

FRIEDBERG'S

FOCUS ON FUTURES

Friedberg Mercantile Group Ltd.



Volume 12, No. 1 March 5, 2009

Sugar deficit in India sets the stage for a bull market

While many commodities have been bouncing off their lows, some rallies can be distinguished from others in that they are driven by fundamental factors.

Estimates for the size of the 2008-09 Indian crop have been shrinking for months. After two seasons of harvesting crops that were roughly 50% larger than typical, Indian output has slid right back to the old range. Government forecasters are now saying that production will reach only 18 million tonnes, down from previous estimates that ranged between 20 and 23 million tonnes. Indian consumption is expected to grow to 23 million tonnes in 2008-09, up 500,000 tonnes from the previous year, leaving a gaping production/consumption deficit. Estimates for a 9-million-tonne carryout were based on a 23-million-tonne crop. At 4 million tonnes, Indian inventories are back to the level that set the backdrop for the rally to 19¢ per pound in early 2006.

Earlier predictions that India would need to import 1 million tonnes or more were broadly dismissed. We are now seeing estimates for imports at 4.5 million tonnes. Restrictive import tariffs have not yet been lifted completely, but dealers have contracted to buy foreign sugar in anticipation of the government's relaxation of the tariff system being inevitable.

On February 6, largely as a result of the Indian revisions, German sugar statistician F.O. Licht redrew the 2008-09 balance sheet. The estimate for world production drops to 156.3 million tonnes, down 4 million tonnes from its previous estimate, and 13 million tonnes below last year's output.

Looking ahead to the upcoming Brazilian harvest and crush, we find a bearish factor. One of the crucial issues that bears careful monitoring will be the upcoming cane crush in Brazil. A record 60% of the crop was turned into ethanol in the 2008-09 marketing year. At present, that figure is expected to drop to about 58% in 2009-10. With the recent rally in the sugar market, arbitrage favors locking in sugar prices, particularly since ethanol prices continue to trend lower along with other energy markets. Besides, the derivatives market apparently does not facilitate the volume for trading ethanol. Clearly it will be more profitable to crush cane into sugar rather than ethanol at this point.

Brazilian ethanol exports, which comprise about 20% of usage, are expected to fall by about 25% from last year, but domestic consumption should continue to grow. The economy is slumping, but a government tax-break program proved to be a huge success for the automotive industry, resulting in a boom in car sales.

Whatever bearish effect the tilt towards lower ethanol production in Brazil may have, it does not fully compensate for the Indian shortfall. The most recent estimate shows that Brazilian exports will increase by about 2 million tonnes, not nearly enough to fill in for the complete elimination of India as an exporter and the leap in its importing requirements.

The participation of the speculative community has two sides. On the one hand it creates much greater volatility and sets the stage for sharper countertrend corrections. On the other it hastens price discovery that reflects the underlying fundamentals. Indeed, open interest has increased, and the net-long position of commodity funds has jumped (Charts 1 and 2). Open interest is still very high in historical terms, but rather moderate, considering that when prices were at current levels one year ago (Chart 3), open interest stood at over 1 million contracts, compared with the current level of just over 600,000 contracts.

Reiterating the point we have made in previous issues –

Inside

Copper: Room to fall?	2
Soybeans: Prices vulnerable to export decline	4
Corn: Can export blip last?.....	5

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

Futures and options trading is speculative and involves risk of loss. Past trading results are not indicative of future profits.

Get Focus by e-mail

Focus on Futures is available by e-mail as an Adobe PDF file. If you prefer to receive your copy of *Focus on Futures* by e-mail, please send us a message at focus@friedberg.ca with your full name, e-mail address, and street address.

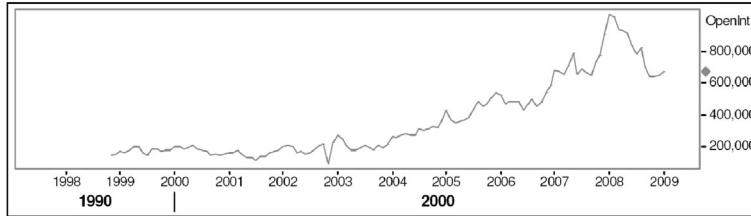
and what is probably the key factor in anticipating moderate growth, and perhaps even a contraction, in world production – is the fact that production costs have risen in recent years, and where the choice exists, sugar is not the favorite crop to

plant. This has already become reality in India and will move to Brazil, unless of course prices continue to rise, which is exactly what we believe is happening.

Remain long.

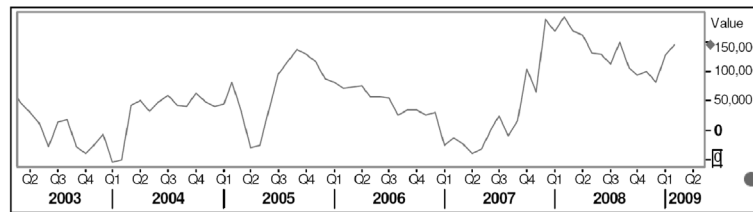
[February 18, 2009]

Chart 1 – ICE sugar open interest



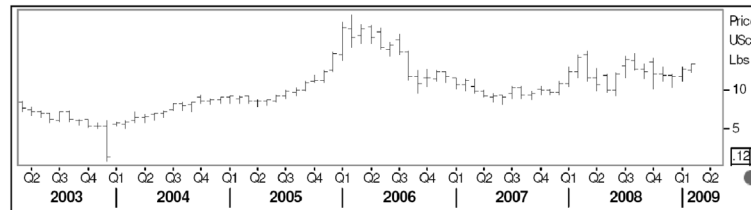
Courtesy Reuters

Chart 2 – ICE sugar commodity fund net-long position



Courtesy Reuters

Chart 3 – Sugar nearest contract



Courtesy Reuters

COPPER

Do prices still have room to fall?

Commodity market participants continue to focus heavily on the prospects for demand and have linked the outlook for those prospects to the performance of the stock market. With some variance, commodity prices have tracked stock prices. Over the past few days, the Dow Jones Industrial Average took out its late-2008 lows (Chart 4) and put a cap on most commodity rallies. There have been exceptions, however, and despite what would seem to be a mostly negative outlook, copper prices are two months and 30¢ per pound from their lows.

Fundamentals for the copper market are as bearish as one might expect them to be at this juncture of a global economic crisis. Charts 5 through 7 show the steep plunge in industrial production in the US, the EU, and Japan.

Chinese copper usage is still growing, but the rate of growth slowed to 7% in 2008, compared with 36% growth in 2008.

Inventories are building. Chart 8 shows that combined warehouse stocks at the three main global warehouse systems – LME, COMEX, and Shanghai – have tripled to over 600,000 tonnes over the past six months.

Furthermore, production costs are still relatively low, which means that despite the huge drop in prices, copper mining is still a very profitable business. Freeport-McMoran, the world's largest publicly traded copper miner, saw its cost of production fall to \$1.04 per pound (net of by-product credits) in the fourth quarter, compared with an average of \$1.16 per pound for 2008. The company expects costs to fall even

further in 2009, because it will be mining high-grade regions. In Chile 2009 production costs are estimated at \$0.70 per pound.

The most recent International Copper Study Report (ICSG), which covers the period between January and November 2008, shows that the global balance sheet is carrying a 147,000-tonne surplus. Actually, to put this surplus into perspective, consider that despite the apparent bearish fundamentals, the surplus isn't really that large. We're actually down from the previous report's surplus of 159,000 tonnes for January through October. But more significantly, last year at this time, the January through November surplus was roughly the same as it is now, in a recession-battered economy.

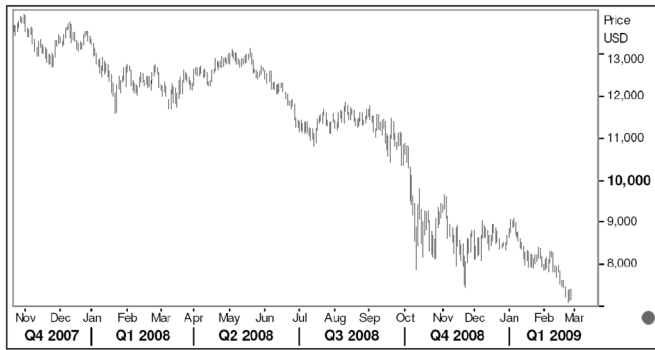
A combination of lower ore grades and operational difficulties has plagued the Chilean copper mining industry. Output in 2008 was down 4.1%. The government is still officially forecasting a 3.7% jump in production in 2009, but pri-

vate analysts are looking at a further drop. While most mines are still profitable, the collapse in prices nevertheless impacts output, because production at unprofitable mines is pared back or shut down. In addition, the credit crunch has seen investment in new projects drop sharply.

This explains why the surplus is not as burdensome as one would imagine it to be. It also leaves the market vulnerable if an economic recovery arrives quicker than the street anticipates. After all, the study period in the ICSG's report takes us well into the slowdown, and total global usage was still growing by 2.5% over the same period in 2007. With any uptick in the industrialized regions or China, we would see warehouse stocks drop in a hurry.

It's difficult to trade this market. On the one hand, how could one entertain being long an industrial commodity during a recession? On the other, the \$2.5-per-pound drop in price may have already discounted all the bearish news. Stand aside for now. *[March 2, 2009]*

Chart 4 – Dow Jones Industrial Average



Courtesy Reuters

Chart 5 – US industrial production

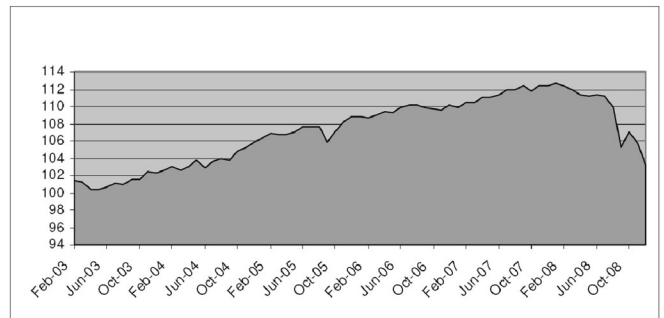


Chart 7 – Japanese industrial production

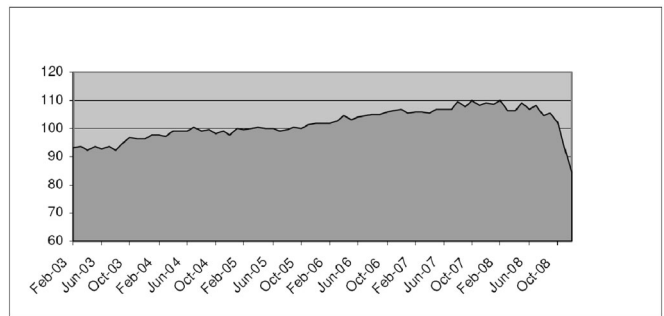


Chart 6 – EU industrial production

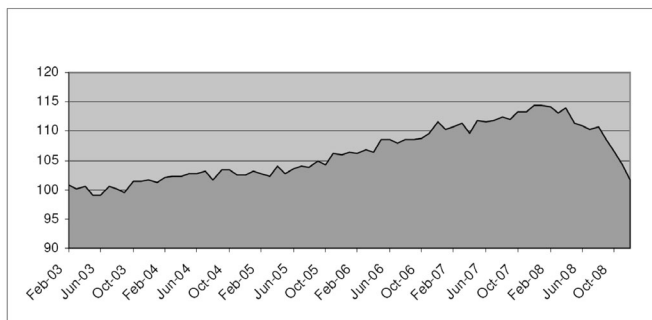
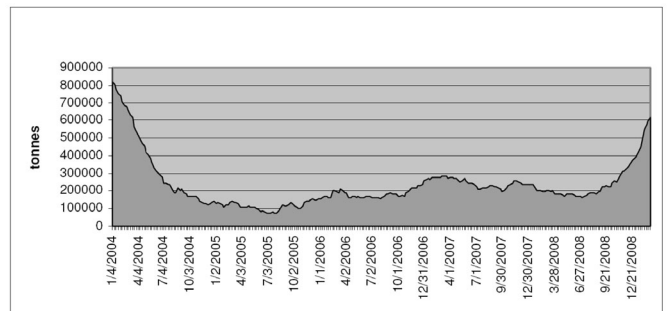


Chart 8 – Copper global warehouse stocks



SOYBEANS

How long can exports keep prices afloat?

Until recently, the soybean market held up fairly well against the monumental unwinding of the great commodity bull market. For most of the past six months, prices hovered in the \$9- to \$10-per-bushel range, down dramatically from the highs, but still well above the historical norm (Chart 9). For good reason.

While virtually all commodity markets are suffering from a sharp drop in demand, soybeans proved to be something of an exception. Domestic usage in the US has clearly fallen, but export demand is still running smartly ahead of last year's pace, which has kept supplies tight – at least until now that is.

The 2008-09 US crush is down 9.8% from last season since the marketing year began in October. The USDA has been revising its forecast down every month, which now stands down 8% from 2007-08. Domestic consumption is a much larger factor than exports, but foreign sales have really baffled everyone. The trouble is that it may not last.

The 2003-04 bull market in soybeans was underpinned by foreign sales, particularly to China. In January and February of 2004 there were three weeks in which US exporters saw net-negative new sales. It seemed that foreign buyers were shifting to South American origins and that demand in general was intact. While significant cancellations are more common in July and August, it is just about unheard of so early in the marketing year. Still, market participants remained bullish, and prices continued to rally through the summer.

Then, the Chinese government tightened credit because rampant economic growth stoked fears of inflation. As a result, crushers had difficulty financing purchases and operations. Chinese importers started canceling Brazilian commitments as well, and the market collapsed – falling to \$5 per bushel from \$10 in just a couple of months.

Rumors began to surface recently that there were Chinese cancellations around the corner – not hard to believe in this environment. Then there were some cancel-

lations, but nothing drastic. Weekly commitments continue to accumulate at a fairly decent pace. More importantly, 21.6 million tonnes of the 26.9 million tonnes committed, or 80%, have already been shipped, compared with only 73% shipped last year at this time.

Actually, a closer examination of soybean sales reveals that the strength of Chinese imports is in fact the broader market's weakness. The Chinese have taken delivery of 13.5 million tonnes of US soybeans this season to date, compared with only 8.7 million tonnes last year at this time. This means, of course, that the purchasing patterns of other traditional customers are far more reflective of the state of the global economy. If the Chinese satisfy their needs before the global economy stabilizes, it is quite likely that US sales will really dry up in a hurry. So we may not have seen any significant cancellations yet, but the market is highly vulnerable in this regard.

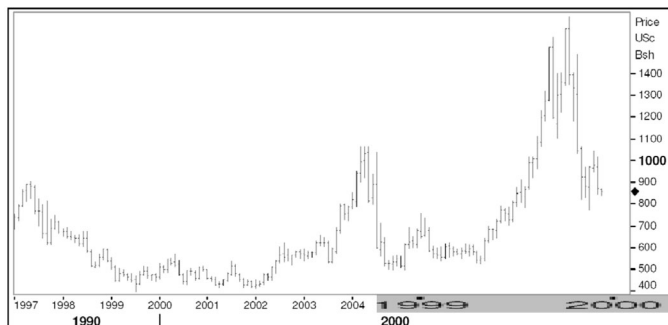
Another factor that kept prices strong was the drought in South America. In the February supply/demand situation report, the USDA cut Brazilian output from the January estimate of 59 million tonnes, to 57 million tonnes, and really took the ax to Argentina, slashing production to 43.8 million tonnes, down from the previous estimate 49.5 million tonnes. It has been raining recently, however, and although we will definitely not see a complete recovery – harvest is 25% complete in Brazil – it is no longer a bullish factor, because we are likely to see upwards revisions to the crop from here on in.

The annual USDA Outlook Forum, which provides the first look at the US new crop to be planted in the spring, was held on February 27. US farmers are expected to plant 77 million acres, which would be a record by 2 million acres.

We're finding it tough to see any upside in what may very well still be an overpriced market. November new-crop soybeans took out the December lows this week. We recommend following the breakdown. Sell November soybeans.

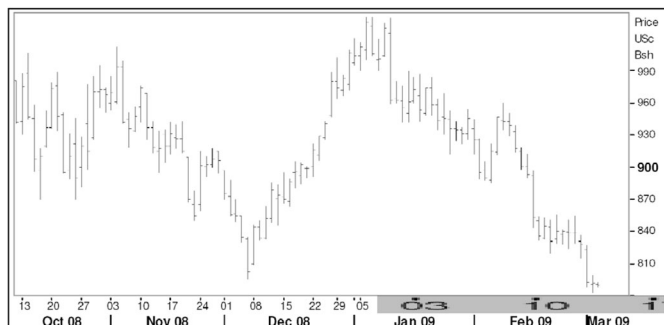
[March 4, 2009]

Chart 9 – Monthly soybeans, nearest contract



Courtesy Reuters

Chart 10 – November soybeans



Courtesy Reuters

CORN

A blip up in exports. Can it last?

For five consecutive weekly reporting periods – from mid-January through mid-February – the US export commitment report gave no clue that corn was in a bear market. Average weekly commitments were 1.26 million tonnes, up sharply from the previous five-week average of 382,000 tonnes. The apparent recovery in foreign sales, however, did not seem to inspire the market very much. There were some bumps and grinds, but prices have continued to trade lower, setting a three-month low this week (Chart 11). This past week, the export market returned to the poor flows we've become accustomed to, with new sales of 448,000 tonnes. To meet the USDA target for annual sales, US exporters have to sell just over 600,000 tonnes per week in the 26 weeks remaining in the marketing year.

On March 4 news of fresh Chinese-government financial stimulus gave the equity and commodity markets a boost, with the hope that the Chinese are one step closer to resuming the purchase of goods and services. This might be very bullish for copper and soybeans or other commodities that China buys abroad. The problem is that just about everything – including corn – rallied on the news, but China is completely self-sufficient in corn, having posted a production/consumption surplus over the past few years.

As we head into planting season, we had a look at the first USDA estimate for 2009-10 crops. The spread between new-crop soybeans and corn is probably the largest factor that helps farmers decide between planting corn and soybeans. The spread favored soybeans in early January, but as Chart 12 indicates, corn prices have been gaining vis-à-vis soybeans. This, perhaps, explains why the forecast that emerged from the February 27 USDA Outlook Forum was higher than any estimates we've seen from private forecasters thus far. Previous estimates were in the 82- to 83-million-acre neighborhood. Planted corn area was estimated at 86 million acres, same as last year, but still down sharply from 2007-08's record area of 93.5 million acres.

The market saw the higher-than-expected acreage estimate in a bearish light, considering the sluggishness of the demand side of the balance sheet for both domestic consumption and export sales.

The Outlook Forum had a bullish surprise as well. The estimate for US ethanol usage was raised to 4.1 billion bushels corn equivalent, up from last year's 3.6 billion bushels. If this turns out to be accurate, it would mean that a record 33% of US corn consumption will be used by the ethanol market, up from 30% in the previous marketing year. The USDA has actually been trimming the estimate for ethanol usage over the past few months. The basis for this estimate is that there is a government-mandated minimum ethanol usage requirement of 10.5 billion gallons in 2009, which is the corn equivalent of 4.3 million bushels.

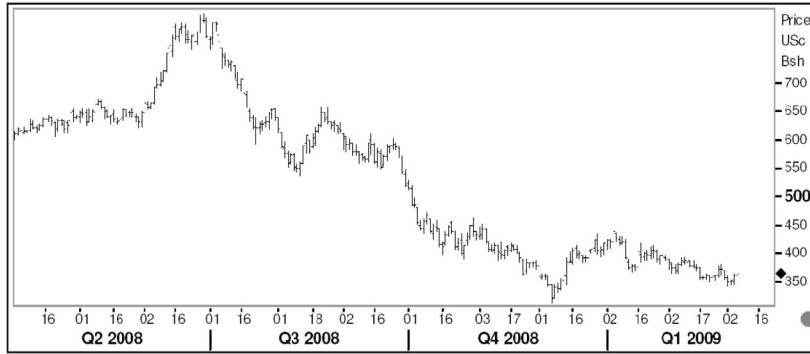
Normally, we would consider this bullish, because an uptick in feed usage – which the market is vulnerable to – would create tightness with such a large portion of the crop devoted to ethanol production. The government mandate is enforced by imposing minimum ethanol requirements to be mixed with gasoline. But the rather large increase in the ethanol usage forecast depends on gasoline usage and assumes that the economy will recover in 2009. In the coming months, however, it is difficult to see the market recovering enough to meet even the 2008-09 estimate of 3.6 million bushels for ethanol usage.

The Outlook Forum estimate for US 2009-10 ending stocks is 1.72 billion bushels, or 13.8% of consumption, down from 14.9% for the current marketing year. There are a number of bold assumptions, including a forecast for yields to reach 156.9 bushels per acre, the second highest on record, which would produce a crop of 12.365 billion bushels. Constant improvement in seed technology has allowed yields to get larger every year, but any weather glitch has the potential to draw US ending stocks back into bull market territory of below 10% of consumption.

In conclusion, the present is bearish, the future – according to the Outlook estimates – has the potential to be bullish. Exports are still limp, animal populations are shrinking, and ethanol-usage estimates may still be too high. In addition, the price of natural-gas-based fertilizer has not been this low in years, which will provide an incentive for farmers to plant. Acreage can still increase.

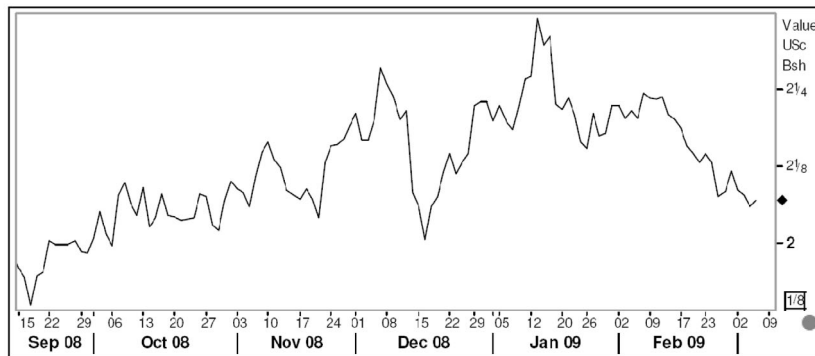
Liquidate the long leg of the long soybean/short corn recommendation we made on January 29, and remain short corn.
[March 5, 2009]

Chart 11 – May corn



Courtesy Reuters

Chart 12 – New-crop soybean/corn ratio



Courtesy Reuters

Friedberg's Focus on Futures is published by Friedberg Mercantile Group Ltd., P.O. Box 866, Suite 250, 181 Bay Street, Toronto, Ontario, M5J 2T3. Contents copyright © 2009 by Friedberg Mercantile Group Ltd. All rights reserved. Reproduction in whole or in part without permission is prohibited. Brief extracts may be made with due acknowledgement. Friedberg Commodity Management Inc., an NFA registered CTA, takes full responsibility for the contents of this publication.

Subscription Enquiries for
 Friedberg's Focus on Futures
 Suite 250
 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 Ltd.
 Suite 250
 181 Bay Street
 Toronto, Ontario M5J 2T3
 416-350-2903
 Attn: Sholom Sanik

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

All statements made herein, while not guaranteed, are based on information considered reliable and are believed by us to be accurate. Futures and options trading is speculative and involves risk of loss. Past trading results are not indicative of future profits.