

# FRIEDBERG'S

## FOCUS ON FUTURES

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## Can smaller crops save cotton from the bear?

Cotton prices have been moving in a relatively tight range since last August (Chart 1). It's been a devastating bear market that saw the market fall from over \$2 per pound in 2011 to the current level.

Unlike other major world crops, such as corn, wheat, and soybeans, which have seen explosive growth, global production has been stagnant. Since the first giant leap in output in 2004-05, to 121 million bales, global production has averaged 118.3 million bales. The estimate for the 2014-15 marketing year is 119.3 million bales.

Still, cotton-growing nations have overproduced in terms of weak demand. And the primary catalyst for falling prices has been the sharp decline in Chinese imports, which peaked at 24.5 million bales in 2011-12. For the current 2014-15 marketing year, imports are expected to fall to 7.5 million bales.

China is working off its gargantuan stockpile of 65 million bales. The government has been slashing its import quotas to encourage domestic purchases.

For the upcoming 2015-16 marketing year, Northern Hemisphere production, where a vast majority of cotton is grown, is expected to fall sharply. Prices are well below the cost of production, and there is little incentive to ramp up planting in situations where more profitable crops can be planted.

In China, early forecasts call for a 20% drop in planted area. The March 31 USDA planting intentions report confirmed early estimates for a 14% drop in US acreage, to 9.54 million acres. Estimates for India have been sketchy, but the crop is being planted late, which will probably spell lower yields.

Even if there are no crop "accidents" and yields are similar to last year's, the drop in output for the US and China alone could mean that production will slide by about 8 million bales from 2014-15. If demand remains constant and output falls elsewhere as well, it would result in the first deficit since 2009-10.

The current global carryover stands at 110 million bales, or 99% of usage. The anticipated broad decline in 2015-16 production will certainly make a dent in this historic stockpile.

US cotton exports have surprised to the upside, at least in terms of commitments. The USDA is still forecasting annual sales for 2014-15 at 10.7 million bales, up from final sales of 10.53 million bales in 2013-14. Commitments stand at 9.9 million bales, compared with 9 million bales at this time last year.

The problem is that the shipment pace is considerably behind last year's. The marketing year ends on July 31. Weekly shipments would have to average about 300,000 bales to hit the target – a tall order. We're likely to see a downward revision in the May crop report.

China consumes more than 30% of global production. Even if economic growth is strong enough to expand global demand, Chinese imports should continue to decline as the country eats into its burdensome supplies. The demand side of the balance is unlikely to provide any bullish stimulus to this market.

As illustrated, with smaller production worldwide, the supply side becomes vulnerable. If any of the key producing countries experience inclement weather that leads to crop failures, the dynamics could change.

For the moment, though, barring unforeseen circumstances, we expect to see prices confined to their current range. Remain sidelined, but stay tuned.

*[By Sholom Sanik, April 23, 2015]*

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Chart 1 – July cotton



Courtesy Reuters

## SUGAR

### Plenty of sugar... for now

Sugar prices have bounced off five-year lows (Chart 2). As we've documented here before, during this bear market, a short-covering rally has appeared in the weeks prior to the expiry of the near-contract month, and for the moment anyway, there is not much more to attribute it to. And the evidence to support this certainly exists: Since early April, open interest has fallen by 100,000 contracts, and the net short position held by speculators has shrunk by more than 20,000 contracts (Chart 3).

For that matter, most of the developing news in the sugar market – at least on the supply side – has been bearish. The Brazilian crushing season begins in April, and although it's quite early, forecasts are for larger output than in the 2014-15 season. One recent estimate puts Center South production for the 2015-16 season at 33.5 million tonnes, up from 32 million tonnes in 2014-15.

Overall, Brazilian output, including the smaller regions outside the Center South, is forecast to rise by about 5%. The cane crop is estimated to be only about 3% larger than last year, but drought limited yields. In addition, these forecasts for sugar production are based on the belief that the sugar/ethanol ratio will rise in favor of sugar production.

But analysts are divided over ethanol production. Estimates range from 2% growth to 9.5% growth. The government is now operating under a 27.5% minimum ethanol/petroleum-mandated blend, which went into effect in February. While the fall in global crude oil prices is believed

to make ethanol less competitive, the government also raised petroleum prices, allowing ethanol to maintain market share.

Furthermore, despite the late start to the crushing season, 2014-15 Indian output has surpassed early estimates. One recent estimate puts production at 26.5 million tonnes, up from about 24.5 million tonnes in 2013-14.

Mills that produce sugar in both Brazil and India will continue to face difficulties. In India in particular, cane prices have not fallen alongside sugar prices, which leaves millers strapped for cash to pay farmers. Arrears are widespread. The problem has been exacerbated because mills use their sugar inventories as collateral to obtain bank loans. With multi-year lows in sugar prices, the value of the collateral has depreciated.

This has been an ongoing issue, and frankly, we are miffed that production has been as robust as it's been. Government subsidies have obviously played a large role, but the industry, as illustrated, is grossly inefficient.

For the moment, 2014-15 Indian ending stocks are estimated at multi-year highs of close to 10 million tonnes. Global ending stocks are estimated at about 45% of consumption. So we are not looking at shortages.

Eventually, we believe, the inefficiencies will backfire. There have been news reports indicating that many mills are in severe financial trouble and that as many as 25% of all facilities will not be able to operate in the 2015-16 season.

On the demand side, news from the Chinese sugar market does not typically make headlines. Over the past few

years, however, imports have been growing, and China may become a bigger player in world trade. Output for 2014-15 fell sharply, to 10.5 million tonnes, down from 13.3 million tonnes in 2013-14. Analysts estimate that as a result, imports

will rise to a record 4.5 million tonnes this marketing year, up more than 1 million tonnes from 2013-14.

Maintain long positions via call options.

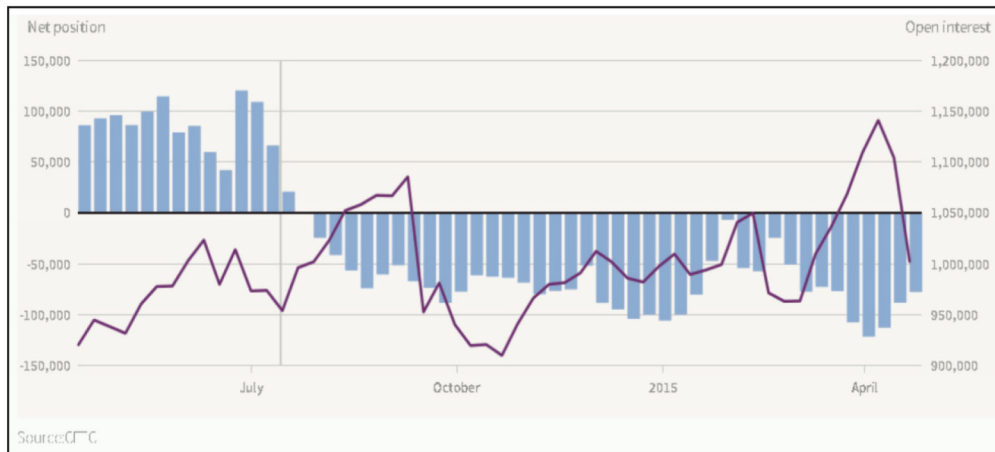
[By Sholom Sanik, April 30, 2015]

Chart 2 – Weekly nearest contract ICE sugar



Courtesy Reuters

Chart 3 – ICE sugar open interest (line), Net short position (bar)



Source: CFTC

## SOYBEANS

### The bear hesitates, but not for long

In the April 19 issue of *Focus on Futures*, we discussed the corn market and the surprise traders were dealt with the March 31 US 2015-16 planting intentions report. For months, the USDA had built expectations of shrinking acreage, but the results were higher than expected. It was the flip side for soybeans: In 2014-15 farmers planted 83.7 million acres, and the USDA was talking about a massive shift, with some private guesstimates as high as 88 million acres. The average of analysts' estimates was 85.9 million acres, but the actual fig-

ure came in at only 84.64 million acres.

Chart 4 shows definitively the market's reaction to higher corn acres and lower soybean acres. New crop soybeans spiked *vis-à-vis* corn. Soybean area will still be a record by far – 3 million acres higher than in 2014-15 – but the market needed to unwind the expectations. Even if we assume a repeat of last year's excellent yields, the difference between expected area and the actual estimate amounts to about 60 million bushels (1.6 million tonnes).

Nevertheless, the overall bearish environment remains intact. With the South American harvests complete, the world will soon be awash with soybeans. The Brazilian crop is estimated at a record 94.5 million tonnes, compared with 86.70 million tonnes in 2014-15. Argentinean estimates keep rising. In its April crop report, the USDA raised its estimate by 1 million tonnes, to 57 million tonnes, up from 2014-15 output of 54 million tonnes. But private forecasters keep raising their estimates, with the latest figures indicating a crop of 59 million tonnes.

Even before the upward revisions in Argentinean output estimates, 2014-15 global ending stocks were forecast at 31% of usage, which surpassed the previous record set in 2010-11 of 28.1%.

US export commitments stand at 49 million tonnes, slightly above the USDA target of 48.7 million tonnes. Shipments have been lagging, though, and with the competition from South American crops, we are likely to see cancellations. There are four months remaining in the marketing year, and if shipments maintain their recent sluggish pace, we'll probably miss the USDA target by about 1 million tonnes.

Looking forward, export demand will remain fairly

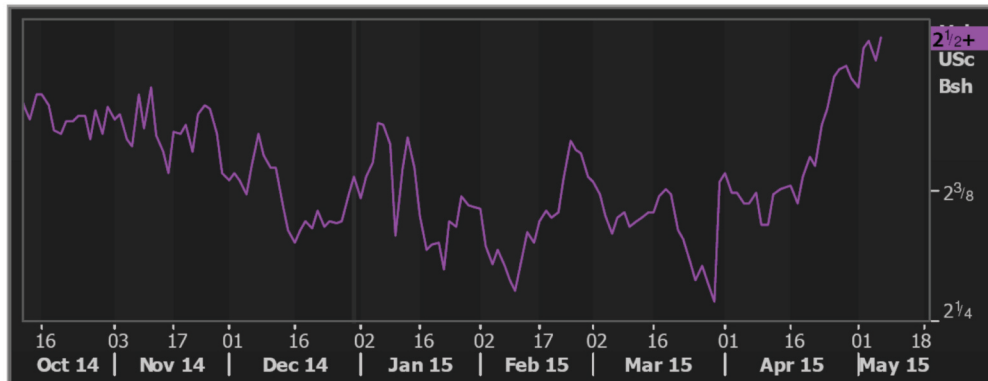
constant. Of course, there is the seasonal shift between the US and its South American counterparts. However, while China is effectively self-sufficient in commodities like corn and wheat, it is almost completely reliant on imports for its protein feed needs.

Although the Chinese government has implemented measures to restrict imports of cotton and soybeans to support domestic farmers, the two commodities have vastly different dynamics. Cotton inventories are overwhelming, to say the least. Soybean ending stocks represent a very modest 16% of consumption, and China still accounts for 63% of world trade. Chinese soybean imports should continue to grow for the foreseeable future despite the government's intervention.

The market was indeed caught with the planting intentions report, but unless there is a US crop failure, there is nothing terribly bullish about this market. The torrent of beans that will come out of Brazil and Argentina in the coming months should push new-crop prices down below \$9 per bushel.

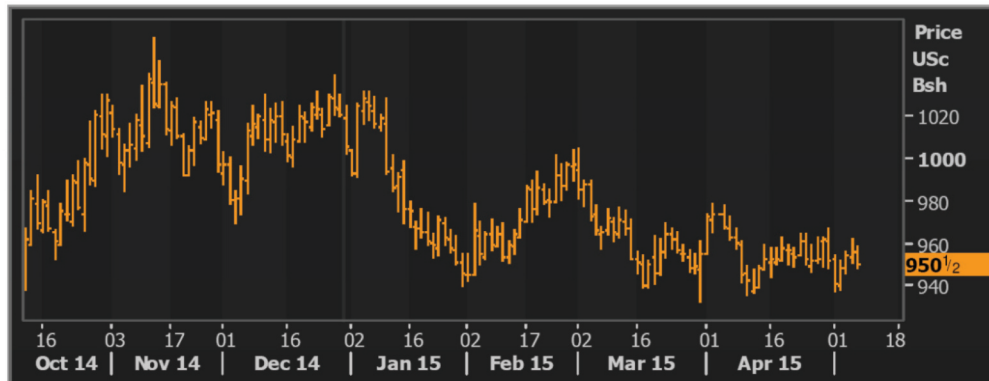
Establish short positions in November soybeans, currently trading at \$9.50 per bushel. Place initial stops at \$9.85, close only. *[By Sholom Sanik, May 7, 2015]*

Chart 4 – November soybeans/December corn ratio



Courtesy Reuters

Chart 5 – November soybeans



Courtesy Reuters

**COPPER****Fundamentals remain bullish**

Copper prices have been rallying since the beginning of the year and now sit at a five-month high, encroaching on the \$3-per-pound mark (Chart 6). All of the indicators that we keep tabs on remain largely bullish.

The extraordinary 13.2% jump in January Chilean production has, indeed, turned out to be an anomaly. It was followed by year-over-year decreases in February and March of 1.1% and 2.3%, respectively. The government has already cut its forecast for 2015 output growth to 2.8% from an early estimate of 3.8%.

The slowdown in output over the past couple of months has been attributed in part to heavy rains in northern Chile, as well as scheduled maintenance, both of which caused significant production halts. While these are temporary issues, output growth is also being stunted by aging mines that are being depleted of higher-grade ores. New mines are being developed, but that is a slow process.

As always, since Chile accounts for roughly one third of global mine output, even small variances in output become the main issue on the supply side. Similarly, China uses about 40% of the world's refined copper output, so whatever happens in China is all you need to know for the demand side.

Back in February, after a sharp drop in imports, to the lowest monthly figure since early 2011, it seemed that all the gloomy predictions about the Chinese economy were coming to fruition. Thus far, the pessimism has been unfounded, at least as far as copper usage is concerned. March imports came back strong. And now preliminary customs data for April show the largest monthly tally since April 2014 (Chart 7).

Global warehouse stocks bottomed in mid 2014 and have risen substantially until recently (Chart 8). At best, warehouse stocks are a coincident indicator, but an inventory drawdown is consistent with lower output and strong demand illustrated above.

According to the International Copper Study Group (ICSG), 2014 finished with a global refined deficit of close to 400,000 tonnes. The most recent ICSG report shows that the market was in surplus in December and January, and that it expects 2015 to end with a surplus of 365,000 tonnes. Naturally, that would hinge on many factors, and we do not see any evidence that the market is heading in the direction of a complete turnaround, into surplus.

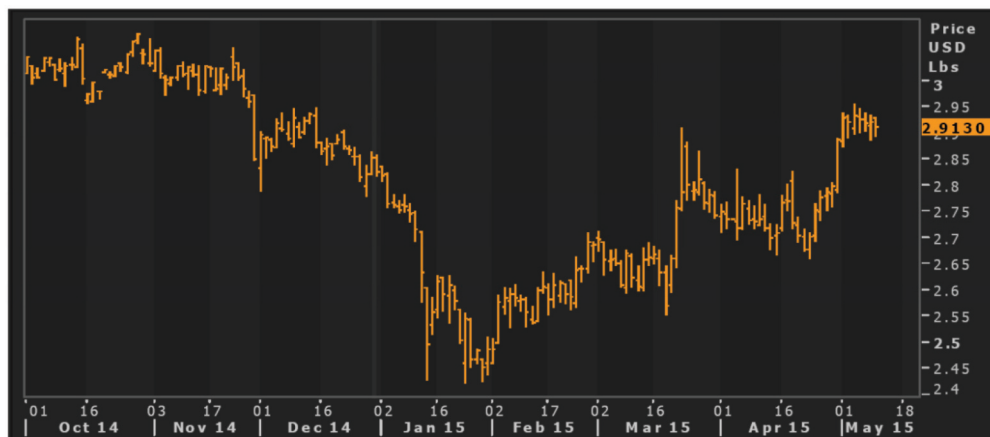
The near-term background – not directly related to supply/demand fundamentals – has supported copper prices, with a correction in the dollar bull market and the stock market hovering near all-time highs. More significantly, the spreads have tightened, indicating some near-term tightness. Just over the past few weeks, July/December copper has moved to a flat market from a \$1.45 contango.

Commodity funds are quite bullish. Chart 9 shows a spike in the net-long position to its highest level since last August.

We were stopped out of our long position prematurely at \$2.75 per pound, as per our March 24 recommendation. It's a volatile market, and opportunities will present themselves. We now advise reentering the long side on any pull-back of, say, \$0.05 per pound and using a \$2.75 stop, basis the near month, close only.

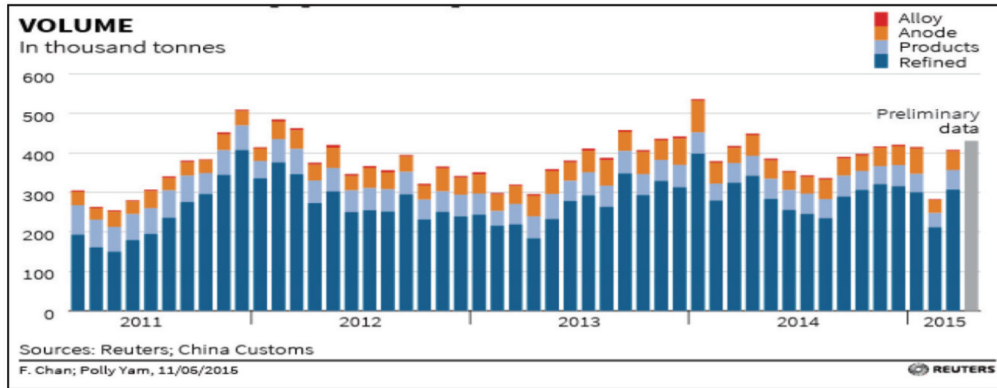
*[By Sholom Sanik, May 12, 2015]*

Chart 6 – July copper



*Courtesy Reuters*

Chart 7 – Chinese copper imports

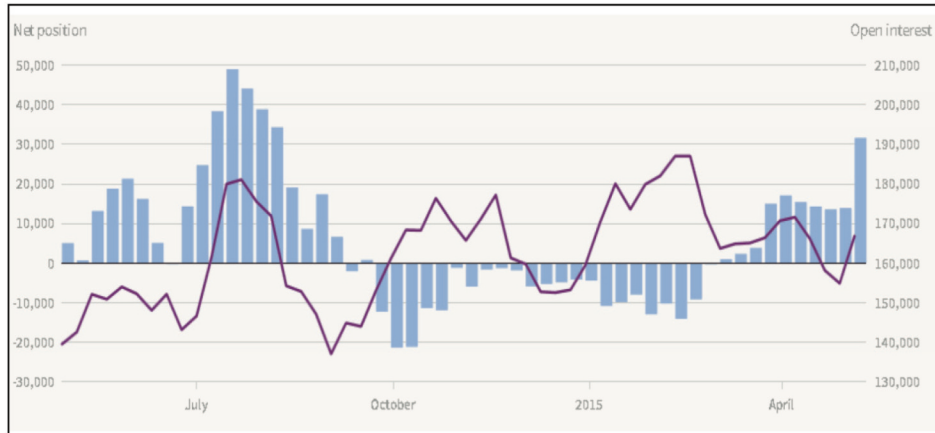


Courtesy Reuters

Chart 8 – Combined global warehouse stocks



Chart 9 – Commodity fund net-long position



Source: CFTC

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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:**  
Friedberg Mercantile Group Ltd.  
Suite 250  
181 Bay Street  
Toronto, Ontario M5J 2T3  
416-350-2903  
Attn: Sholom Sanik

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