FRIEDBERG'S
FOCUS ON FUTURES

Friedberg Mercantile Group Ltd. Volume 21, No. 4 May 31, 2018

Sugar: a spike for Indian output

Sugar prices have plummeted to two-and-a-half year lows (Chart 1). Two newsworthy developments emerged over the past several weeks – one bearish, and one bullish:

India – bearish

In the early stages of the Indian crush, which began late last year, estimates for the 2017-18 season were calling for a recovery from the disastrous 2016-17 crop that yielded only 20 million tonnes of sugar, to 26 million tonnes. In February both government sources and private analysts were still working with estimates that ranged between 25 and 27 million tonnes. In early March, estimates started climbing, first to 29.5 million tonnes, then to 30.3 million tonnes.

Clearly, yields were far greater than first believed, moving the 2017-18 Indian balance sheet from a balanced market to a 4-million-tonne surplus. The effect on world trade will be felt. The government has eliminated a 20% export tax and implemented measures to force export of between 2 and 4 million tonnes, further increasing the pool of available global supplies. Estimates for a global surplus of 10.5 million tonnes have ballooned to 15 million tonnes.

Brazil – bullish

While the surge in Indian output portends much lower sugar prices, the situation in Brazil looks a whole lot different. The Brazilian marketing year ends in March, as mills start crushing for the 2018-19 season in April. Final output numbers for 2017-18 were 36.05 million tonnes for the Center-South where over 90% of sugar is produced.

Forecasts for the current year range between 30 and 31.5 million tonnes. Analysts expect a massive shift to ethanol production mainly because with the sharp drop in sugar prices, ethanol profitability is as much as 25% higher than that of sugar.

In 2017-18 the ethanol/sugar output ratio was 53.5/46.5. It is very premature to make any projections based on early results, but consider that in the first few weeks of processing the new crop, 78% of cane was diverted to ethanol output.

So while the Indian surprise is kind of ugly for bulls, it may be totally mitigated by a plunge in Brazilian output. And the longer sugar prices remain weak, the longer the ethanol/sugar output ratio will remain strong.

China continues to be somewhat of an enigma for the sugar market. Until the 2013-14 season, China was near self-sufficient. Then annual production dropped by about 4 million tonnes and has not recovered since, averaging about 10 million tonnes. Domestic consumption has grown steadily and is now close to 16 million tonnes.

Imports grew to as high as 6 million tonnes in 2015-16, but have tapered off. In calendar 2017 imports fell to just over 2 million tonnes. According to government announcements, the import regime is restrictive with the goal of protecting local sugar growers, but the numbers do not add up. If carryover stocks are being depleted, sooner or later China will become a significant demand force.

Frankly, we did not see the gargantuan upward revision to Indian production coming. Looking forward, the monsoon season begins in June, and early forecasts are calling for a normal amount of rainfall. But until that happens, 2018-19 output remains a variable factor. At least 65% of Indian crops rely solely on rainfall, so in order to maintain these production levels into next year, the monsoon rains are crucial.

Commodity funds have flooded onto the short side. Open interest has almost doubled over the past six months, to over 1.1 million contracts, and the net short position has grown to 170,000 contracts (Chart 2). Most of the selling was done below 13.5¢ per pound. So the funds have some vulnerability to any bullish developments.

On January 19 we recommended rolling existing long

Inside

Soybeans: Will prices rise? 2
Corn: Not enough 4
Cocoa: Lights out for the bull 5

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.

©2018 by Friedberg Mercantile Group Ltd. Reproduction in whole or in part prohibited.

call option positions to March 17¢ calls, which have since lost about two thirds of their value. We suggest not committing any new funds to this position at this time. Do keep an eye on the Brazilian ethanol/sugar ratio as the 2018-19 crush moves into full swing.

[By Sholom Sanik, April 11, 2018]

Chart 1 – July sugar

Chart courtesy Reuters

Chart 2 – CFTC net-long position (bar), open interest (line)

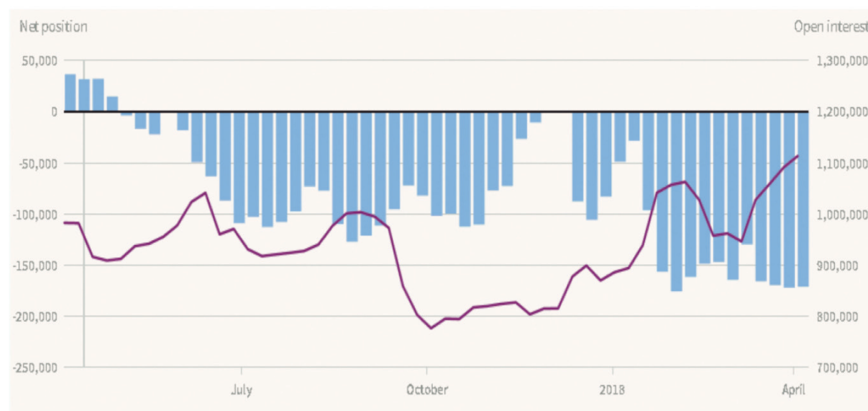

Chart courtesy Reuters

SOYBEANS

Argentinean soybean estimates continue to shrink, but are higher prices in the offing?

The problems with the 2017-18 Argentinean soybean crop were first addressed in earnest in mid-February. By mid-March, new-crop US soybean prices rose by as much as 80¢ per bushel, to $10.60. Crop estimates have fallen steadily, but prices have consolidated and – thus far, anyway – have not been able to surpass the March highs (Chart 3).

Before drought ravaged the crop, early-season forecasts called for production of 57 million tonnes, just slightly below 2016-17. The USDA April crop report dropped its estimate to 40 million tonnes. One estimate now puts the crop at 37.6 million tonnes. On March 22 we wrote: "...history has shown that analysts get a bit carried away and paint a very worst-case scenario." More than half the crop has been harvested, however, so it seems as though the bleak outlook will hold.

Actually, the March 29 acreage report sparked the largest one-day rally for this entire bull run. Analysts were expecting an increase in US planted area from 2017-18 levels and were emboldened by the fact that prices were rising during the farmer survey period. The average of analysts' estimates was 91.056 acres, up from 90.142 million acres a year earlier. The actual figure came in at 88.9862 million acres. Using a 50-bushel-per-acre yield, that works out to just over 2.5 million tonnes fewer soybeans than were expected.

©2018 by Friedberg Mercantile Group Ltd. Reproduction in whole or in part prohibited.

In the grand scheme, when compared with a 20-million-tonne drop in Argentina, it was small change. Indeed, over the following week the market plunged by 40¢ per bushel, erasing the entire "acreage" rally. Analysts believe that the USDA acreage estimate was indeed understated and that we will see upward revisions going forward. Traders then returned to worrying about Argentina, with several tests of the highs.

The Trump Administration's imposition of tariffs on Chinese imports has prompted China to threaten import tariffs on soybean shipments to China. Chinese buyers who do not want to run the risk of paying the tariffs have turned to Brazil and others. US sales to China – shipped and unshipped – stand at 28.86 million tonnes, compared with 35.72 million tonnes last year at this time. New sales have all but ground to a halt.

The loss of Argentinean exportable surplus spruced up the US export balance sheet. Total commitments to all countries are only 3.3% behind last year, compared with the USDA estimate that we will finish the year 5% lower. But with China out of the picture, that will not last for long. We expect the USDA to trim its forecast in the May crop report. To illustrate, consider that according to Chinese customs data, imports from the US in March were down 26.6% year-over-year, while Brazilian purchases were 33% higher. The April customs data promise to be even more stark.

As noted above, the consensus of estimates for Argentina is roughly 2.5 million tonnes below the USDA's April estimate. After deducting this amount from global ending stocks, inventories as a percentage of usage would be 25.8%, down from the April estimate of 26.5%. That compares with 29.4% in 2016-17, but still higher than 25% in 2015-16. Average carryout in the five years prior was 25.34%, a period in which farmers responded to high prices and drove the market down to $8.50 per bushel from $17 per bushel (Chart 4). Hardly a tight market. The years of plenty have insulated the soybean market.

The big variable will soon become US weather. Only 2% of the crop has been planted, down from 9% last year at this time and compared with a 5-year average of 5%. But it is much too early to even consider discussion of planting progress.

The Argentinean crop failure is very much "in the market," and prices have now traded in a range for about two months. By the same token, between Argentina and a potentially smaller US crop, there is upside vulnerability. We suggest liquidation of the long position in November $10 puts, which are currently trading at roughly the same price as when we recommended the position on March 22. Stand aside.

[By Sholom Sanik, May 4, 2018]

Chart 3 – November soybeans

Chart courtesy Reuters

Chart 4 – Weekly nearest contract soybeans

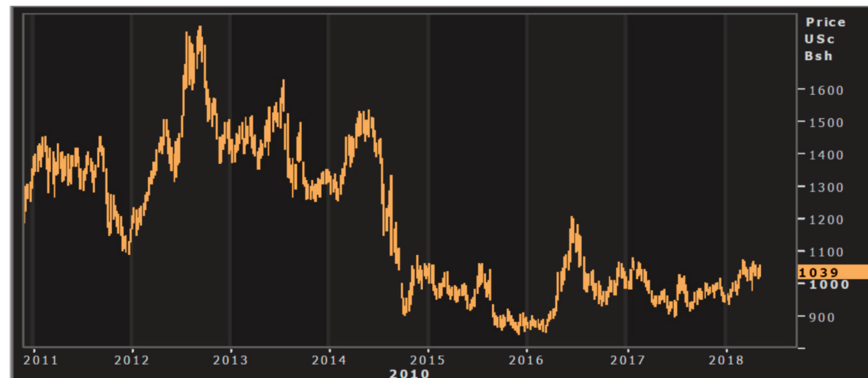

Chart courtesy Reuters

©2018 by Friedberg Mercantile Group Ltd. Reproduction in whole or in part prohibited.

CORN

Can't seem to grow enough

On May 10 the USDA issued its first comprehensive outlook for the 2018-19 marketing year.

US

For the US, production held no surprises. New-crop acreage was based on the March 29 planting intentions. Yield of 174 bushels per acre (bpa) was the standard conservative early-season forecast, 2.6 bpa below last year's record 176.6 bpa. Wet planting conditions have impeded planting progress in recent years. This year, however, farmers have whisked right through the planting season. As of the most recent weekly report, 81% of the crop had been planted, compared with 82% last year at this time, and a five-year average of 81%.

The surprise was on the demand side, with domestic feed and export demand forecast to fall below last year. The only domestic demand category expected to rise is ethanol. As a result, US ending stocks were 50.4 million bushels above the average of analysts' guesstimates. The market sold off for a few days.

Global

The global picture, however, was clearly bullish. Although it came as no big surprise, the single largest revision was a 5-million-tonne reduction for the estimate of the 2017-18 Brazilian crop that is currently being harvested, to 87 million tonnes.

Even with reduced area for the US – the world's largest corn grower – global production is forecast to be the second largest on record at 1.056 billion tonnes.

Brazil and Argentina are expected to return to trendline production, with crops of 96 million tonnes and 41 million tonnes, respectively, compared with 87 million tonnes and 33 million tonnes in 2017-18. But it is absurdly early to talk about 2018-19 Southern Hemisphere crops, which are not planted until October.

Northern Hemisphere forecasts are more realistic because they are based on spring planting estimates. Chinese output will jump 10 million tonnes, to a record 225 million tonnes. China continues to be irrelevant for world trade because it remains almost completely self-sufficient in corn.

FSU production is expected to rise by 10 million tonnes, to 53.5 million tonnes, adding 7 million tonnes to the pool of available export supplies.

Consumption is growing at a faster pace, though, resulting in a balance sheet that shows a gaping spread between global production and consumption. The new season will mark the second consecutive season of production/consumption deficits. We've moved from an 18-million-tonne surplus in 2016-17 to a 33-million-tonne deficit in the outgoing 2017-18 marketing year. The USDA is forecasting a 35-million-tonne deficit for 2018-19. The May estimate for global ending stocks is 159 million tonnes, or 14.5% of consumption, down from 18.5% in 2017-18. That would be the lowest carryout in seven years.

There are two important variables, both leaning to the bearish side at the moment. Of course, the weather in the US is one. As mentioned above, the USDA has kicked off the season with a 174 bpa yield estimate, which should grow easily with normal weather. So we'd place that in the bearish camp until proven otherwise.

Then there are US exports. The 53.3-million-tonne estimate for 2018-19 may be based on recent sloppy sales and shipments for the old crop. Total commitments for 2017-18 stand at 53.4 million tonnes, slightly ahead of 2016-17 at this juncture of the season, but exporters have shipped only 35.6 million tonnes compared with 40.5 million tonnes a year earlier. So the pessimism for new-crop exports is understandable.

In conclusion, there is some room for an uptick in global ending stocks. We can't ignore, however, that corn-growing nations have not been able to match the growth in demand. Stocks will continue to be drawn down even if we do get great crops going forward.

Remain long July corn as per our October 4, 2017, recommendation. Raise stops to $3.85 per bushel, close only.

[By Sholom Sanik, May 25, 2018]

Chart 5 – July corn

Chart courtesy Reuters

©2018 by Friedberg Mercantile Group Ltd. Reproduction in whole or in part prohibited.

COCOA

Lights out for the bull

After a meteoric rise that saw cocoa prices gain $1,100 per tonne, or 60%, over the past six months, the market has set back by $400 per tonne (Chart 6). Has the bull tired?

Supply

The powerful rally began when it seemed that 2017-18 Ivorian output would lag the previous season's record of just over 2 million tonnes by a wide margin. Most recently, 2017-18 arrivals stand at 1.672 million tonnes, 49,000 tonnes behind last year. The gap keeps shrinking.

As we progress through the mid-crop, weekly volumes have generally been higher than last year. In the most recent reporting period, arrivals at the two ports at Abidjan and San Pedro totaled 38,000 tonnes, up from 22,000 in the comparable period last year. So there is still a decent chance we can see total output get very close to last year's final numbers. At this rate, there is even a possibility that we could exceed last year's output.

In 2016-17 Ghana, the world's second-largest cocoa producer, yielded a record crop of over 950,000 tonnes. Early this season, weather forecasts were not favorable. The government estimate was about 800,000 tonnes, but as the season wore on, improved conditions prompted analysts to raise estimates for Ghana as well. Weekly reports are not available as they are for the Ivory Coast, but the decline in prices is certainly related.

Demand

At least part of the strength in the market was related to anticipation that demand would grow. Indeed, first-quarter grind statistics were respectable for the most part. The Asian grind grew by 7.2%, year-over-year. It was the largest grind since the first quarter of 2011. Europe was up 5.5%, while the Ivory coast gained 2%. North American activity was a disappointment, down 1.1%.

We're not confident that strong grinding activity is sustainable. Product prices had increased, and the theory was that processors would buy more beans as profitability expanded. The principal indicator for demand is the price of cocoa butter, which is measured as a ratio of the London spot price. From mid-2017 through the end of the year, the ratio moved up from 2.5 times the bean price to 3.5 (Chart 7). That window is closing though. Over the past few months the ratio has fallen to 2.9. Powder prices had firmed as well, but they too have set back. So going forward, it will be a challenge to see the first quarter grind results repeated in the second-quarter.

The facts show that the supply/demand fundamentals are just not as bullish as they have been. With a second consecutive year of bumper harvests in the Ivory Coast and uncertainty surrounding demand, the market has become overpriced. As evidence that there are no shortages, consider that the market was in a full backwardation – briefly – one month ago, but the July-December spread has collapsed into contango (Chart 8).

It is interesting to note that bullish fund managers have barely budged from their exuberance. Chart 9 shows the fund net-long position. Over the past few weeks the huge position has stopped growing, but at some point – sooner rather than later, we believe – liquidation will commence.

Liquidate long July cocoa positions. Establish short positions in December cocoa, currently trading just below $2,800 per tonne. Place initial buy stops at $2,600, close only.

[By Sholom Sanik, May 30, 2018]

Chart 6 – July cocoa

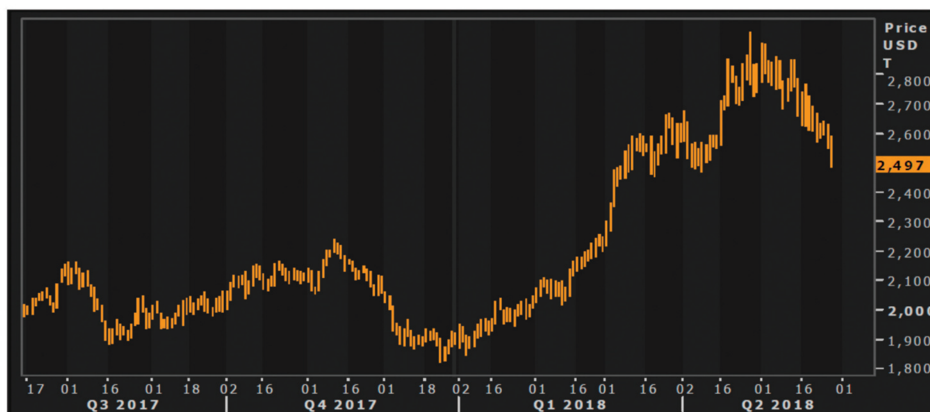

Chart courtesy Reuters

©2018 by Friedberg Mercantile Group Ltd. Reproduction in whole or in part prohibited.

Chart 7 – Cocoa butter/beans ratio

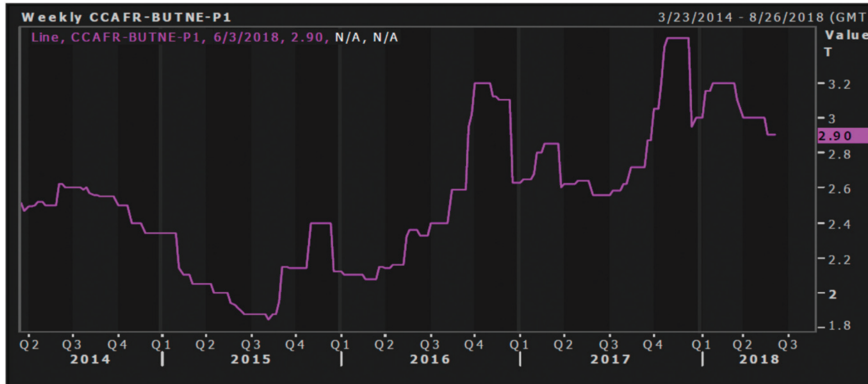

Chart courtesy Reuters

Chart 8 – ICE cocoa July/December spread

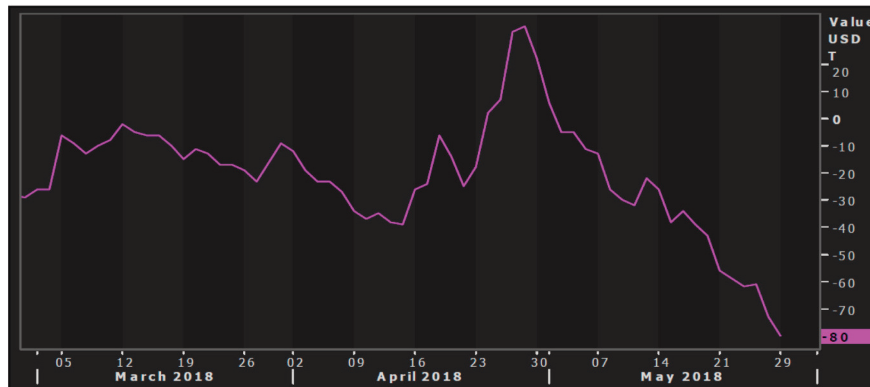

Chart courtesy Reuters

Chart 9 – CFTC commodity fund net-long position

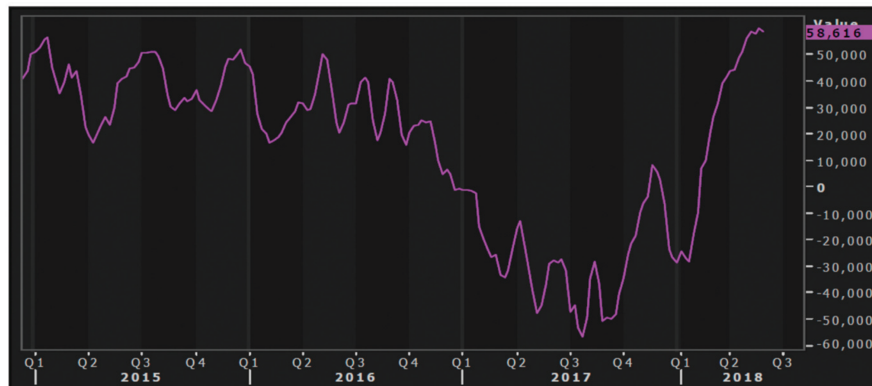

Chart courtesy Reuters

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 © 2018 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.

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

Futures and options trading is speculative and involves risk of loss. Past trading results are not indicative of future profits. This report is a solicitation for entering into a derivatives transaction. The author of this report may have a position in the underlying derivative securities mentioned in this report. The information in this report was obtained from sources we believe to be reliable but is not guaranteed by Friedberg Mercantile Group Ltd. or its affiliates. Derivatives are high-risk investments, and there can be no assurances that the securities mentioned or recommended will maintain their value at a constant amount or that the full amount of your investment will be returned to you. Derivatives' values change frequently and past performance may not be repeated.