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Wheat: crop problems galore

Northern Hemisphere winter wheat crops for the upcoming 2016-17 marketing year are currently being planted, and 2015-16 Southern Hemisphere crops are growing. In keeping with the broad bear market in commodities, wheat prices fell to multi-year lows in early September, but have been trending upwards as weather problems have emerged in both hemispheres.

Most attention has been focused on FSU exporting countries. Dry weather in the Ukraine will limit winter wheat acreage planting. There is a wide range of estimates – from between 10% to 30% below last year's planted area. Most recently, the weather has been unseasonably warm, which resulted in extending the planting window through the end of October.

The agriculture ministry and the trade unions typically set the amount of wheat available for export, but they have delayed the decision due to the uncertainty surrounding the size of the crop.

Similarly, but not nearly as severe, Russian planting was hampered by dry weather. Planting progress is about 5% behind the same time last year.

Dry soil conditions in the US have been of some concern as well. Planting progress has been steady. The most recent USDA weekly progress report shows that 83% of the crop has been planted, the same as last year. However, the first crop-condition estimate of the season put the good-to-excellent portion of the crop at only 47%, down from 59% last year. Traders were expecting a much higher figure of 55%. This added to the bullish tone.

El Niño was both beneficial and subsequently harmful for the Australian crop. During the early growing stages, there was ample rainfall, resulting in forecasts for a near-record crop. Then the weather turned extremely dry, and output estimates dropped. The USDA is well behind with its estimate. The October crop report raised output by 1 million tonnes, to 27 million tonnes, but its Australian counterpart ABARES recently revised its estimate down to

24 million tonnes.

Rounding out the list of wheat exporters who will produce a smaller crop than in 2014-15 is Argentina. A drop in planted area and drought will combine to yield a crop of only 9.5 million tonnes, down from 11.75 million tonnes in the previous season. The USDA lowered its estimate by 500,000 tonnes, to 10.5 million tonnes, but there should be a further downward revision.

This information all seems to explain why wheat prices have been firming, and while we seem to be heading in the direction of building a bullish case, we are not.

Global ending stocks for 2014-15 were 30% of consumption, close to the high end of the 10-year range. The bull market of recent years certainly performed its function of incentivizing farmers to plant a lot of wheat.

The current USDA forecast for 2015-16 is for a further jump to 31.9%. With the crop problems for the soon-to-be harvested Southern Hemisphere crops discussed above, we do not believe that this will be achieved. And with the uncertainty surrounding the Northern Hemisphere crops, the outlook for 2016-17 is not much better. Nevertheless, the years of stock building should leave the world amply supplied with wheat. The rally will run out of steam.

For now we recommend observing this market from the sidelines. *[Sholom Sanik, October 30, 2015]*

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NOTE: In the first draft of this article, which was e-mailed to subscribers on October 30, we pointed out erroneously that USDA estimates for FSU 2016-17 winter wheat crops that are being planted this autumn were too high. In fact, the information contained in the November USDA crop report was for the already-harvested 2015-16

crops. The USDA has not published any estimates for the 2016-17 crops. We sincerely regret this oversight and apologize for any confusion that may have resulted. This revised article deleted all references to this comparison.

[By Sholom Sanik, November 18, 2015]

Chart 1 – December wheat



Courtesy Reuters

SOYBEANS

Brazilian soy crops spike, but US exports revive

As falling prices have squeezed profit margins, production for many commodities has been sagging. Not so for soybeans. Brazilian farmers continue to expand planted area. For the 2015-16 crop that is currently being seeded, the USDA's October crop report showed a revised estimate of 100 million tonnes, an increase of 3 million tonnes from the September estimate, and a record high. That compares with 96.2 million tonnes and 86.7 million tonnes in 2014-15 and 2013-14, respectively. One forecaster's estimate puts the crop as high 102 million tonnes.

It is early, though, and most of the crop has yet to be planted. To achieve this extraordinary target, weather must cooperate. Thus far, only 31% of the crop has been planted, compared with the five-year average of 42%. Much-

needed rain appeared near the end of October, but was scarce until then.

Soy area in Argentina is expected to be slightly smaller than in 2014-15. Early estimates for the 2015-16 marketing year call for output of 57 million tonnes, compared with 60.8 million tonnes the previous season.

With the US harvest almost complete, the USDA was expected to lower its estimate for US planted acreage in the October crop report, but the cut was deeper than expected. This resulted in a downward revision to the crop of 1.3 million tonnes, to 105.8 million tonnes, but still just shy of last year's record crop of 106.88 million tonnes.

Even with lower output in the US and Argentina, global production will reach 320.5 million tonnes, 1.5 million

tonnes higher than in 2014-15. Consumption, on the other hand, is expected to jump by 12 million tonnes, to 310.5 million tonnes. The production/consumption surplus will narrow materially, but will still be large enough to tack on an additional 10 million tonnes to global ending stocks, bringing the stocks-to-consumption ratio to 27.4%, the highest level since the 2010-11 marketing year.

With massive supplies becoming available from South America in the spring and a near-record crop being harvested in the US, a bearish case would seem natural. And up until a month ago, the demand side of the equation did not provide much support.

US bean exports were sluggish from the beginning of the marketing year. By early October, commitments were running about 30% below the same time in 2014-15, compared with the USDA forecast for annual sales that would be only 6% behind the previous season. New sales, however, have increased steadily for each weekly reporting period since then. As of the most recent weekly report, commitments are still 20% behind a year earlier, but the gap has narrowed.

For many commodities, an economic slowdown in China could mean shrinking imports – particularly for industrial materials. But the Chinese grow only a bit more than 10% of

their annual consumption needs and therefore typically account for about 65% of world trade. Perhaps the turmoil surrounding the yuan devaluation delayed some purchases, but ultimately, stronger Chinese buying should emerge.

South American competition will continue to be a growing factor for US exporters, but in the short term, there will be no fresh supplies available from Brazil and Argentina for at least four months. So we expect the trend of improving US sales to be maintained.

With the overhang of South American beans coming to market, there is definitely a bearish bias. Still, the crop is not even in the ground yet, and with a long season ahead, it is impossible to predict the weather. There have been years in which crops in Brazil and Argentina did not meet early exuberant forecasts.

In conclusion, prices have been moving sideways since August. There are two variables at work. The improved pace of US sales has averted a demand disaster, which at one point seemed to be a possibility. Then, even if demand continues to grow, South American bumper crops would overwhelm increasing consumption. Until there is some clarity for either of these factors, we recommend observing from the sidelines.

[By Sholom Sanik, November 4, 2015]

Chart 2 – December soybeans



Courtesy Reuters

SUGAR

The sugar bull charges ahead as Indian and Brazilian output fall short of targets

After dropping perilously close to the 10¢-per-pound level in late August, the sugar market spiked to over 15¢ per pound (Chart 3). After five consecutive years of global production/consumption surpluses, the 2015-16 marketing year is shaping up for a deficit. One recent estimate puts the deficit at 5.6 million tonnes.

There have been several developments in the supply/demand fundamentals over the past few weeks that have underpinned the rise in prices.

In the 2014-15 marketing year, Indian exports totaled less than one million tonnes. The announcement back in September that the government would push mills to export four million tonnes of sugar during the 2015-16 season put a damper on the market. However, as we pointed out in our most recent article on sugar (see *Focus on Futures*, October 14), the program never had much chance of succeeding – certainly not without subsidies and a substantial rally that would make economic sense. The subsidies have not materialized, and prices are not quite high enough.

Moreover, as the crushing season has begun and early output results are filtering in, the forecasts for record output have been pared back. Maharashtra is the largest production state in India. Last year it accounted for close to 40% of Indian output. The weak monsoon hit growing regions in Maharashtra the hardest, and as a result, production will be down about 20% over the previous season. Plantations in other areas were impacted as well, but to a lesser degree.

The government forecast for total Indian output has dropped to 26 million tonnes from 29 million tonnes, with

private-forecaster estimates coming below 26 million tonnes. At that level, we are closing in on the domestic consumption figure. Whatever Indian surplus there may have been is shrinking quickly.

The effects of the weak monsoon may have even deeper implications. The dry soil is likely to keep yields low through the next season as well. One analyst has forecast 2016-17 Indian output at below 24 million tonnes. At that point we would be looking at the possibility of domestic production/consumption deficits.

We therefore do not see India being an important factor in world trade, if at all – at least for the next two years.

In Brazil the 2015-16 crushing season is almost over, and recently released statistics provides further evidence that low prices are finally starting to impact production. To begin with, weather has not been cooperative. Excess humidity has lowered yields by about 7% from last year.

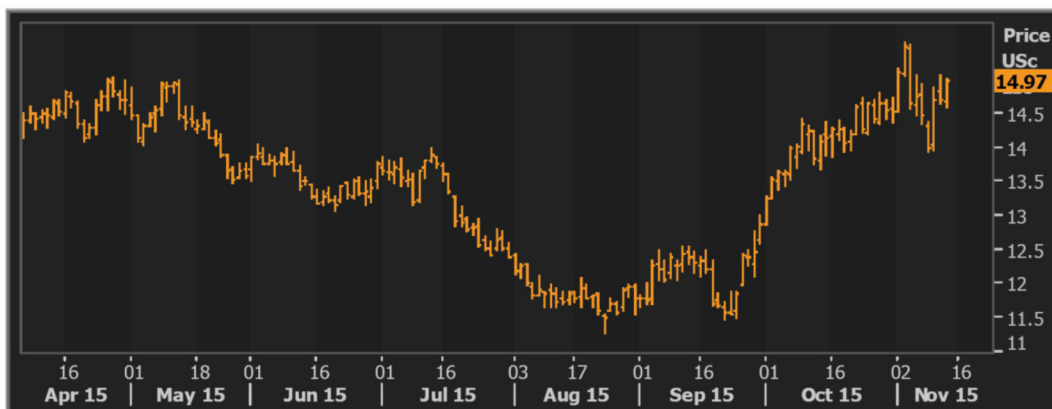
Ethanol production has been more profitable. The sugar/ethanol crushing ratio has fallen to 42.2%, compared with 43.4% at this time last year. Total Center South production stands at only 27.52 million tonnes, compared with 29.49 million tonnes at this time last year.

Commodity funds continue to pile onto the long side. CFTC data show that the net-long position has shot up to over 150,000 contracts, from a net-short position of 120,000 contracts in August (Chart 4). To be expected.

We believe the market has bottomed and that we will see considerably higher prices in the coming months. Hold on tightly to long call options.

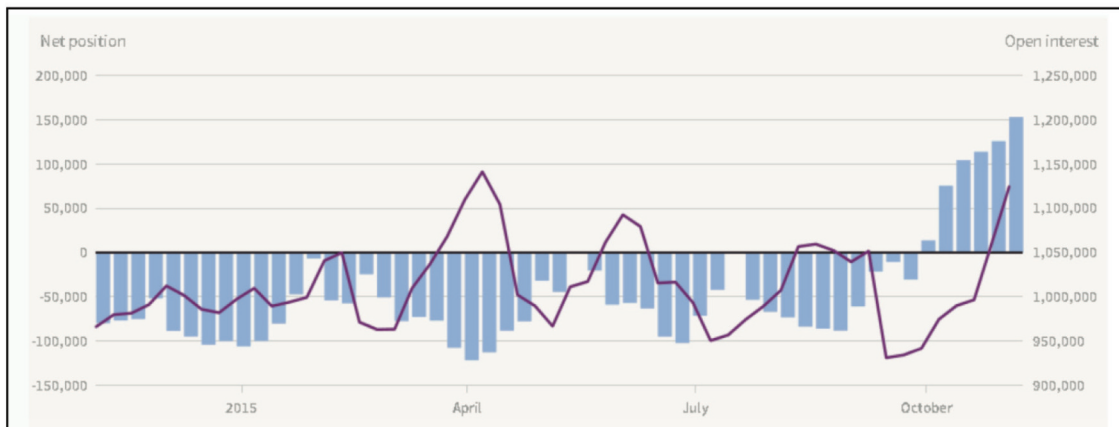
[By Sholom Sanik, November 12, 2015]

Chart 3 – March sugar



Courtesy Reuters

Chart 4 – CFTC commodity fund net-long position



CORN

US corn silos will be bursting at the seams

As the US corn harvest nears completion, the results are looking a whole lot better than they did several months ago. Despite planting the fewest amount of acres since the 2010-11 season, US farmers are expected to harvest 13.654 billion bushels (347 million tonnes), the third-largest crop on record. The bushel-per-acre (bpa) yield was revised upwards, to 169.3 bpa, from the October estimate of 168 bpa. That's just shy of last year's record yield of 171 bpa, and compared with early season forecasts that were as low as 166.8 bpa. The average of traders' guesstimates was 168.4 bpa.

On the demand side, the estimate for domestic feed usage was revised upwards by 25 million bushels, but the other two import categories were lowered. The era of rapid growth in ethanol demand has ended, but consumption was still growing at a moderate pace. News that the USDA lowered 2015-16 usage by 75 million bushels, coupled with a 50-million-bushel drop in the export estimate, overshadowed any improvement in feed demand.

All these surprising revisions contained in the November 10 monthly USDA crop report dragged corn prices down to fresh contract lows (Chart 5).

On the international front, global demand was revised downwards by 10 million tonnes, pushing the estimate for ending stocks up to 21.6% of consumption. That compares with 19.2% in 2014-15 and – if achieved – would be the largest carryover since 2002-03.

The USDA raised its estimate for the Argentinean crop to be harvested this coming spring by 1.6 million tonnes, to

25.6 million tonnes. One recent private estimate put the crop as low as 20 million tonnes. More telling is a November 6 USDA attaché report that puts output at 21 million tonnes.

There is an explanation, however, for the wide gap between estimates. A presidential election will be held on November 22. One of the candidates has promised to do away with the 23% export tax imposed on corn exports. In addition, if victorious, he plans on ending currency controls, which would amount to a *de facto* devaluation of the peso. Both measures would boost the competitiveness of Argentinean corn, which can be planted until mid-December.

The lower estimates are based on an anticipated sharp reduction in planted area, but, as illustrated, those planting intentions can change in a flash.

In any case, the potential for a smaller Argentinean crop is the single bullish component of an otherwise overwhelmingly bearish case.

The USDA lowered its forecast for 2015-16 exports by 1.3 million tonnes, to 45.7 million tonnes, down only 3% from the previous marketing year. However, the pace of export commitment has been absolutely dismal. Thus far, US exporters have contracted to sell only 13.7 million tonnes, down 30% from this time last year. And this is even before new-crop South American supplies become available.

Establish short positions in March corn, currently trading around \$3.70 per bushel. Place initial stops at \$4.15, close only.

[By Sholom Sanik, November 18, 2015]

Chart 5 – March corn



Courtesy Reuters

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