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Did US farmers plant too much corn?

The USDA delivered a scathingly bearish outlook for corn in its May crop report, which contains the first comprehensive forecast for the new crop year. Of course, the bearishness revolves mostly around the anticipated record US corn crop to be harvested this coming autumn. So in a sense, the report was not really that shocking. We already knew from the March 30 planting intentions report that at 95.9 million acres, corn acreage would be the largest in modern history.

However, there were several unexpected items. First, going back to the current 2011-12 marketing year, feed usage was lowered by 50 million bushels. While a large, but not an overwhelming amount, it was not in the spirit of the assumptions made by most analysts that near-term US supplies were so tight. The estimate for ending stocks rose by the same amount, to 851 million bushels, up from the April estimate of 801 million bushels.

Moving on to 2012-13, aside from huge acreage, the quality of the crop is expected to be excellent. Unlike the planting seasons of some recent years, the weather has allowed for rapid planting, which just about eliminates any risk of frost, because an early harvest will be comfortably distanced from cold weather in the late-summer and early-fall. As of the most recent planting progress report, 71% of the crop has been planted, compared with 32% at this time last year and the five-year average of 47%. The estimated yield is 166 bushels per acre (bpa), also at record levels. That compares with an average of 153.9 bpa over the previous five years.

Then – something we've been harping on in past issues – ethanol usage has peaked. The last year in which ethanol usage grew was 2010-11. The forecast for the upcoming 2012-13 marketing year is 5 million bushels, unchanged from the previous two seasons. The US farmer has finally addressed the issue of having to allocate the corn crop between the feed market and the ethanol market, but at a time when there is no growth in the ethanol market.

The true test of the viability of the US corn-based ethanol market is how it will fare without government hand-outs, now that direct subsidies to producers and import tar-

iffs on Brazilian sugarcane-based ethanol imports have been terminated.

US ending stocks are estimated at 1.881 billion bushels, or 13.65% of consumption. That compares with 6.7% and 8.6% in 2011-12 and 2010-11, respectively, and the largest carryover since 2008-09.

Global ending stocks are estimated at 152 million tonnes, or 16.5% of consumption, up from last year's 14.7%.

A significant amount of FSU winter wheat acreage will be abandoned (see *Focus on Futures*, April 30), and the Ukrainian agriculture ministry issued a statement saying that the abandoned wheat area will be replanted with corn for the 2012-13 crop. This would increase the estimate for Ukrainian corn by at least 2 million tonnes, and that is not accounted for yet in the USDA 2012-13 balance sheet.

When we last wrote about corn on April 5, we were bearish for many of the same reasons presented above, but were hesitant to take an outright short position with most of the crop still to be planted. To participate in a bearish corn strategy, we advised a long wheat/short corn spread. As illustrated, however, with most of the crop in the ground at such an early date, planting is no longer an issue. Weather can still wreak havoc as the plants mature, but if all goes well, we can see corn prices retreating to 2010 levels.

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It's been a while since we've faced burdensome corn supplies. Strong demand would certainly make a difference, but the USDA has already estimated US exports at 1.9 billion bushels, well above the previous two seasons and the highest level since 2009-10. So to a degree, improved

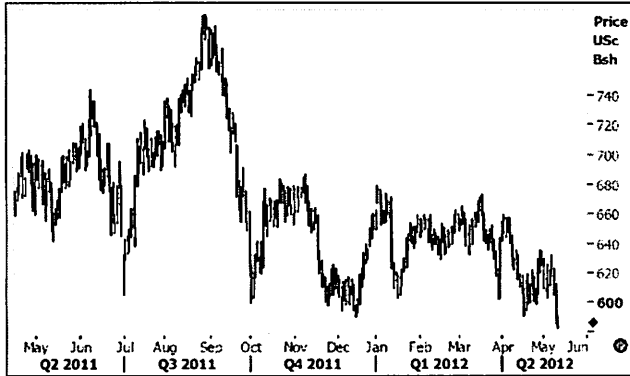
demand has been factored into the balance sheet.

Sell July corn. Place initial stops at \$6.40 per bushel, close only.

Maintain long July wheat/short July corn spread.

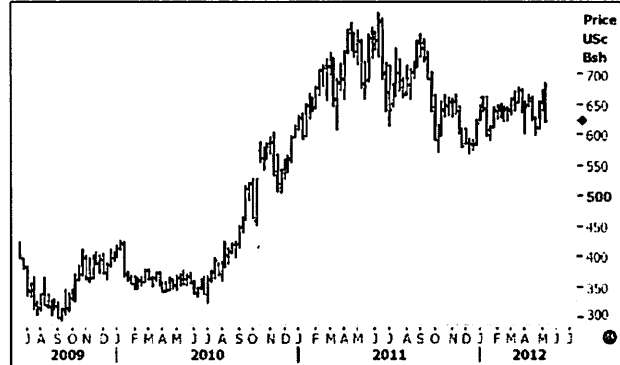
[May 11, 2012]

Chart 1 – July corn



Courtesy Reuters

Chart 2 – Weekly nearest contract corn



Courtesy Reuters

SOYBEANS

Global market remains tight

The May 10 USDA crop report, which included the first comprehensive forecasts for the upcoming 2012-13 marketing year, presented a fairly bullish picture for soybeans.

For the US old-crop, estimates for both domestic and foreign demand were raised yet again. This resulted in a significant 40-million-bushel downward revision to the estimate for ending stocks, to 210 million bushels, or 6.8% of usage, down from the previous estimate of 8.2%.

Planted area for the 2012-13 US crop is expected to fall by 1.1 million acres, to 73.9 million acres, or 1.3%. Yields, however, are expected to jump by 2.4 bushels per acre, to 43.9 bushels per acre, or by 5.8%, resulting in a near-record crop of 3.2 billion bushels. Nevertheless, ending stocks are expected at a record low of 145 million bushels, or 4.4% of usage, because demand is forecast to outstrip production, drawing inventories down even further.

The market rallied initially, but the rally lasted for only the day of the report, and then proceeded to drop sharply to multi-month lows (Chart 3). There were no great shocks *per se* contained in the report, but the data were definitely more bullish than expected. The average guesstimate for 2012-13 US ending stocks was 164 million bushels, against the actual figure of 145 million bushels.

US exports for the current 2011-12 marketing year are forecast at 1.315 billion bushels, considerably lower than last year's 1.501 billion bushels. However, exports have been

much better than expected, and the USDA is scrambling to keep up. The USDA has revised its estimate for the second consecutive month and is still behind. As of the latest weekly export report, commitments stand at 1.317 billion bushels.

Old-crop sales have been outstanding and much larger than is typical for this time of year, when old-crop sales are winding down. Over the past four weeks, average weekly old-crop commitments were 22.7 million bushels, compared with only 4.3 million bushels during the comparable period last year. Even if the current pace is not sustainable, any degree of continued sales will force the USDA to raise the estimate for annual shipments once again in the June crop report.

The chink in the armor of the seemingly powerful export market is that shipments are a bit weak. Last year at this time US exporters had shipped 90% of final sales, whereas this year that figure is 85%. This leaves commitments vulnerable to cancellations. In fact, there have been stories circulating that China is getting ready to cancel some old-crop soybean shipments from the US in favor of switching to significantly lower-priced new crop South American origins. In any case, the commitment data are only a week old when they are reported, and it's hard to believe that the Chinese would be loading up only to turn around and cancel orders.

Another potential bearish factor that's been talked about and that could explain the market's weakness is traders'

belief that the USDA may have underestimated 2012-13 soybean acreage. Charts 4 and 5 show that soybean prices have been much stronger than corn or cotton. However, soybean planting progress has moved at a torrid pace and is nearly complete. Most of the crop was in the ground before farmers could take advantage by switching crops.

Finally, rounding out the bear case, some estimates for the battered South American crops have improved in recent days.

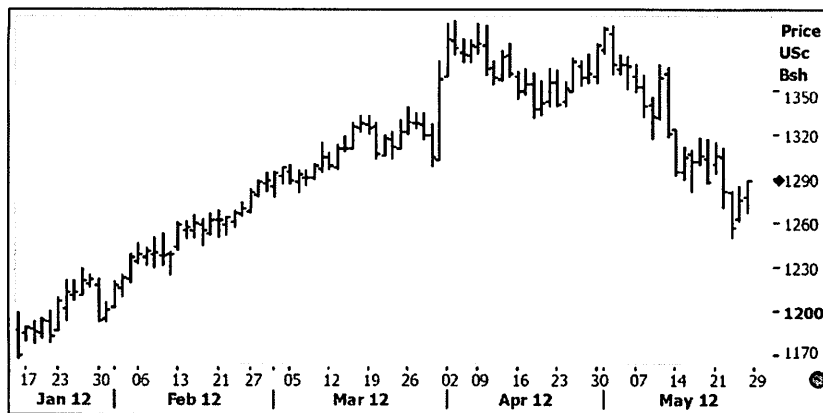
Nevertheless, the hard fact is that we're limping out of one season that is ending with a dangerously low carryover into yet another, as illustrated above. The bearish factors,

even if all are realized, will not significantly change the world balance, which is going to have a sizeable drawdown in ending stocks for 2011-12. Global ending stocks were revised downwards in the May crop report, to 20.9% of usage, down from the April estimate of 22.4%, and compared with 27.5% in 2010-11.

All commodities are taking it on the chin, and the prices of some with basically bullish fundamentals are affected as well. We believe soybean prices should move back up to the highs and beyond.

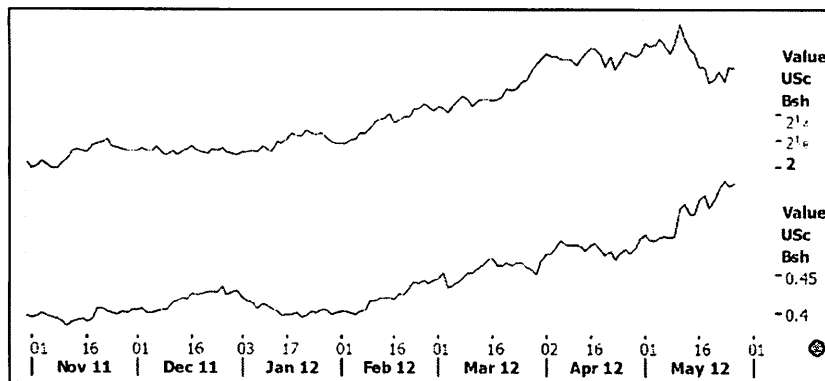
Buy November soybeans. Place initial stops at \$1,250 per bushel, close only. [May 25, 2012]

Chart 3 – November soybeans



Courtesy Reuters

Chart 4 & 5 –
Chart 4 (top) Soybean/corn ratio,
Chart 5 (bottom) Soybean/cotton ratio



Courtesy Reuters

SUGAR**Falling prices do not square
with bullish fundamentals**

Commodity prices have taken a severe beating. A sputtering US recovery, a weak outlook for the Chinese economy, and fear of contagion resulting from the ongoing European debt crisis sparked a selloff in the stock market. The Dow Jones Industrial Average tumbled by 10% since it peaked in early May and – save for gold – the selling extended to virtually all other markets.

True, some markets that rely heavily on Chinese imports could see a direct impact from shrinking demand. However, amidst their zeal to liquidate increasingly painful long positions, in some cases, and to get on board with what seems to be the new downtrend in commodities, in others, funds and individual traders have perhaps ignored the fundamentals of some markets.

To illustrate, Chart 6 shows that open interest in sugar jumped to two-year highs over the past couple of months, while the sizeable net-long speculative position swung to a net-short position. We believe that the selling pressure in the sugar market overshot basically bullish fundamentals.

Thai production skyrocketed over the past few seasons. Normally a producer of 6 million to 7 million tonnes, output shot up to 9.5 million tonnes in 2010-11 and then to 10.5 million tonnes in 2011-12. Early estimates for 2012-13 are just shy of 11 million tonnes. Domestic consumption is about 2 million tonnes, and the rest of the crop is exported. Unless a weather problem pops up, the addition of 3 to 4 million tonnes to the pool of available sugar for world trade is a permanently bearish factor.

While India also helped “save” the market from sloppy Brazilian output (more on that later) by exporting close to 3 million tonnes in 2011-12, the situation is much different than in Thailand. Indian domestic consumption is the largest in the world. The 22-million to 23-million-tonne estimate that has been used in calculating Indian ending stocks is probably stagnant. In the May 2012 edition of its bi-annual survey *Sugar: World Markets and Trade*, the USDA lists Indian domestic consumption for 2011-12 at 25.5 million tonnes, up from

23.5 million tonnes in 2010-11. The forecast for the upcoming 2012-13 marketing year is 26.5 million tonnes.

As we’ve pointed out in the past, because of extremely high per capita consumption, the government has maintained policies intended to keep the domestic market comfortably supplied. Before the devastating drought years of 2008-09 and 2009-10, ending stock levels were typically over 50% of usage. Now, because of the liberal export policy, inventories hover around 25% of usage. We’re at the beginning of the key monsoon season – the key to Indian agriculture – and over the past week, the rains were 30% below the 50-year average. While it is still early, it underscores the fact that India leaves itself vulnerable by running its stocks too low. India cannot be considered a reliable exporter.

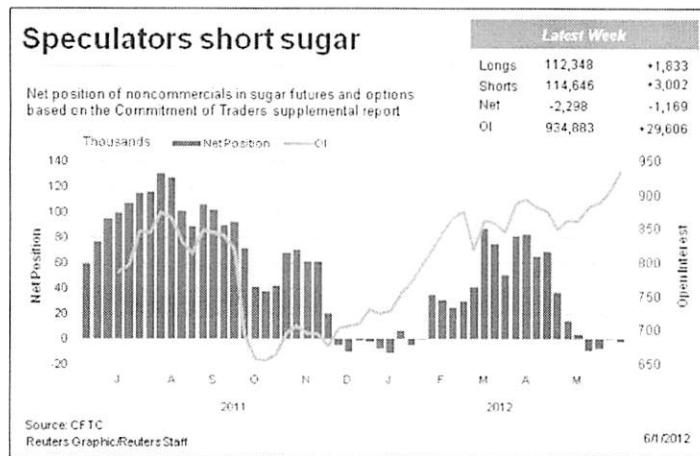
Recent developments in Brazil, however, have given the bullish case more immediacy. As recently as one month ago, 2012-13 Brazilian output was expected to recover from the current season’s drop in production – the first in a decade. Excessive El Niño related rains, however, have quashed any hope of an improved crop. Some recent estimates actually put production in the center-south output region, which accounts for 90% of Brazil’s crop, below last year’s levels.

Forecasts for output and exports vary wildly, but both have been dropping. Some estimates put export availability as low as 20 million tonnes, down from estimates for 2011-12 that according to some analysts were as high as 24 million tonnes.

The International Sugar Organization (ISO) forecasts that the 2012-13 global surplus will fall to 3 million tonnes from 6.5 million tonnes in 2011-12. Although the early-May ISO estimate anticipated deteriorating weather conditions in Brazil, it seems that conditions are even worse than expected. As a result, the global balance is probably closer to a balanced market.

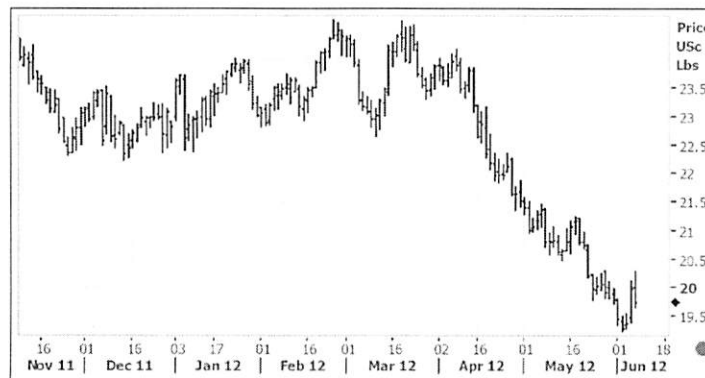
We were stopped out of our long position in May sugar at 23¢ per pound. We recommend re-establishing long positions in October sugar, using a 19¢ per pound stop, close only. [June 7, 2012]

Chart 6 – ICE sugar open interest and CFTC net position



Courtesy Reuters

Chart 7 – October sugar



Courtesy Reuters

WHEAT

A complacent market despite FSU crop failure

While most commodities have been falling to multi-month or multi-year lows, the wheat market bucked the trend and went on something of a wild bender. In mid-May wheat prices rallied by over \$1 per bushel in the space of just five sessions. The rally came unglued over the next two weeks, erasing just about the entire advance (Chart 8).

The reason for the rally was a series of production-related problems for both maturing Northern Hemisphere crops and soon-to-be planted Southern Hemisphere crops.

Very hot weather and strong winds in the US Plains suddenly threatened what was expected to be a bumper crop. The most recent USDA weekly progress report shows that the good-to-excellent portion of the crop fell to 52%,

from 54% the previous week. Just a few weeks earlier, that figure had been 60%.

The news from the FSU wasn't really news at all. Drought and frosts wreaked havoc with wheat crops, particularly in the Ukraine and Kazakhstan well back in February and was documented in *Focus on Futures* on April 30.

Recent estimates put the 2012-13 Ukrainian crop as low as 12 million tonnes, down from 22 million tonnes in 2011-12. That's below the USDA May estimate of 13 million tonnes. The USDA estimates that exports will fall by only 1 million tonnes, to 4 million tonnes. For that matter, the Agriculture minister claims that exports will remain at last year's level. Last year's domestic food and feed usage

was close to 15 million tonnes. Supplies for the domestic market will have to be compromised to accomplish maintaining exports at any level. That is one possibility. The other is that the government will restrict exports – although government officials say they intend to honor all export commitments.

The USDA estimates Kazakhstan production at 15 million tonnes, down from 23 million tonnes in 2011-12. Exports are estimated to fall by only 2 million tonnes, though, to 8.5 million tonnes.

Maintaining historical export levels helps to stabilize global markets. The depletion of ending stocks, however, may just be delaying a supply shock down the road if there is a weather-related crop failure in another major production/exporting region.

Yields in Russia are said to have been affected by the same weather patterns, but all analysts, including the USDA, estimate that total output was not impacted materially and that output will be the same as last year's 56 million tonnes.

In the Southern Hemisphere, key exporter Argentina is reducing its wheat area by 17.5% over 2011-12. Farmers have been shifting to crops that are not vulnerable to export restrictions. To boot, estimates for the already smaller crop

have been reduced due to poor planting weather.

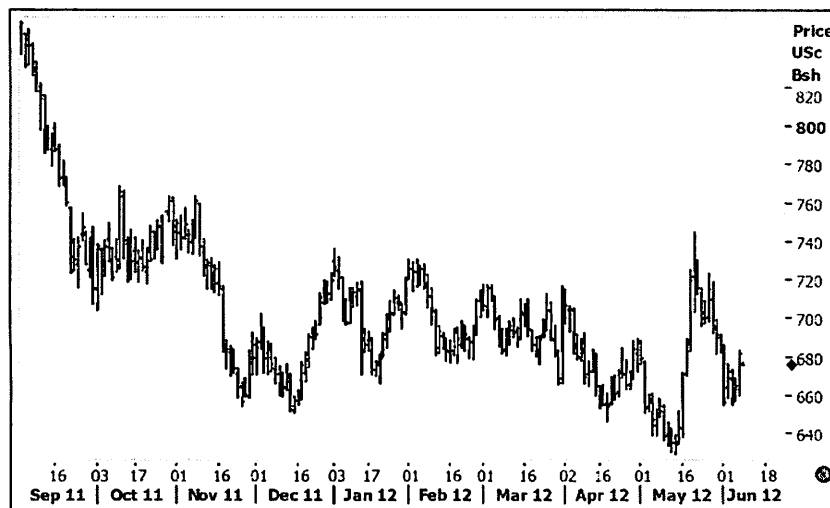
A similar situation is developing in Australia as the planting season gets underway. Based on smaller wheat area, the crop was estimated at 26 million tonnes, down from 29.5 million tonnes in 2011-12. Dry weather now threatens yields, and early estimates have now fallen to 25 million tonnes.

The USDA's first comprehensive look at the 2012-13 crop year accounted for most of the supply issues cited above. Global ending stocks are estimated at 188 million tonnes, or 27.4% of consumption, down from 28.4% in 2011-12 and 30% in 2010-11. That's still a fairly well-supplied market when compared with global inventory levels that sank as low as 20% of usage in 2007-08 and that sparked the bull market.

There are supply problems or potential thereof in almost all major producing countries. We were stopped out of our long position in December wheat at \$6.40 per bushel, as per our April 30 recommendation. That was the low. We still believe that this market has major upside potential. Buy December wheat and use the same stop. Alternatively, roll our highly profitable spread of long July wheat/short July corn to September.

[June 7, 2012]

Chart 8 – December wheat



Courtesy Reuters

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