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## FOCUS ON FUTURES

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## Indian cotton exports resume. Bearish... for now

*Note: All bales quoted have been converted to US 480-pound bales.*

On March 5 the Indian government announced that it was banning all cotton exports, effective immediately. Shipments of 7.7 million bales in the 2011-12 marketing year had already shot past original export estimates of 6.8 million bales. An additional 2 million bales that were contracted for shipment were not at issue, because exporters would be allowed to honor all commitments. The government felt it needed to ensure that supplies would be available to feed the domestic mill industry.

China, Bangladesh, and India's other customers would have to look elsewhere for new purchases. With the possibility that US stocks would be run down to historically low levels, prices closed up the daily trading limit in the session following the announcement of the ban (Chart 1).

The bullishness was short lived, though. There was no follow-through to the rally, with the market closing lower the next day. Estimates for global ending stocks have been swelling in recent months. In December the USDA estimate for the 2011-12 carryout was 51.8% of usage, but the March 9 monthly crop report showed that the figure had climbed to 57.3%. Production forecasts remained steady, but consumption estimates fell by about 2.5%. So while it was quite likely that US stocks would be run down further if there were substantial interest in old-crop cotton, in the grand scheme there is still plenty of supply available before the new crop is harvested this coming autumn.

In any case, it all became a moot point, because by March 11, the ban was lifted as the government yielded to pressure from China and other concerned parties. The market proceeded to new lows for the move.

Looking at other areas, we find that US exports have been steady. We were surprised that in the March crop report the USDA did not raise its 2011-12 forecast from its 11-million-bale estimate. Commitments have already reached that level, and there are over four months remaining to the marketing year. In addition, the shipment pace has been excellent. Shipments need to average 271,000 bales per week to

meet the USDA target. Average shipments over the past four weeks have been 340,000 bales.

The other bullish wrinkle for this market is that prices have been falling relative to the other major agricultural commodities. Although we won't get a clear picture for awhile yet, it is fair to say that acreage would have been switched away from cotton where possible. The most stark example is soybeans. Chart 2 shows new-crop soybeans soaring *vis-à-vis* new-crop cotton.

China is the world's largest cotton producer, and 2012-13 output will be similarly affected. Chinese cotton area is expected to fall by 10%.

The motivation for the Indian export ban was far from ludicrous. Ever since India became a self-sufficient cotton producer in the mid 2000s, inventories have been ample, with ending stocks averaging about 35% of domestic consumption. After this season's export spree, the carryover has been revised downwards and is roughly 20% of usage.

In conclusion, while the USDA balance sheet is telling us that this is a bear market, the demand side developments are not adequately reflected. The flip flop on Indian exports may have resulted in cotton becoming available, but it also highlights strong mill usage in India

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

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and in Asian importing countries. Demand has not recovered to pre-recession levels, which reached 118 million bales in 2009-10, but is not as weak as the current estimate. In all likelihood, we're probably closer to the early-season forecasts.

We continue to believe that prices will drift lower, but it is highly improbable that prices will plunge. Lower buy stops on December cotton to 91.5¢ per pound from the 95¢ per pound stop recommended on February 23.

[March 16, 2012]

Chart 1 – May cotton



Courtesy Reuters

Chart 2 – Soybean/cotton ratio



Courtesy Reuters

## SOYBEANS

# South American estimates keep falling

Soybean prices have been moving steadily higher since December, when South American soy regions began to experience drought. There were pockets of relief from the dry weather, but overall crop estimates have been slashed across the board for both major producers, Brazil and Argentina, as well as for smaller producers, such as Paraguay.

Both Brazilian and Argentinean output will be substantially below last year's and – more significantly – well below expectations that were based on planted area. According to the March 9 USDA crop report, the estimate for Brazilian output has tumbled to 68 million tonnes, down from 75 million tonnes in December. Argentinean production is now estimated at 46.5 million tonnes, down from the 52-million-tonne December forecast. The weather in Argentina improved in the late going, resulting in upwardly revised estimates for the crop.

Last year, Brazil and Argentina harvested 75.5 million tonnes and 49 million tonnes, respectively.

The global balance sheet takes a big hit from the South American situation. The estimate for ending stocks was 24.8% of usage at the end of December and has now fallen to 22.5%. While inventories are not quite as low as the 19.2% level reached in 2008-09, there has definitely been an impact.

Studying US exports, we find that commitments are still lagging last year by a wide margin – 30.8 million tonnes compared with 40.2 million tonnes last year at this time. We should hit the USDA target for final sales of 34.7 million tonnes, though, because shipments are keeping pace with historical

trends. Exporters have shipped 83% of commitments, virtually the same percentage as last year at this time.

Demand for US beans, which typically fades at this time of year – has definitely reflected some nervousness about smaller supplies from South America. Commitments for old and new crop beans have been well above average. Over the past five weeks, old crop commitments averaged 723,000 tonnes. In the previous five years, average commitments in the comparable four-week period were 340,000. Moreover, during this period, new-crop commitments are normally insignificant, but this year they averaged 1.01 million tonnes. Much of the surge in sales was part of the deals that a well-publicized Chinese delegation signed with exporters. Regardless, the sales are booked for the 2011-12 marketing year, and if the beans are shipped, they will draw down inventories.

The USDA's 34.70-million-tonne 2011-12 US export estimate has not been revised since the number was lowered in January from December's 35.38-million-tonne estimate. It is not surprising that the USDA did not raise the export estimate in the March crop report. However, the balance of evidence suggests that with more than five months remaining in the marketing year, the estimate could very well be raised.

The poor showing of South American crops, as illustrated, has reignited the bull market that began at mid-decade (Chart 3). Global inventories remain at levels that have sparked fears of tightness and have spurred purchases by overseas importers. US farmers – at least according to preliminary reports – are

putting a heavier emphasis on corn acreage to the detriment of soybean plantings.

However, Chart 4 shows that new-crop soybean prices have improved dramatically *vis-à-vis* corn prices over the past few months, and that will play heavily on upcoming decisions by farmers. We'll get a better idea on March 31, when the USDA reports planting intentions.

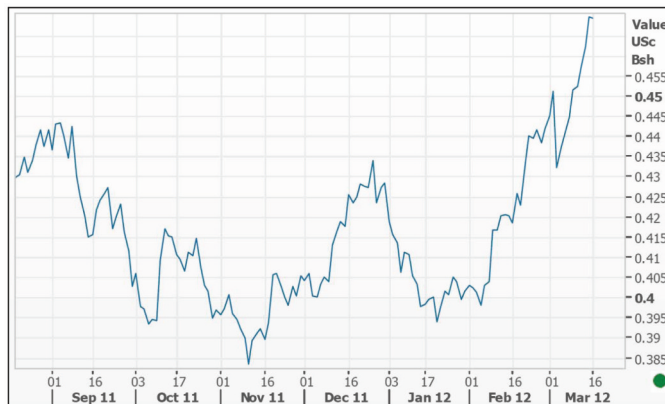
We remain bullish, but we have company. Open interest has soared and has continued to rise even as the market began to pull back a bit (Chart 5), a time-tested indication that we could be looking at a top, albeit a temporary one. We advise adding to existing long positions or establishing new positions only on pullbacks. Raise stops on existing positions to \$1,250, basis July close only. *[March 23, 2012]*

Chart 3 – Nearest contract soybeans



Courtesy Reuters

Chart 4 – New-crop soybean/corn ratio



Courtesy Reuters

Chart 5 – CBOT soybean open interest



Courtesy Reuters

## SUGAR

### Is a liberal Indian export policy enough to tame the bull?

On March 26 the Indian government announced that it will allow a further 1 million tonnes of sugar exports, in addition to the 2 million tonnes already approved for the 2011-12 marketing year. The move was largely expected, but the 3.5¢-per-pound rally that began in early January took a 50% haircut in the days following the news.

Indian sugar output has made a full recovery from the

drought-reduced crop years of 2008-09 and 2009-10. Production is expected to be as high as 26 million tonnes, up about 7.5% from the previous season. Recent press reports put domestic consumption at 22 million tonnes, which seemingly leaves enough supply for a generous export policy.

Until the years of drought ravaged sugar output, India

maintained inventories equal to about 50% of consumption. This season, after accounting for the new wave of exports, 2011-12 ending stocks will fall to about 6 million tonnes, roughly 27% of usage.

We're skeptical about the modest estimate for domestic consumption of 22 million tonnes. The population is growing at about 1.7% per annum, and over the past few years estimates were quoted as high as 24 million tonnes. While consumption may have gone flat, it is unlikely to have fallen.

Flooding the market with its excess inventories appears to us to be a somewhat misguided strategy. The Indian government's commodity policies have been influential in other markets of late as well – and have proven to be erratic. In early March cotton exports were halted to ensure domestic supplies remain at comfortable levels. The resulting rally sparked a limit-up move in cotton prices. Days later the ordinance was withdrawn, and cotton prices retreated.

Indeed, over the past few years, restrictive export policies for sugar were installed as soon as the domestic market showed any sign of tightness. Counting on India as a reliable exporter of last resort is not a sure thing. Allowing 3 million tonnes of exports is therefore bearish for the short term, but potentially bullish for the longer term outlook if India depletes its inventories to uncomfortable levels.

Weather in Brazil for the soon to be harvested 2012-13 crop has not been ideal. Production is expected to improve after last season's uncooperative weather caused the first year-over-year drop in production in 11 years. But the crop will not reach the level achieved two years ago.

Many plantations needed to be replanted, so full production is not expected until the following crop year, in 2013-14.

Brazilian cane output is shared by the sugar and ethanol industries. The government's minimum ethanol blend requirement for cars was lowered from 25% to 20% back in October to alleviate a very tight market. Export demand for ethanol competes with domestic demand. The market is so tight that Brazil has been importing from the US. In fact, Brazil is currently the largest foreign customer of US corn-based ethanol.

In 2011-12, 51.4% of the cane crop was used for ethanol. One early estimate puts this year's ethanol portion at 53.8%.

Other important sugar exporters, such as Thailand and Australia, have had excellent crops. Exports will be at optimum levels. Analysts estimate that the global balance sheet for 2011-12 will show a surplus of about 5 million tonnes.

Nevertheless, the action in the sugar market over the past few years has demonstrated clearly that bull and bear markets in sugar result from surplus and deficits in Brazil and India. Everything seems quite comfortable now. India's liberal export policy has served to ease the potential for tightness that could result from Brazil's second consecutive year of sub-par production.

Global demand for ethanol will continue to grow, and Brazil will remain under pressure to meet both domestic demand and deliver on its export commitments without sacrificing sugar output.

Maintain long May sugar positions. Place stops at 23¢ per pound, close only. *[April 4, 2012]*

Chart 6 – May sugar



Courtesy Reuters

**CORN**

## US stocks dwindle, but record crop looms

The March 30 quarterly stocks report confirmed that near-term US corn supplies are very tight. Inventories as of March 1 were reported at 6.009 billion bushels, 140.75 million bushels below the average trade guesstimate and close to 500,000 million bushels below stock levels the same time last year. The March USDA crop report estimated ending stocks as a percentage of consumption at 6.2%, already the lowest level since 1995-96. If disappearance continues at this pace through the end of the marketing year, the carryover would be the lowest in modern history.

The planting intentions report was released concurrently with the stocks report and tempered the bullishness. US farmers are expected to plant a modern-day record 95.864 million acres to corn, 3.943 million acres more than they did for the 2011-12 crop, but far more significant, 1.144 million acres above the trade guesstimate. And estimates from private forecasts have been growing since the report was released. On April 3, Informa Economics raised its estimate to 96.4 million acres.

The market's reaction in the trading session following the release of the reports was in sync with their implications. Old crop months May and July rose the 40¢-per-bushel daily trading limit, while new-crop December was up only 16¢-per-bushel, widening the spread, which was already indicating near-term tightness to be alleviated by a monster harvest in the fall (Charts 7, 8, and 9).

Most other corn fundamentals that we've been following over the past few months, which could affect the short-term supply picture, remain bullish.

Complicating matters is further confirmation that the Argentinean crop was truly a disaster. Estimates have now slipped below 20 million tonnes, down from the USDA's March crop report estimate of 22 million tonnes, and down as much as 10 million tonnes from early season estimates, which were based on a vastly expanded planted area.

Late last year the US government stopped protecting the corn-based ethanol industry by removing the import tax on Brazilian sugar-based ethanol and halting subsidies to US ethanol producers. Any impact from the elimination of the import tariff, however, has been delayed for the

foreseeable future. For the moment, Brazil cannot produce enough ethanol to meet the needs of domestic demand and long-term export commitments, let alone enter into new export agreements with US importers. Brazil is actually a net importer of ethanol.

We are not quite that bullish, however. The quarterly stocks report has proven to be a major market mover for corn over the past year or so, with the USDA finding and losing hundreds of millions of bushels from quarter to quarter. This report was no different. In the days leading up to the report, the price of old-crop contract months dropped sharply to multi-month lows, only to have the results of the report send the market back to the high end of the range (not beyond, though).

The export market is key to any sustained tightness, and the hard facts do not support the kind of tightness that market participants seem to be trading on.

The USDA estimate for 2011-12 US exports is 43.18 million tonnes, down 7.3% from last season. Commitments stand at 34 million tonnes, which is down 12.5% from the same time last year. There have been some weeks in which commitments surprised to the upside, but even with the poor South American crops, foreign purchases will shift to Argentinean and Brazilian origins soon enough, leaving the prospect for US exporters to meet the export target in question.

If we muddle through this marketing year, the record acreage on which US farmers are planting their corn crops should serve to replenish US stocks. We should remember that last year's inclement weather drove the national average yield down to 147.2 bushels per acre (bpa), down from 152.8 bpa the previous year and a record 164.7 bpa in 2009-10. A return to normal yields will overwhelm the silos.

It would be dangerous to take an outright short position in corn when the crop has not even been planted. We continue to advise a long July wheat/short July corn spread (Chart 10), believing that the historical anomaly of wheat trading at or near the price of corn is unsustainable given developments in both the corn and wheat markets.

*[April 5, 2012]*

Chart 7 – May corn



Courtesy Reuters

Chart 8 – December corn



Courtesy Reuters

Chart 9 – May/December corn spread



Courtesy Reuters

Chart 10 – July wheat/corn spread



Courtesy Reuters

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**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

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