position at 59.95; we are currently long November soybeans at 530.50, with our stop at 550; long December cotton at 54.25, with our stop at 57.50; long August gold at 363.60, with our initial stop at 348.00; and long December corn at 239.75, with our initial stop at 230. All stops are close only.

Flash Update **– Tuesday, June 24, 2003:**
Good afternoon for Tuesday, June 24, 1:40 pm. This is a Flash Update. We have liquidated our long August gold position at 346.80.

Flash Update **– Wednesday, June 25, 2003:**
Good afternoon for Wednesday, June 25, 1:40 pm. This is a Flash Update. We have liquidated our long December cotton position at 57.37.

Flash Update **– Thursday, June 26, 2003:**
Good afternoon for Thursday, June 26, 2:05 pm. This is a Flash Update. We have liquidated our long December corn position at 229.25.

Friday, June 27, 2003:
Good afternoon for Friday, June 27, 3:45 pm. The following is a recap of this last week's trade recommendation history, and our latest recommendations and stop levels: On June 24 we liquidated our long August gold position at 346.80; on June 25 we liquidated our long December cotton position at 57.37; on June 26 we liquidated our long December corn position at 229.25; we are currently long November soybeans at 530.50, with our stop at 550. All stops are close only.

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