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More beans please!

Soybean prices pulled back a bit after a rally that saw the market rise by close to $3 per bushel since early August and have been consolidating.

On the supply side, most of the focus has been on the deterioration of the US crop. Estimates have shrunk consistently over the past several months, from a high of 78.5 million tonnes for the first estimate back in July, to the current, November, estimate of 66.73 million tonnes. We did not participate on the long side mainly because we kept rationalizing that whatever supply drawdown the market suffers as a result of a small US crop would handily be compensated for as South American supplies become available.

To get an idea of how we came to this unfortunate conclusion, consider the explosive soybean-crop growth in Brazil and Argentina (Table 1). A year ago we were musing how perhaps in a couple of years, combined Brazilian and Argentinean output would rival the US crop. Not only have we blown right past that mile marker, Brazilian production alone is catching up to US output. As recently as 1999-00, Brazil was growing less than half the beans grown in the US. If USDA forecasts hold up, the 2003-04 US crop will be only slightly more than 10% larger than Brazil's crop.

Table 1 - Soybean Production

millions of tonnes	**US**	**Brazil**	**Argentina**
1999-00	72	34	21
2000-01	75	39	28
2001-02	79	44	30
2002-03	75	53	36
2003-04	67	60	38

South American shipments peaked in the middle of this past summer, however, and obviously did not contribute very much in the way of alleviating the tight global supply/demand balance. With 95% of the US crop now harvested, we seem to have escaped any harvest pressure, and the market continues to trade near the highs even as US supplies are becoming available.

The balance sheet is probably even tighter than indicated by the USDA's November estimates. The forecast for US 2003-04 exports was raised a notch, to 24.22 million tonnes, but is still well below 2002-03 exports of 28.44 million tonnes. But the flow of weekly export commitments is going to make it increasingly difficult to defend this position. Last season we also anticipated cancellations that would trim the expectations of huge 2002-03 shipments indicated by export commitments, but those cancellations never came. US exporters shipped 98% of soybean commitments.

We've been putting some pretty impressive numbers on the board. The past two weeks saw record-size commitment tallies. This past week's figure of 1.8 million tonnes (1.5 million went to China) was a staggering amount. As of the most recent weekly export report, commitments stand at 16.25 million tonnes, compared with only 12.2 million tonnes at this juncture of the 2002-03 season. This means that US exporters have sold 67% of the USDA's total estimate for the year, compared with only 43% at this time last year. While we obviously are not going to see these kinds of figures for very long, the current annual estimate is only realistic if exports slow down to a trickle.

Naturally, USDA economists know all this, and they are forced into cutting annual export estimates. The US cannot possibly sell as many beans as it did last year, because it does not have that many beans. If export estimates were even close to last year's, 2003-04 US ending stocks – currently at 3.39 million tonnes – would have to be zero. Since this is unlikely

Inside

Unless otherwise indicated, all articles have been written by Sholom Sanik (E-mail: *ssanik@friedberg.com*).

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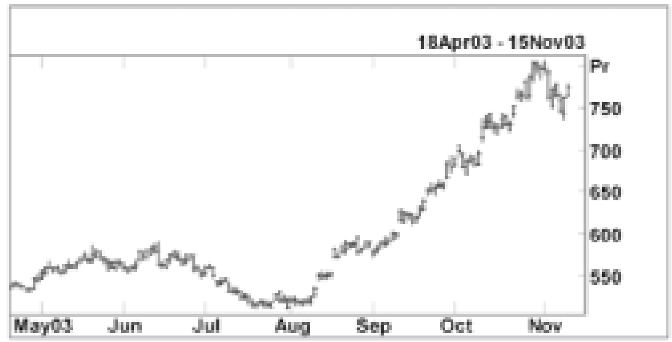
to happen, the USDA must assume that consumption will be rationed. At the moment, domestic crush margins are attractive, so we are not likely to see domestic consumption drop very much. It is therefore assumed that the rationing process will shift to the export side.

Anyway we look at it, this market has become as tight as a commodity can be. We're getting long at these lofty levels, and we're definitely latecomers. But considering that the US is on the verge of a historically anomalous situation – that of running out of a commodity – we believe that there may yet be ample profits left for bulls. *[Nov. 12, 2003]*

CURRENT STRATEGY: *Liquidated January soybeans as per Flash Update of November 19.*

Chart 1 – January soybeans



Courtesy Reuters

COTTON

What happened to the bull market?

After soaring to 8-year highs at the end of October, cotton prices have taken a nasty, 20¢-per-pound plunge. Has the supply/demand balance shifted dramatically enough to warrant such an about face?

In its November supply/demand situation report, the USDA increased its estimate for 2003-04 US production by 660,000 bales, to 18.22 million bales, well above both last month's 17.56-million-bale estimate and the average analyst's estimate of 17.78 million bales. Domestic consumption was lowered by 200,000 bales. Aside from these bearish items, however, the report continued to paint a bullish picture for the cotton market.

The USDA responded to the surge in export commitments by raising its estimate for annual US exports by 1.2 million bales, to a record 13.2 million bales. Last week's export report once again surprised traders with a much-higher-than-expected result. Polled analysts were looking for between 200,000 and 300,000 bales of net new sales, but the figure came in at 538,000 bales.

Also in the bullish column, the USDA confirmed the downward revision in the Chinese crop, lowering its forecast to 22 million bales from 25.5 million bales last month and from a season-high 27 million bales back in the summer. The street was looking at 22.5 million bales, so this should have been friendly for prices as well.

Global domestic consumption was revised downwards by 750,000 bales, but regardless, the drop in the size of the Chinese crop was large enough to cause a sharp drawdown in inventories. Global ending stocks were revised down by just over 2 million tonnes, to 31.66 million bales, or 32.4% of consumption, compared with last month's 34.3%. The new stocks-to-consumption ratio represents a fresh low for the marketing year.

So why has the market been so weak? For starters, commodity funds were holding an extraordinarily lopsided net-long position. The persistent buying that it took to build that position almost certainly exaggerated the fundamentals, bullish as they may be. The fact that the global supply/demand balance remains the tightest it's been in many years could not stop the inevitable liquidation that typically feeds on itself once it's in gear.

The market was 3 weeks and 10¢ per bushel into its correction when we received some genuinely bearish news. On November 18 the Bush Administration imposed import tariffs on Chinese textile products that would cap imports on a select list of goods at a 7.5% increase over last year's imports. This would be bearish – on the surface anyway – for two reasons. First, China would presumably need to import less cotton if it were going to sell less finished products to the US. Second, China might retaliate and find other sources for its shortfall or eat further into its already tight inventories.

The market continued to fall after this news was released. Indeed, the day after the announcement, the Chinese cancelled trips planned by purchasing groups that were scheduled to tour the US in late November to explore possibilities of buying cotton, wheat, and soybeans.

Overall, though, we believe that the bull market is not over. The emergence of some bearish developments understandably added fuel to a due-course correction that was already underway. We don't expect either of the two bearish fear factors surrounding the brewing trade battle between the US and China cited above to affect the global supply/demand balance materially.

The US move applies to just under 5% of all clothing and textile imports. As we pointed out above, the quota caps year-over-year growth in total shipments of the affected items at 7.5% and the quotas expire in one year. So while the unexpected aggressive maneuver is likely to upset some retailers in the US and an equal number of suppliers in China, the impact on the industry as a whole is minimal, assuming, of course, that the situation doesn't spiral out of control with several rounds of retaliatory moves by both parties. The countries will quibble in public for the benefit of the media, but beneath the headlines neither party wants to shoot itself in the foot and harm its own interests. There are very slim pickings when it comes to alternative sources of cotton for the kind of volume required by the Chinese.

We can safely assume that China has no interest in stymieing its textile industry and that it will continue to purchase the cotton it needs to run its mills for both domestic usage and the finished-goods export market. As we've illustrated in recent articles on the cotton market, supplies in China are tight. At 6.78 million bales, 2003-04 ending stocks as a percentage of consumption stand at 22%, compared with 48% just 2 years ago.

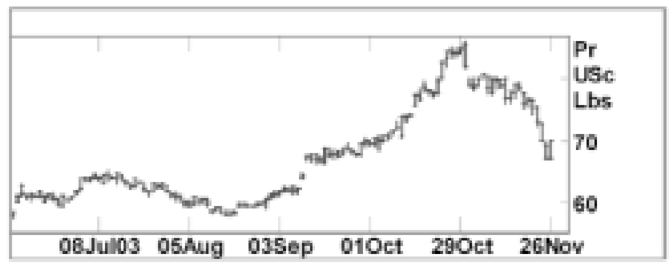
To present a balanced picture, we acknowledge that bears can structure valid arguments as well. In the 2002-03 marketing year, China bought about 1.8 million bales of cotton from the US and has already bought 2.7 million bales this season. Domestic consumption is estimated at 30.2 million bales, up from last year, but only by 700,000 bales. While it is true that inventories are quite low, the Chinese could decide to respond to the US import quotas by halting purchases and taking its chances with running down its ending stocks further.

In the meantime, however, export commitments keep rolling in. We're 2 million bales out in front of last year's sales at this juncture of the season, and it's still very early.

In conclusion, before we consider entering the long side of this market, we will want to see the net-long position shift into the hands of commercials. Additionally, the export flow must continue. The market has become very volatile, with limit-up and limit-down moves having become a rather frequent event, which makes trading this market an especially tricky affair. But we remain bullish and believe that if we get by the trade fracas, this market has the potential of returning to the highs and then to challenge price levels we saw in the 1990s at above $1 per pound. *[Nov. 30, 2003]*

STRATEGY: *Remain sidelined, but stay tuned.*

Chart 2 – March cotton



Courtesy Reuters

COPPER

Demand continues to outstrip available supplies

In its November report, the International Copper Study Group (ICSG) estimates that inventories of refined copper rose by 42,000 tonnes since its previous monthly report. At the end of August the global supply/demand deficit stood at 256,000 tonnes, compared with 298,000 tonnes at the end of July. The market is still markedly tight, however, particularly when compared with inventory levels for the same period last year, when the market was showing a surplus of 127,000 tonnes.

Although prices have been coming off their highs throughout November, we do not believe that the marginally bearish data have affected the major trend. While the bull run has stalled, prices have consolidated at levels we have not seen since a spike to the 90¢-per-pound level in 2000 and before that in 1997.

The rally is broad based in the sense that all base metal prices are very strong, indicating that the source of buying is bona fide industrial demand. While we've seen rallies in recent years that were closely tied to sudden, synchronized production cuts by major producers, this rally coincides with much healthier economies in the US and Europe.

China, of course, remains the kingpin of demand. Its huge economy is enjoying a much faster rate of GDP growth than other key regions, which are just now stringing together several quarters of impressive economic data. To illustrate the role China continues to play in the demand column of the global balance sheet, consider that as recently as 2001, the US was the world's leading copper-consuming nation. In 2002, China took over top spot with usage of 2.8 million tonnes, compared with US usage of 2.4 million tonnes.

Using year-to-date data and assuming usage continues at a fairly constant rate through the end of the year, Chinese demand will grow to 3.04 million tonnes in 2003, while US consumption will fall to 2.2 million tonnes. Some analysts are talking about Chinese demand growing to 3.5 million tonnes in 2004.

Consumption in the US and the EU has been shrinking since 2001, and the bull market was a direct result of the surge in Chinese imports. While the expanding Chinese economy will likely to continue to demand copper imports at the same or similar rates of usage, the strengthening US economy could solidify this bull market from here on in.

It is not unreasonable to expect demand to improve in the US. In fact it may have already. ICSG's data are current as of the end of August, so they are a bit dated, but US usage in

August was 199,000 tonnes, slightly higher than the monthly average for 2003. This week's upwards revision to US GDP showed that the economy grew at an annualized rate of 8.2% in the third quarter. In fact it would be rather unlikely for US consumption not to rise.

After mine output in Chile – which produces more than 25% of the world's copper supply – fell flat this past summer, production picked up steam in September and October, when output rose 6.7% and 8.1% respectively. Through the end of October, Chilean output was up 7.7% over 2002, to 4.04 million tonnes.

So far this year, global mine production is growing at 2.2% per annum and is actually growing faster than global demand, which is increasing at a rate of 1.7% per annum. But the market relies on secondary production from scrap for more than 10% of its supplies. When the two sources are combined, production of refined copper is down 2.1% over last year, hence the supply/demand deficit.

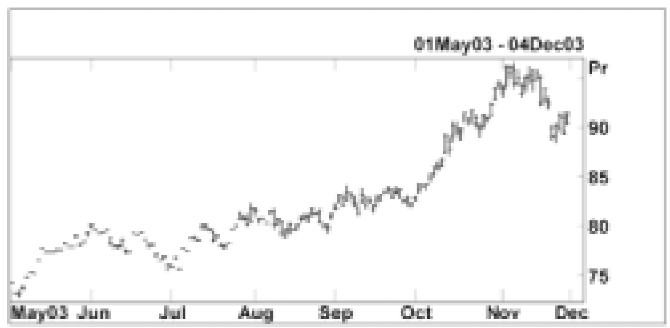
Warehouse stock levels reflect the market's strength, with LME stocks down to 466,000 tonnes, having fallen from just under 1 million tonnes over the past 18 months. Along with inventories held at the other two principal exchanges in New York and Shanghai, warehouse stocks stand at 865,000, down from a peak of about 1.5 million tonnes. Herein lies a potentially bearish factor. Codelco, the Chilean state-owned mining company has held back 200,000 tonnes of copper from the market and pledged not to release it until global warehouse levels reached 800,000 tonnes. At the current rate of depletion, analysts estimate that we will reach that level by January. While the arithmetic of the global balance sheet will not change because the 200,000 tonnes has already been counted in production, it will ease tightness in the physical market. On the other hand, the market is well aware of the looming sudden increase in supply and if new demand continues to appear from the US – as discussed above – the market could well absorb Codelco's 200,000 tonnes without disturbing the bull market.

Open interest is quit high, but the recent 10¢-per-pound correction helped to shed 20,000 contracts to bring the total down to 90,000 contracts. Commodity funds and small speculators participated in the move and still own a hefty net-long position, but both groups have been liquidating, leaving the market somewhat less overbought.

We continue to be bullish on this market, but we also continue to miss opportunities to get long. We're satisfied that the fundamentals – as illustrated – remain bullish. We will be interested in buying this market if the long position continues to shift over to the commercial side without a further decline in price, while open interest falls or remains stable. *[Nov. 30, 2003]*

STRATEGY: *Remain sidelined, but stay tuned.*

Chart 3 – March copper



Courtesy Reuters

CORN

The bumper US crop may be no match for demand

Much attention has been focused on the size of the 2003-04 US corn crop this past summer and fall. During the summer, hot and dry weather threatened to deliver a poor crop. But as we neared harvest, it became increasingly clear that the weekly reports were misleading. Instead of a disappointing crop, we were looking at record or near-record output. Soybeans were trading at multi-year highs, and wheat was threatening, but corn prices continued to languish. We believe the tide has turned, however, in favor of the corn market.

The November USDA supply/demand situation report raised its forecast for the US crop to 261 million tonnes, up 1.8 million tonnes from the October estimate, and the highest estimate of the season. The November estimate is of greater significance than any previous one because over 80% of the crop had been harvested at the time the data were collected. Although the crop forecast was higher than the previous month's estimate, prices were firm in the days following the release of the report. For the first time in months, analysts guessed in the wrong direction. The average estimate was about 1.5 million tonnes higher than the actual figure. The market then pulled back, consolidated, and found support between $2.35 and $2.40 per bushel.

This past week, prices began to firm up again. In our view, the market is shrugging off the implications of a bumper US crop and is beginning to focus on demand. In previous articles on corn, we pointed out the USDA has been behind with its forecast for 2003-04 US exports. Indeed, in its November report, the USDA responded to several weeks of very strong export commitment data. It raised its estimate by close to 2 million tonnes, to 47.63 million tonnes.

This past Friday's weekly export report showed that US exporters sold 1.6 million tonnes in the reporting period, an extraordinary figure and significantly above analysts' estimates for sales of 900,000 tonnes. US exporters have now sold 20.8 million tonnes of corn this marketing year, a substantial 25% increase over the 16.6 million tonnes sold last year at this time. The USDA's revised forecast for 2003-04 exports represents an increase of about 18% over 2002-03. We believe that this is unrealistic.

The US shipped an average of 49 million tonnes of corn in every season since 1998-99, excluding the dismal 2002-03 season, when there was an excessive amount of feed wheat available from huge crops in the FSU and Eastern Europe, an event that has not been repeated. Judging by the appetite we've seen for US corn in recent months, the 47.63-million-tonne estimate is too low, and we expect the USDA to keep revising its estimate upwards.

If in fact demand from overseas purchasers remains strong, the US will be the only place to meet their needs. Argentina is the only other country in the world that grows enough corn to be an exporter of consequence. Its crop was revised down by 2 million tonnes this month, to 14 million tonnes, because of an acreage shift to more profitable soybean crops and imperfect weather conditions. Argentina has almost no carryover stocks so its ability to export is directly tied to the size of the crop.

China is the only other country that has supplied large Asian buyers, such as Japan and South Korea, with some of their needs. But as we detailed in our October 30 issue, China has taken steps to restrict its export market because of tightening conditions at home. The USDA maintained its Chinese export estimate of 8.5 million tonnes of exports, but much of that includes corn that has already been sold. Based on the recent moves by the Chinese government, it is very unlikely that China is exporting corn at that rate any longer.

While China has not bought US corn for years now – and we're not saying that it will – bears should be wary of what the balance sheet of Chinese corn looks like. Domestic consumption is estimated at 129 million tonnes, but the 2003-04 crop is expected to reach only 114 million tonnes, down from 121 million tonnes in 2002-03.

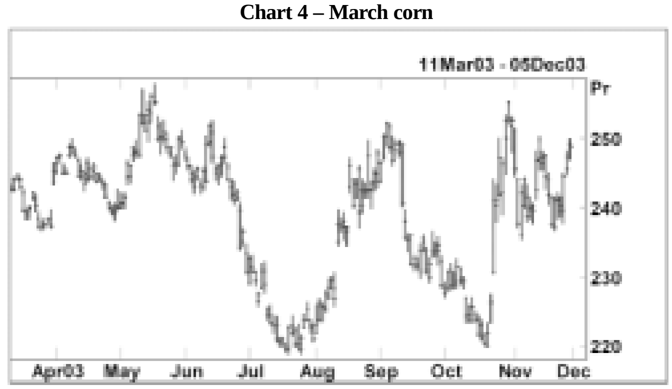
Although China has always run production/consumption deficits, it has also had huge stockpiles in years past, which have now been run down. Only 2 years ago, 2001-02 ending stocks were 63 million tonnes, or 51% of consumption, compared with the USDA's estimate for this season's ending stocks of 19.5 million tonnes, or 15% of consumption.

The US corn crop may be big, but the street is underestimating potential demand. We believe that corn prices will trade at much higher levels in the coming months.

[Nov. 30, 2003]

CURRENT STRATEGY: *Buy March corn as per Flash Update of Nov. 26. Place initial stops at 230, close only.*

Chart 4 – March corn



Courtesy Reuters

HOTLINE UPDATE

Flash Update **– Monday, November 3, 2003:**
Good afternoon for Monday, November 3, 3:00 pm. This is a Flash Update. We have covered our short December mini S&P position at 1060.

Flash Update **– Tuesday, November 4, 2003:**
Good morning for Tuesday, November 4, 10:30 am. This is a Flash Update. We have liquidated our long December corn position at 239.

Flash Update **– Thursday, November 6, 2003:**
Good afternoon for Thursday, November 6, 12:30 pm. This is a Flash Update. We have purchased December Japanese yen at 9089, placing our initial stop at 8960, close only.

Friday, November 7, 2003:
Good afternoon for Friday, November 7, 4:45 pm. The following is a recap of last week's trade recommendation history, and our latest recommendations and stop levels: On November 3, we covered our short December mini S&P position at 1060; on November 4, we liquidated our long December corn position at 239; on November 6 we purchased December Japanese yen at 9089; we are currently long December gold at 382, with our stop at 375; long March cocoa at 1398, with our stop at 1315; and long December Japanese yen at 9079, with our stop revised to 8980. All stops are close only.

Flash Update **– Tuesday, November 11, 2003:**
Good morning for Tuesday, November 11, 11:15 am. This is a Flash Update. We have purchased January soybeans at 767, placing our initial stop at 735, close only.

Flash Update **– Friday, November 14, 2003:**
Good morning for November 14, 10:00 am. This is a Flash Update. We have purchased March coffee at 63.75, placing our initial stop at 58.75, close only.

Friday, November 14, 2003:
Good afternoon for Friday, November 14, 3:45 pm. The following is a recap of last week's trade recommendation history, and our latest recommendations and stop levels: On November 11, we purchased January soybeans at 767; on November 14, we purchased March coffee at 63.75; we are currently long December gold at 382, with our stop at 375; long March cocoa at 1398, with our stop at 1315; long December Japanese yen at 9079, with our stop at 8980; long January soybeans at 767, with our initial stop at 735; and long March coffee at 63.75, with our initial stop at 58.75. All stops are close only.

***Flash Update* – Tuesday, November 18, 2003:**
Good afternoon for Tuesday, November 18, 5:30 pm. This is a Flash Update. We have sold short December mini S&P at 1032.25, placing our initial stop at 1056, close only.

***Flash Update* – Wednesday, November 19, 2003:**
Good morning for Wednesday, November 19, 9:20 am. This is a Flash Update. We have liquidated our long March cocoa position at 1532. We repeat our Flash Update of yesterday evening, where we sold short December mini S&P at 1032.25, placing our initial stop at 1056, close only.

***Flash Update* – Wednesday, November 19, 2003:**
Good afternoon for Wednesday, November 19, 2:05 pm. This is a Flash Update. We have liquidated our long January soybean position at 750.25. We repeat our previous Flash Updates, where we liquidated our long March cocoa position at 1532 and sold short December mini S&P at 1032.25, placing our initial stop at 1056, close only.

***Flash Update* – Friday, November 21, 2003:**
Good afternoon for Friday, November 21, 3:00 pm. This is a Flash Update. We have sold short December Canadian dollar at 76.65, placing our initial stop at 77.50, close only.

Friday, November 21, 2003:
Good afternoon for Friday, November 21, 3:45 pm. The following is a recap of last week's trade recommendation history, and our latest recommendations and stop levels: On November 18, we sold short December mini S&P at 1032.25; on November 19, we liquidated our long March cocoa position at 1532, and liquidated our long January soybean position at 750.25; on November 21, we sold short December Canadian dollar at 76.65; we are currently long December gold at 382, with our stop at 375; long December Japanese yen at 9079, with our stop at 8980; long March coffee at 63.75, with our stop at 58.75; short December mini S&P at 1032.25, with our initial stop at 1056; and short December Canadian dollar at 76.65, with our initial stop at 77.50. All stops are close only.

***Flash Update* – Monday, November 24, 2003:**
Good afternoon for Monday, November 24, 4:10 pm. This is a Flash Update. We have covered our short December mini S&P position at 1051.

***Flash Update* – Tuesday, November 25, 2003:**
Good morning for Tuesday, November 25, 9:20 am. This is a Flash Update. We have rolled over our long December gold position into February at 1.30 February over.

***Flash Update* – Tuesday, November 25, 2003:**
Good morning for Tuesday, November 25, 10:40 am. This is a Flash Update. We have liquidated our long March coffee position at 60.25. We repeat our Flash Update of earlier today, where we rolled over our December gold position into February at 1.30 February over.

***Flash Update* – Wednesday, November 26, 2003:**
Good morning for Wednesday, November 26, 9:15 am. This is a Flash Update. We have covered our short December Canadian dollar position at 76.25.

***Flash Update* – Wednesday, November 26, 2003:**
Good morning for Wednesday, November 26, 11:20 am. This is a Flash Update. We have purchased March corn at 246.50, placing our initial stop at 230, close only. We repeat our Flash Update of earlier today, where we covered our short December Canadian dollar position at 76.25.

Friday, November 28, 2003:
Good afternoon for Friday, November 28, 3:55 pm. The following is a recap of last week's trade recommendation history, and our latest recommendations and stop levels: On November 24, we covered our short December mini S&P position at 1051; on November 25, we rolled over our long December gold position into February and liquidated our long March coffee position at 60.25; on November 26, we covered our short December Canadian dollar position at 76.25 and purchased March corn at 246.50; we are currently long February gold at 391.30, with our stop at 375; long December Japanese yen at 9079 with our stop at 8980; and long March corn at 246.50, with our initial stop at 230. All stops are close only.

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