

FRIEDBERG'S

FOCUS ON FUTURES

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Soybeans: The bear market is over

Soybean prices have rallied 50¢ per bushel since the beginning of the year. The strength is somewhat suspicious when considering only the seemingly overwhelming supply side fundamentals, but easier to understand when taking demand factors into account.

Production in the three major producing countries has grown dramatically to meet the equally dramatic growth in global consumption. Over the past 2 years, output has grown by 14.4%, to 182.91 million tonnes, compared with a slightly higher increase in demand of 14.9%, to 184.68 million tonnes. The lion's share of output growth comes from South American growers in Brazil and Argentina whose cumulative production increased 16.85 million tonnes during this 2-year period, an extraordinary gain of 30%.

Recent developments have been checkered. The biggest positive for prices was the implications of the interim agreement reached between the US and China that would clear the way for Chinese imports of GMO beans. The pact could not have come at a better time, because the pace of US export sales, which has been very strong this marketing year, has slowed considerably in recent weeks and could use a boost.

Average commitments in the past 4-week period totaled 275,000 tonnes, compared with 486,000 tonnes in the previous 4-week period and 650,000 tonnes in the period before that. Despite the slowdown, we are on track to meet or exceed the USDA's projection for record exports of 27.76 million tonnes. Net commitments for the season stand at 24.8 million tonnes, still 1 million tonnes, or 4.3%, ahead of last year's total at this juncture of the season. US exporters have already shipped 21.2 million tonnes, or 85% of sales, to foreign customers, which is ahead of last year's shipment pace of 19.1 million tonnes, or 80% of sales.

With 25 weeks remaining in the marketing year, new commitments would have to average a rather modest 116,000 tonnes per week to meet the USDA target of 27.76 million tonnes. Shipments would have to average 260,000 tonnes per week. Both of these targets are well within the parameters of the historical norm.

Countering the benefits from the Chinese deal, however, the Russian ban on US poultry imports could hurt domestic meal consumption if it is not resolved quickly – according to the headlines anyway. Russia imports about 1 million tonnes

of poultry from the US each year, which is about 6% of total US poultry production. American chickens and turkeys consume about half of the 36.5 million tonnes of soybean meal (46-million-tonne bean equivalent) produced annually in the US. This means that poultry going to Russia consume about 1.4 million tonnes of beans, or close to 3% of total US consumption. The impact, however, will not be that dramatic even if the ban took long to resolve. Russia imports dark meat and parts of the birds that are consumed sparingly in the US. US producers will not cut back production very much, because they will need to meet demand for white meat regardless of what happens in Russia.

Assuming that the potential increase in demand from the US-Chinese pact and whatever consumption is lost because of the Russian situation balance each other out, we are left with a fairly bullish, longer-term outlook. According to the

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USDA's March supply/demand situation report, global carry-over stocks at the end of the 2001-02 season will fall to 28.8 million tonnes, or 15.6% of consumption, down from 16.6% of consumption at the end of the previous marketing year. The stock-to-consumption ratio has been ticking down every year since the 1997-98 season, but this will be the largest drop since the bull market ended in mid-1997.

These ending-stock figures are calculated using the USDA's estimate for Brazilian production of 43.5 million tonnes (39 million tonnes last year). The Brazilian Agriculture Ministry's estimate is 41.5 million tonnes, and Brazil's Association of Vegetable Oils Industries estimates the crop at 42.7 million tonnes. We have no comment on their partiality, but some independent Brazilian analysts feel that with yields somewhat lower than last year because of insufficient rainfall, the USDA's estimate is on the high side. This would put the stock-to-use ratio closer to 15% and goes a long way to explaining the rally.

We are between the North and South American marketing seasons. With export sales having been so strong in the US and South American crops not available just yet, it is not difficult to imagine that the near-term supply situation would be tight. (We would stop short, however, of declaring this a seasonal pattern. A careful look at a monthly chart (Chart 1) shows clearly that there is no such seasonal pattern. The market was strong in 6 of the past 10 years, but weak in the other 4 years.) Naturally, the true test of this rally will come when significant amounts of South American supplies become

available over the next month or so.

On March 28, the USDA will update its forecast for US acreage for the 2002-03 season. Sparks Commodities estimated soy acreage at 73.697 million acres, below both the USDA's February 21 estimate of 75.5 million acres and last year's 74.1 million acres. Although it is a bit premature to talk about the new crop, a number at or below Sparks' estimate would confirm the bullish environment.

Commodity funds have contributed to the strength of this market, having added 16,977 contracts to their net-long position according to last Friday's Commitment of Trader's report, making them long 25,486 contracts. While we might typically view this in terms of fear that any bad news would spark a massive liquidation, we would also point out that this position is dwarfed by the net-long position the funds held last July, which grew to 43,819 contracts and pushed the market to a far broader rally of over \$1 per bushel (Chart 2). As such, the long speculative presence is not excessive.

The statistics cited above indicate that despite record production levels, the market is not oversupplied. Quite to the contrary. We have definitely developed a taste for the long side of this market, but we are not going to chase it (just yet).

[March 18, 2002]

CURRENT STRATEGY: Remain long May Soybeans as per Flash Update of March 20. Maintain stops at 450, close only.

Chart 1 – Nearest contract monthly

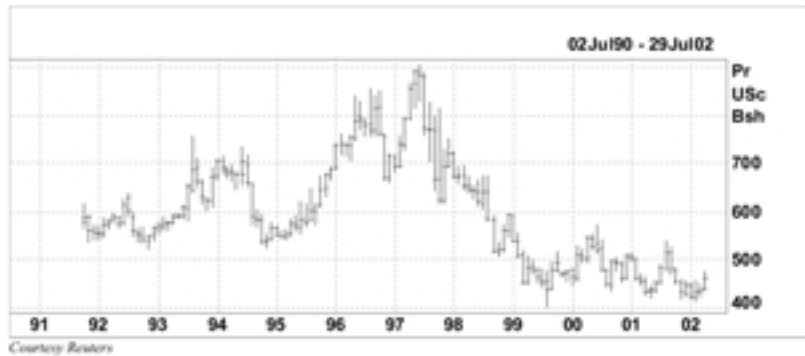
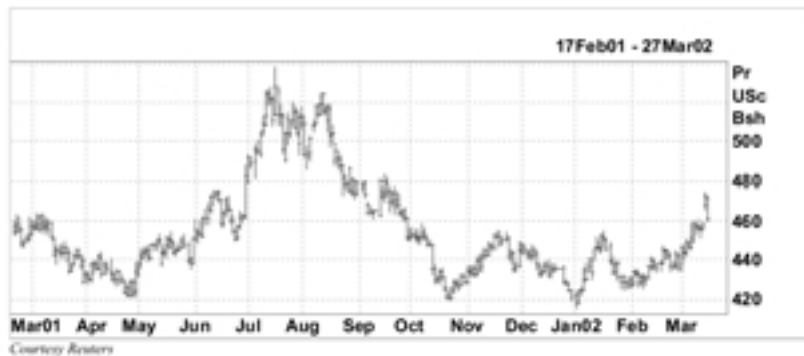


Chart 2 – Nearest contract daily



SUGAR**Has the market already discounted the monster Brazilian crop?**

Sugar prices have retraced almost the entire spectacular bull run they enjoyed in the first half of 2000. The market didn't quite make it back to the 4.5¢-per-pound lows, with the slide halting at 5.5¢ per pound. We've bounced off those lows, but where do we go from here?

The three primary statisticians for this market, The International Sugar Organization, Czarnikow, and F.O. Licht, have all weighed in with their latest estimates for 2001-02. Their numbers are not exactly the same, but not far off. Global production in 2001-02 was 1 to 1.5 million tonnes higher than 2000-01 output. Consumption in 2001-02, however, was 2.5 to 3 million tonnes higher than it was in 2000-01, leaving the market with a 1- to 2-million-tonne deficit.

This deficit is not terribly significant in a market that is burdened with carryover stocks of over 40% of consumption. Still, the rally in 2000, which saw prices rise by more than 100%, illustrates that despite the large carryover stocks, the market can rally significantly if the deficit grows to over 3 million tonnes as it did back then. The pool of inventories that is available for world trade is not as awesome as the stocks-to-consumption ratio seems to indicate.

India – as we've pointed out several times over the past year – has over 10 million tonnes of stocks. The government is in the process of liberalizing its sugar industry, which until recently was restrictive and did not facilitate a significant amount of export activity. Its bulging inventories could become a bearish factor. For the moment, though, India is not likely to enter the export market in a significant way while prices are low. Besides, the country's domestic usage rises every year, and there will be a drawdown in stock levels this year because the drought-reduced 2001-02 Indian crop came in at about 17.5 million tonnes, some 1 million tonnes below last season's crop.

China imported 1.2 million tonnes of sugar in 2001 and is slated to increase imports to 1.74 million tonnes in 2002 based on WTO guidelines. Media reports say that it is not clear whether China will actually meet this quota. It is quite possible, however, that it will not have much choice if the country's needs warrant imports.

The information from China is a bit confusing. On the one hand there are constant reports of plentiful domestic supplies. But according to most analysts, it does not have any carryover stocks to speak of. Production in 2001-02 jumped back to more normal levels of 7.5 million tonnes

after a dismal 2000-01 season that yielded about 6.5 million tonnes. However, the Chinese consume about 8 million tonnes per year, so even in good years they were building a deficit. Still, talk is that their importing habits will not change very much. The Chinese situation, as always, remains a wild card – but an important wild card.

Then there is Brazil. The world's largest producer is leaving all other producers in the dust. All analysts agree that the 2002-03 Brazilian crop, which will be available soon, will be much larger than last year's 20-million-tonne crop. Estimates range from 22 to 24 million tonnes. The only factor that tempers the very bearish implications of the anticipated bumper crop is that much of the increase – according to media reports – will not find its way to ports for export but will be used for the domestic gasohol industry. Regardless, it is difficult to make any case in which such a large crop will not be a drag on prices.

All in all, it seems that we are developing a bearish case. Yet we are long this market primarily because we feel that the bears could be trapped. Observing the bear market in commodities over the past few years, we have seen markets that carried a lopsided speculative short position at or near a low but bottomed long before the bullish fundamentals became apparent. Notable examples are gold, copper, crude oil, cocoa, and cotton. Chart 3 shows the massive buildup in open interest that accompanied the 4¢-per-pound drop in price. Chart 4 shows commodity funds switching from a 50,000-plus contract net long position to a net short position that was almost as large. True, the coming Brazilian crop is hanging over the market, but we also believe that the selling pressure from commodity funds has exacerbated the move.

It is tempting to argue that the spreads have remained persistently tight only because of short-term supply concerns until the Brazilian crop arrives. Charts 5 and 6 show that the spreads between the first and second contract months were in a downtrend from early 1995 until the market bottomed in early 2000, but the market has been inverting ever since. With a backwardation of 67 basis points, the current May/July spread is hardly the stuff of a classic bear market and supports our theory that the shorts are in a very vulnerable position.

[March 20, 2002]

CURRENT STRATEGY: Liquidated long May sugar as per Flash Update of March 22.

Chart 3 – Sugar open interest

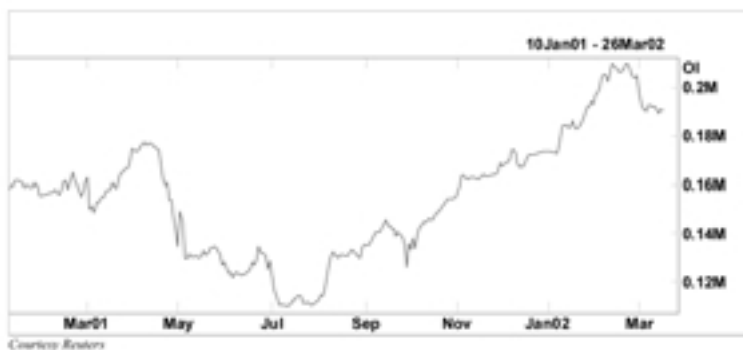
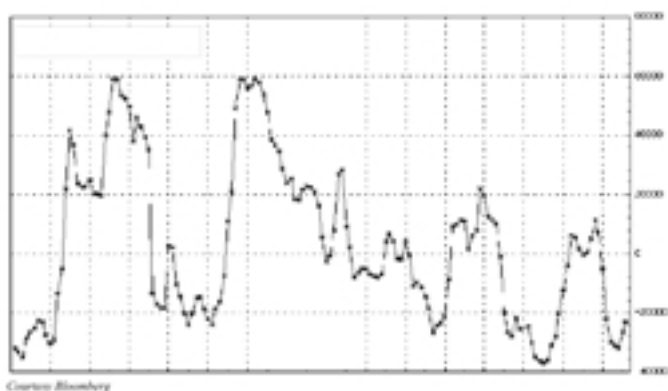
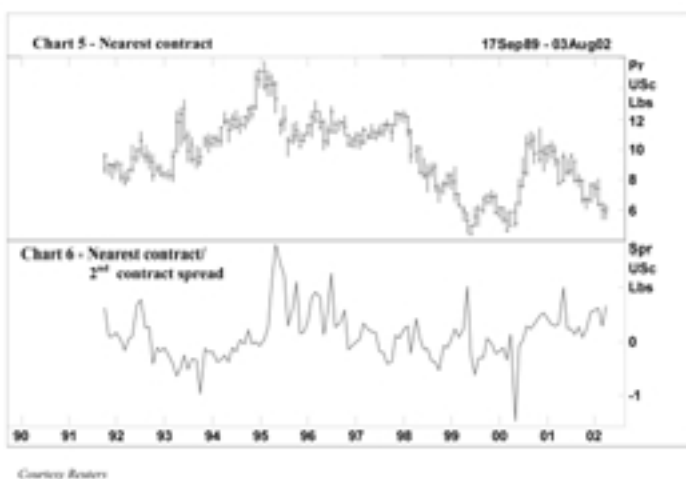


Chart 4 – Commodity funds net position



Charts 5 & 6



COCOA

Not to worry, just a correction

The most recent data out of the Ivory Coast show that main crop arrivals stand at 1.01 million tonnes and have moved slightly ahead of last year's pace. The most recent \$250-per-tonne leg of the bull run was precipitated on the belief that the main-crop would struggle to reach 1 million tonnes. Admittedly, this is not something we expected, and this widely watched figure is giving cause for some selling. Have we overshot fair value?

In its most recent report, E.D.&F. Man forecast that the total crop would reach 1.22 million tonnes. This would consist of a main-crop of 1.12 million tonnes and a mid-crop of 100,000, far shy of the 200,000-tonne average of the past few years. Arrivals at this point have slowed down to a trickle of 5,000 tonnes per week. At that rate, the main-crop won't get much past 1.05 million tonnes.

Although it is still too early to tell if Man's mid-crop estimate wasn't a tad too pessimistic, the weather in both the Ivory Coast and Nigeria is hot and dry with precipitation lev-

els below normal, and the crops are being stressed. Even if we were to be a bit generous with the mid-crop and say it will reach 150,000 tonnes, the total crop would amount to 1.2 million tonnes, below Man's 1.22 million tonnes.

Market participants, then, are trading off almost the same main-crop production figure that inspired the strength in the first place. The arrival numbers slipping ahead of last year's level don't change the bullish picture very much. If Man's mid-crop figure turns out to be accurate, we'll be back to a 200,000-plus tonnes production/consumption deficit drawing stocks down below the 30%-of-consumption level.

The naysayers, shaking their heads in disbelief over the way this bull market has developed, have argued all along that the demand side has been a disappointment. Indeed, the grind statistics have been poor for the past few quarters. However, there is evidence that the grind statistics that we receive are not telling the complete story. A look at the two principal warehouse systems confirms that global stocks have been drawn

down. The International Cocoa Organization released a report a few days ago indicating that stocks in European warehouses fell by 130,000 tonnes, or about 12%, for the 2000-01 marketing year (October - September), to 941,000 tonnes.

More recent data in the US show that the rally from \$1,300 to \$1,550 per tonne was accompanied by a draw on CSCE warehouses of a further 25,000 tonnes, or about 11%, to 198,000 tonnes. Supporting these figures – albeit from the anecdotal evidence camp – industry sources tell us that every dip in the market is met with buying from traders representing commercial interests.

A careful examination of the open interest, though, is not completely commensurate with the seemingly bullish information of physical flows presented. On the surface, an open interest of 95,000 contracts – down 45,000 contracts over the past year – seems to indicate a very low level of speculative activity. A closer look at the breakdown from the Commitment of Trader data, however, shows commercials on the short side and speculators on the long side. Last Friday's report showed commercials net short 11,488 contracts, commodity funds net long 6,607 contracts, and small speculators net long 4,881 contracts.

Even before the market began to come off the highs, the longs and shorts were slowly shifting their respective weights. The commercial short position peaked as of the February 12 report at 14,651 contracts, while the fund long position peaked at 9,755 contracts. The small spec position has not changed very much.

Spot May cocoa has pulled back from the highs by \$60

per tonne (Chart 7). And from a bull's perspective, the open interest has behaved as it should. Considering that market is working with the fresh news that Ivorian arrivals are running ahead of where they were expected to be at this point of the main-crop season, the market is understandably correcting what are probably overbought conditions.

Typically, speculators who are frustrated at having missed a glorious, low-risk opportunity will buy the dips. The commercials will sell them all the cocoa they want, and a buildup in open interest will ensue. That's when long-term bulls know that the bullish fundamentals are probably waning and that any support the market is getting is from the "wrong," uninformed sources. This does not seem to be the case here.

It will be interesting to see if Man will revise its Ivorian main-crop forecast, but its next report is not due out for a while. Chart 8 shows a 10-year history of the 1-year spread. That this market is still in such a steep backwardation leaves no doubt in our minds that we are in the midst of a powerful bull market and that we will see new highs eventually.

All major trends have minor, countertrend reversals, and that is what we are experiencing at present. We recommend maintaining moderate-sized positions at this time, but with an open mind to establishing a larger position when the correction abates. [March 21, 2002]

STRATEGY: *Remain long September cocoa as per Flash Update of December 12, 2001. Raise stops to 1375, close only.*

Chart 7 – May cocoa

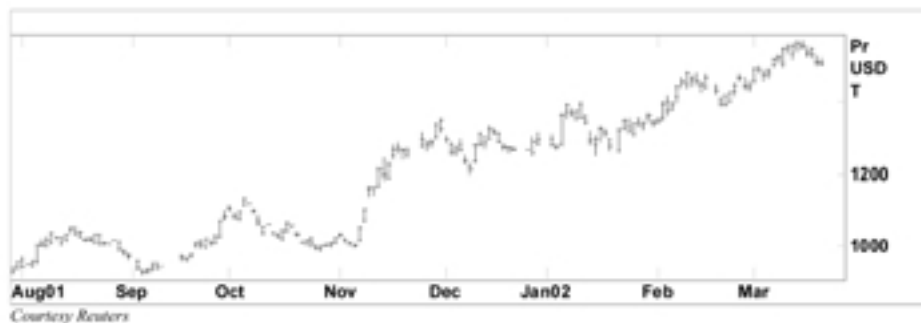
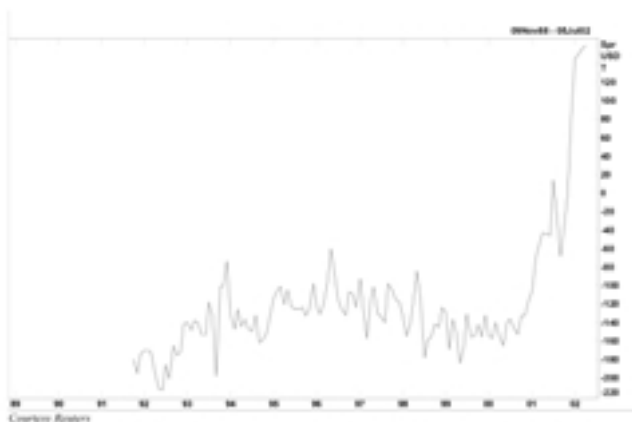


Chart 8 – Front month/ 1-year cocoa spread



WHEAT**Oversold with improving fundamentals,
a lethally bullish combination**

The March 8 USDA supply/demand situation report was not kind to bulls. Global production was revised upwards by 390,000 tonnes, to 579.03 million tonnes, and consumption was lowered by 1.62 million tonnes, to 588.89 million tonnes. The two revisions combined to inflate ending stocks to 154.27 million tonnes, an increase of close to 2 million tonnes, or 26% of consumption, compared with last month's 25.8%.

In the grand scheme of things, though, little has changed. This will still be the fourth consecutive year of lower world production, three of which had production/consumption deficits. Consumption has slipped the past two years, but the production/consumption balance has remained in deficit regardless. Those deficits have grown each year. This year's shortfall will be close to 10 million tonnes.

The May wheat contract registered a new contract low at \$2.695 per bushel in the days following the monthly report, but has firmed since and with good reason (Chart 9). A number of bullish developments on both the supply and demand side may negate the increase in reported global ending stocks.

A cold snap in the winter wheat belt in the US Plains is threatening to lower yields. Temperatures are expected to fall some 20 degrees Fahrenheit below normal over the next few nights. As it is, the USDA estimates that US farmers have planted only 41.03 million acres of winter wheat this season, the smallest number in over 30 years.

The latest crop condition report for Kansas, the largest winter wheat state, is showing that 42% of the crop is in the poor to very-poor category, compared with 26% at this time last year. There have been no estimates of how output might be affected, but if the weather doesn't improve, there will be losses.

Argentina, an important player whose exports are expected to make up 8.8% of world trade this season, has seen its wheat crop downgraded again. The Agriculture Department in Buenos Aires lowered its forecast of the crop to 15.3 million tonnes from its last estimate of 15.5 million tonnes. This compares with the USDA's forecast of 15.7 million tonnes, and last year's 16.5 million tonnes.

On the demand side, US exports are still lagging last year's pace by a fair margin. As of the latest weekly report, US exporters have sold 22.5 million tonnes to foreign buyers, 1.75 million tonnes less than last year. They've shipped 19.1 million tonnes, 1.5 million tonnes less than this time

last season.

Recent activity, however, has given a much-needed shot in the arm to an otherwise gloomy outlook for US exports. This week's new commitments totaled 575,000 tonnes and were above the high end of analysts' expectations, something that hasn't happened in a while.

Earlier this week, Egypt announced the purchase of 300,000 tonnes of US wheat. The Egyptian purchase is not included in this week's exports, so we begin the tally of next week's sales with a nice head start.

During the Argentinean crisis – when fears of restricted supplies became the primary fundamental in this market – the spreads exploded into a backwardation not seen for about two and a half years (Chart 10). Although Argentina's customers have continued buying, shipments are still not back to normal levels because of the export tax issue and the difficulty exporters have in converting dollars to pesos. The matter faded from headlines and so did the spreads. But the May/July spread has begun to tighten again, indicating perhaps that the market is not as well supplied as the various USDA summaries would have us believe.

Despite the budding bullish fundamentals described above, the wheat market has frustrated bulls for ever so long. We know much about that. But we find that there is an extraordinary situation developing in the Commitment of Traders data.

The net short position of commodity funds is the largest in modern history. To us this means that whatever weakness there's been in this market is largely a result of excessive selling by commodity funds. This is an argument we use frequently in weak markets, but it is particularly poignant in this instance.

We do not believe that these depressed price levels are consistent with the current fundamentals. The market has not accounted for any of the potential issues that would surely put the shorts in a highly vulnerable position, such as Chinese purchases or a weather-damaged US winter wheat crop.

We believe we are looking at a highly undervalued market, and sooner or later, prices will adjust to levels that reflect market realities. *[March 22, 2002]*

STRATEGY: *Remain long May wheat as per Flash Update of March 20. Maintain stops at 2.70, close only.*

Chart 9 – May wheat

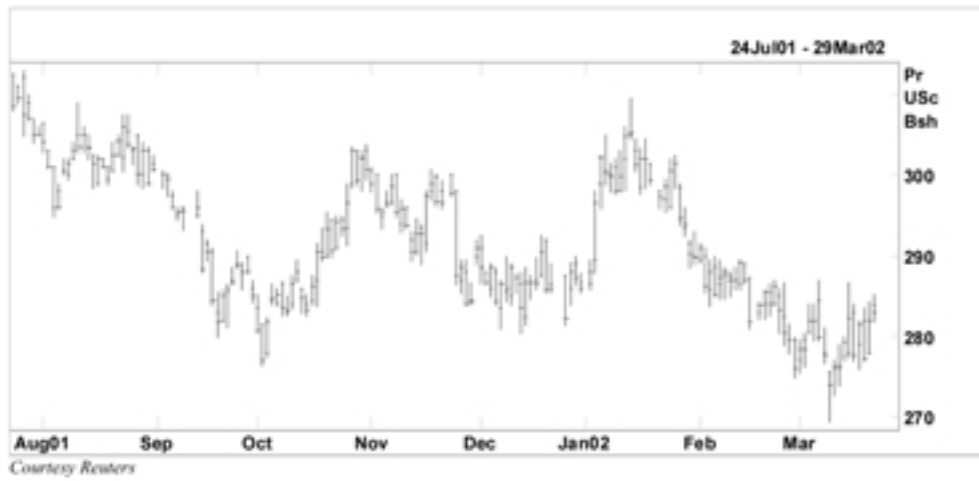
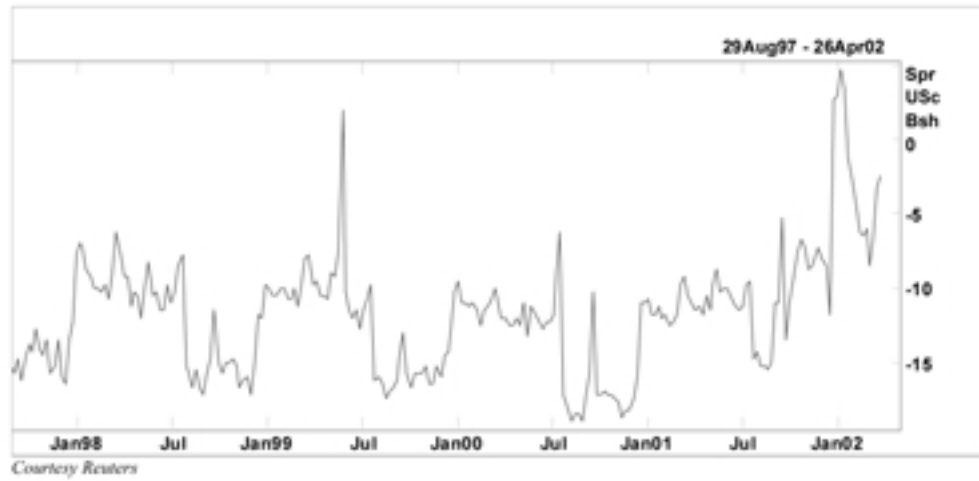


Chart 10 – Nearest contract month/2nd contract month



HOTLINE UPDATE

Flash Update – Monday, February 25, 2002:

Good morning for Monday, February 25, 9:15 am. This is a Flash Update. We have purchased May wheat at 286.25, placing our initial stop at 278.

Flash Update – Wednesday, February 27, 2002

Good morning for Wednesday, February 27, 11:15 am. This is a Flash Update. We have liquidated our May wheat position at 280.25.

Friday, March 1, 2002:

Good afternoon for Friday, March 1, 4:15 pm. The following is a recap of our current open position recommendations, and our latest stop levels: We are long April gold, with our stop at 260; long September cocoa, with our stop at 1250; and short March mini S&P, with our stop at 1140. All stops are close only.

Flash Update – Monday, March 4, 2002:

Good afternoon for Monday, March 4, 4:05 pm. This is a Flash Update. We have covered our short March mini S&P position at 1153.25.

Flash Update – Wednesday, March 6, 2002:

Good morning for Wednesday, March 6, 9:20 am. This is a Flash Update. We have purchased May sugar at 6.06, placing our initial stop at 5.30, close only.

Flash Update – Thursday, March 7, 2002:

Good morning for Thursday, March 7, 10:50 am. This is a Flash Update. We have purchased May wheat at 285, placing our initial stop at 275, close only.

Friday, March 8, 2002

Good afternoon for Friday, March 8, 4:15 pm. The following is a recap of our current open position recommendations, and our latest stop levels. We are long April gold, with our stop at 260; long September cocoa, with our stop at 1250; long May sugar, with our initial stop at 5.30; and long May wheat, with our initial stop at 275. All stops are close only.

Flash Update – Monday, March 11, 2002:

Good afternoon for Monday, March 11, 2:25 pm. This is a Flash Update. We have liquidated our long May wheat position at 273.

Friday, March 15, 2002:

Good afternoon for Friday, March 15, 5:20 pm. The following is a recap of our current open position recommendations, and our latest stop levels: We are long April gold, with our stop at 260; long September cocoa, with our stop at 1250; and long May sugar, with our stop at 5.30. All stops are close only.

Flash Update – Wednesday, March 20, 2002:

Good morning for Wednesday, March 20, 10:50 am. This is a Flash Update. We have purchased May soybeans at 463.5, placing our initial stop at 450, close only. We have also purchased May wheat at 282.5, placing our initial stop at 270, close only.

Flash Update – Friday, March 22, 2002:

Good morning for Friday, March 22, 9:35 pm. This is a Flash Update. We have liquidated our long May sugar position at 5.75.

Flash Update – Friday, March 22, 2002:

Good afternoon for Friday, March 22, 3:50 pm. This is a Flash Update. We have sold short June mini S&P at 1150, placing our initial stop at 1180, close only. We have also liquidated our long May sugar position at 5.75.

Friday, March 22, 2002:

Good afternoon for Friday, March 22, 4:20 pm. The following is a recap of our current open position recommendations, and our latest stop levels: We are long April gold, with our stop at 260; long September cocoa, with our stop revised to 1375; long May soybeans with our initial stop at 450; long May wheat, with our initial stop at 270; and short June mini S&P with our initial stop at 1180. All stops are close only.

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