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Where did all the cocoa go?

The 2010-11 marketing year for cocoa in the Ivory Coast ended on September 30. The crop reached – reportedly – a record 1.51 million tonnes. Although this was the year in which the vulnerability of the Ivory Coast's position as producer of 40% of the world's cocoa was exposed, the country – and its cocoa crop – survived for months without a government. The halt to cocoa exports allowed 500,000 tonnes of beans to pile up with the risk of spoilage, but the beans were apparently able to withstand the questionable storage conditions. Prices have responded accordingly – falling to mid-2009 levels (Chart 1).

Neighboring Ghana also produced a record-by-far crop of over 1 million tonnes.

The fantastic output levels in the Ivory Coast and Ghana were compromised by number-three producer Indonesia. Excessive precipitation allowed disease to flourish, and as a result, output will reach only 400,000 tonnes, down from its normal crop size of about 500,000 tonnes.

West African production for the new crop year, however, is expected to fall short of the stellar performances of 2010-11. The strength of this past season's crop was due largely to unusually excellent weather, which will not necessarily be repeated. There have been more reports of Black Pod disease than we can remember seeing in quite some time. Nevertheless, the Ivorian government announced recently that its forecast is calling for further increases to 1.6 million tonnes. The consensus among industry participants, however, is that new crop will decline. With only three weeks of data since the beginning of the marketing year to judge by, port arrivals are 44% below the same period in 2010-11.

The Ghanaian government's forecast is more grounded and believable. It estimates that production will fall by about 10% to 15%, to between 850,000 and 900,000 tonnes, probably to reflect the improbability of seeing last season's weather duplicated.

There is a distinct possibility that arrival figures might not be a true reflection of the Ivorian crop, because of the premium being paid in Ghana. With Ghanaian farmers getting \$2 per kilo compared with \$1.5 per kilo in the Ivory Coast, smuggling could be rampant. That is what happened last year. In fact, we continue to view the size of last season's reported Ghanaian output with some suspicion because of the largely

inexplicable 40% jump from the 2009-10 season.

The overall demand picture is actually looking much stronger. We keep hearing that grinding activity in non-origin grinding countries has peaked because of the shift of processing to origin countries. Third-quarter results were very strong, though. The North American grind rose 3.42%, slightly higher than expected. The European grind was up 14%, considerably higher than expected. Both of these items were greeted with a yawn, as prices proceeded to trade down to new lows for the move.

Although butter prices continue to fall, powder prices have maintained their strength. The combined butter/powder ratio sits at multi-year highs, which explains the increase in grinding activity (Chart 2).

Open interest has soared to near record highs (Chart 3), a clear indication that at least part of the drop in prices was fund selling. The \$200-per-tonne bounce off the lows is a short-covering rally in progress. Is there more to this rally?

Analysts are talking about a balanced market in 2011-12. How did that happen, with the two largest producing nations who grow more than half of the world's cocoa beans growing record crops in 2010-11? In addition, the estimates we've been seeing are likely using a 2.5% to 3% annual growth rate for demand, when demand is probably growing at 4% to 5% per annum.

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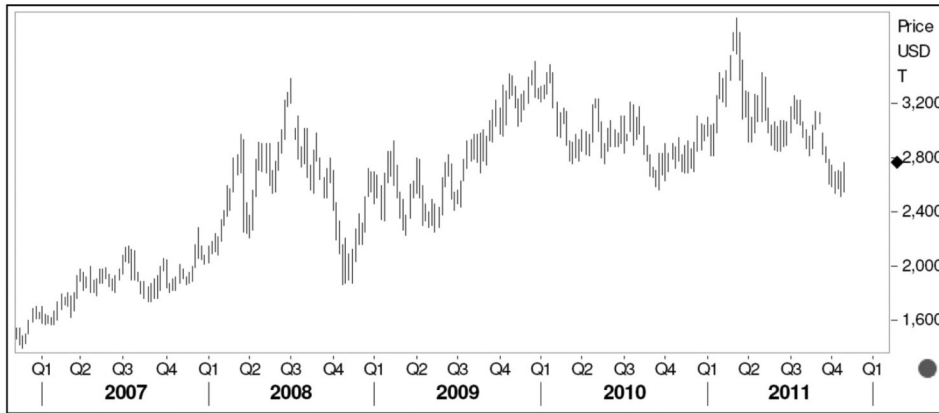
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Short-covering ignited this rally, but the fundamentals might carry it. We were stopped out of our long position at \$2,800 per tonne as per our September 16 recommenda-

tion. Re-establish long positions in March cocoa, using a \$2,650 stop, close only.

[October 27, 2011]

Chart 1 – Weekly cocoa



Courtesy Reuters

Chart 2 – Combined cocoa butter/powder ratio

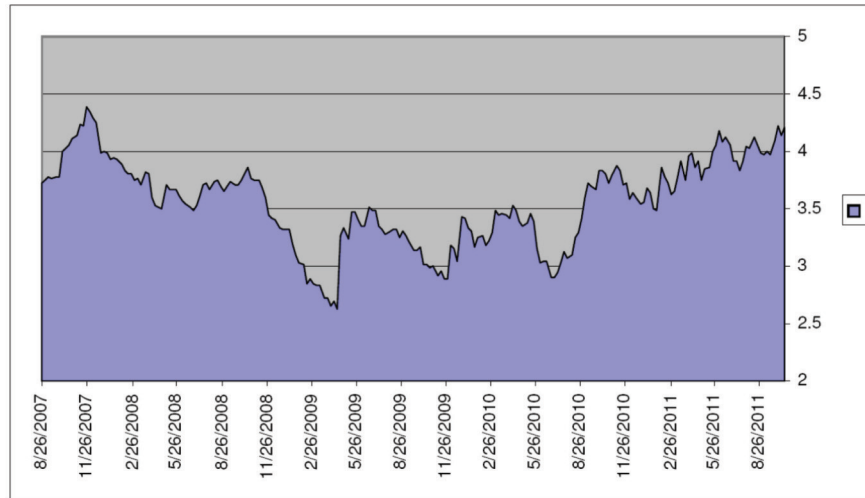
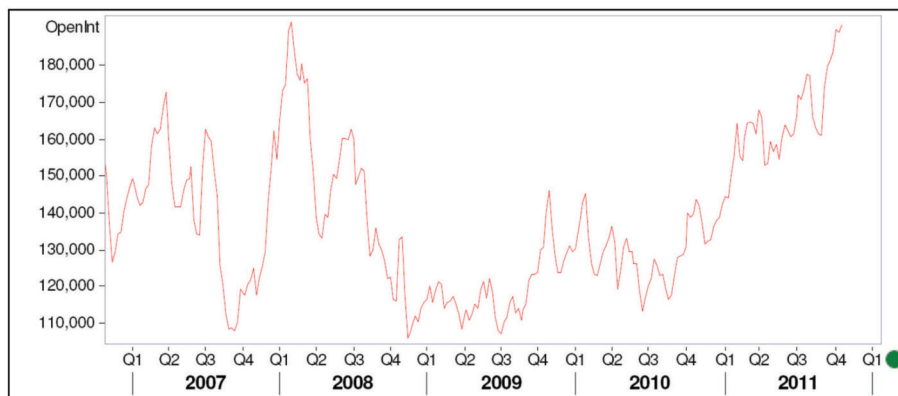


Chart 3 – ICE cocoa open interest



Courtesy Reuters

COTTON

A disappointing US crop does little to keep the bull alive

After collapsing from \$1.4-per-pound highs this past summer, new-crop cotton prices have fluctuated in a relatively narrow band (Chart 4).

Prices are still very high in historical terms – the average price over the past 20 years has been about 55¢ per pound. About 65% of the absolutely abysmal US 2011-12 crop has been harvested. Drought devastated the crop, which was planted on 14.72 million acres – the largest area in modern history. The harvested/planted ratio is estimated at 66.9%, compared with 97.5% in 2010-11 and 82.2% in 2009-10. That is the lowest recovery rate in US history. Production is estimated at 16.61 million bales, down from an 18.1-million-bale crop in 2010-11, which was planted on a relatively scant 10.97 million acres. Bulls have been clinging to what would normally have created a very tight world supply situation, with the US being the world's largest exporter of cotton.

Most other major producing countries had much better luck with expanded acreage. Chinese production is expected to jump to 33.5 million bales, up from 30.5 million bales in 2010-11. Indian output is expected to increase to 27.5 million bales, from 25.4 million bales the previous season.

Pakistan, the fourth-largest cotton producer, was an exception among Asian growers. A record crop of 10 million bales was expected, but heavy flooding reduced output by about 800,000 bales from earlier estimates. A rough estimate puts production at 9.2 million bales, still above 2010-11 output of 8.8 million bales.

Even after accounting for the US disaster and adjusting for Pakistan, global production is estimated at a record 123.4 million bales. Problem is, it seems that nobody wants much of it. US exports have fallen dramatically behind last year.

The weekly USDA export report shows that commitments stand at 7.5 million bales, down from 11.4 million bales at this time last year. During September and October, US farmers sold an average of 150,000 bales per week. That compares with 486,000 bales per week in the same

period last year. There was one large sale to China during the period, which brought the tally for that week up to 385,000 bales, but the following week saw a return to the anemic pace of sales with commitments of only 92,000 bales.

There is a silver lining in this dismal demand outlook. Exports must average only about 110,000 bales for the balance of the marketing year to meet the USDA's very pessimistic forecast for final sales of only 11.5 million bales, down from last year's final sales of 14.38 million bales.

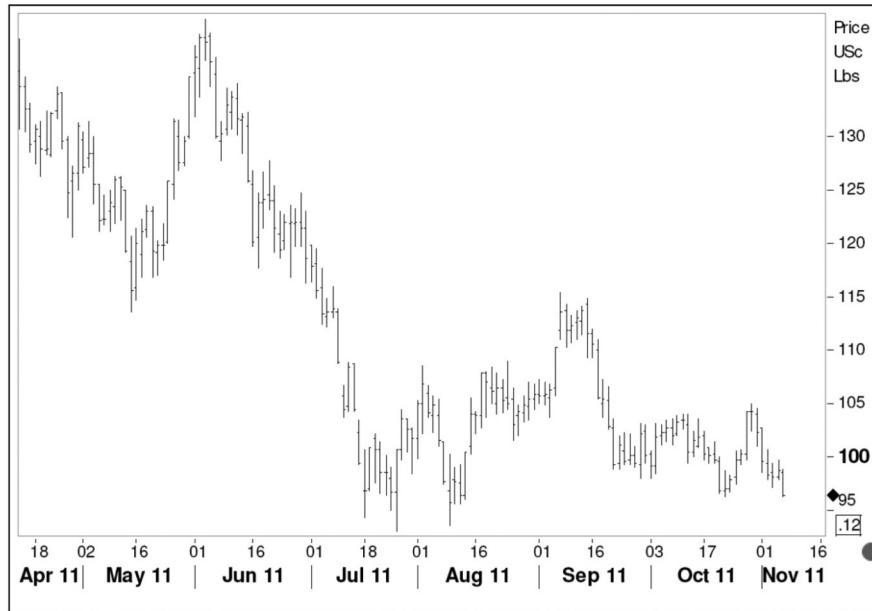
There are many economic and financial events popping up all around the globe that give credence to expectations of demand destruction for goods and services – cotton included. But it's entirely possible that the USDA has underestimated demand. For example, since the summer, the USDA has been ratcheting down its estimate for a huge jump in Chinese imports over last season. The June estimate was as high 16 million bales. With the most recent downward revision, that estimate is now 14 million bales. A recent government report, however, says that the Chinese cotton imports will rise by 22% this year, which is about 600,000 bales above the USDA's revised estimate. It is not very much cotton in the grand scheme of things, but it does mean that the negative demand news has been discounted and better news from the export front could actually be bullish.

Global inventories have been replenished. After adjusting the October USDA data for a smaller Pakistani crop and higher Chinese usage, ending stocks will jump to 45.7% of usage, up from 39% and 37% in 2010-11 and 2009-10, respectively.

By all rights – at least in terms of apparent fundamentals – we should be back to 70¢ per pound. Yet the market has held support at the 96¢-per-pound level. The low was set way back in July at 93.20¢ per pound. Our September 9 recommendation to take a long position is under water and certainly should be stopped out at 95¢, close only.

[November 8, 2011]

Chart 4 – December cotton



Courtesy Reuters

SOYBEANS

A weak US crop fails to hold prices

Soybean prices have been coming off since late summer. After a corrective \$1-per-bushel bounce in October, the market is testing the lows (Chart 5).

The 2011-12 US crop was planted on 75 million acres, 2.5 million fewer acres than the previous two seasons, to accommodate expectations of lower global demand and because it was more profitable to grow corn.

The crop turned out much worse than planned. Although acreage was 3% below the previous season, output was down 9%, to 3.046 billion bushels. Inclement weather hampered the crop's development, which resulted in very weak yields. The USDA lowered its yield estimate once again in the November crop report, to 41.3 bushels per acre (bpa), down a notch from last month, but significantly below the 43.75 bpa average of the past two seasons.

The disappointing US crop kept prices well supported at the \$13-per-bushel level until they broke in mid-September. There are two issues that will influence prices over the near term: the size of South American crops and demand.

There have been conflicting estimates regarding the Brazilian and Argentinean crops. We're past the fears that La Niña will affect the planting season. Moisture required for developing plants may not be at optimum levels, but seems to be adequate. The USDA revised its estimate for the Brazilian crop upwards by 1.5 million tonnes from its October estimate, to 75 million tonnes. That was a bit of a surprise, in part because it was widely believed that Brazil would be sacrific-

ing some soy acres to grow corn, which has been and remains more profitable (Chart 6).

Argentina is following the script, however. The USDA lowered its estimate by 1 million tonnes from the October estimate, to 52 million tonnes. It's still very early in the growing season for both countries, and production forecasts are anything but certain at this point.

The USDA forecast for US exports indicates low expectations for overseas demand, at least for US beans. The November estimate was slashed by 1.36 million tonnes, to 36.06 million tonnes. That's down from 40.86 million tonnes in 2010-11.

Export commitments have been choppy since the marketing year began on September 1, with some decent weeks and some horrible weeks. Overall, though, sales are running well behind both last year's pace and the pace required to meet the USDA's 2011-12 target. Commitments stand at 19 million tonnes, down from 29.7 million tonnes last year at this time. A year ago, that represented 72% of final sales. The current commitment figure is a limp 51% of projected USDA sales! That would mean new sales must average about 450,000 tonnes per week for the balance of the marketing year to meet the USDA forecast, a heady task.

Studying US sales, however, does not present a complete picture. Larger crops in South America are here to stay, and with that comes a shift to larger sales from South American origins. The 2011-12 marketing year will be the

first year in which combined Brazilian and Argentinean exports of 48.8 million tonnes will overtake 36.06 million tonnes sold by the US. Last year US sales were 40.86 million tonnes, compared with 39.16 million tonnes combined for Brazil and Argentina.

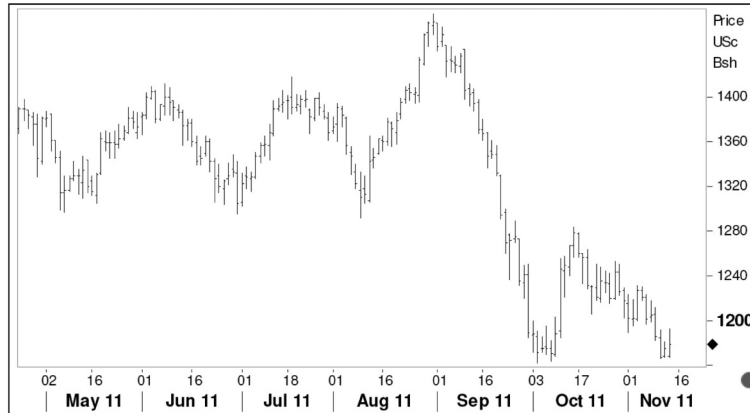
In fact, the estimate for global ending stocks is actually down from last year's 30.9% of consumption, to 27.6%,

partly because of the large drop in the US crop but also because of expectations for higher global demand. US exports are no longer the sole harbinger of global demand.

If US exports do not begin to improve significantly, we will maintain our short position. In the meantime, we advise using a \$12.35 per bushel stop, basis January, close only.

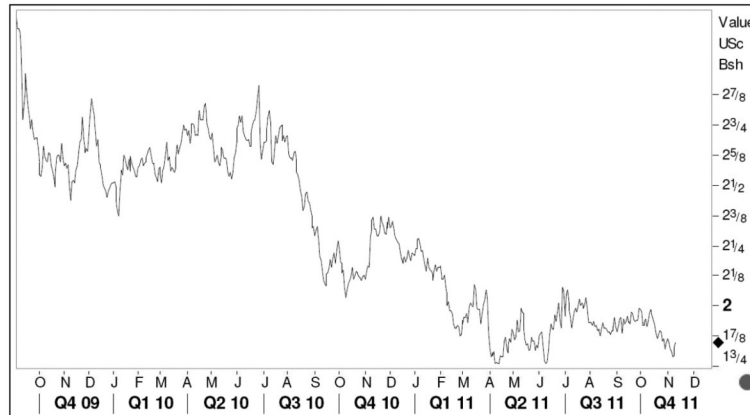
[November 14, 2011]

Chart 5 – January soybeans



Courtesy Reuters

Chart 6 – Soybean/corn ratio



Courtesy Reuters

WHEAT

Well stocked

Global wheat production over the past several years has stagnated, albeit at record high levels. The exception was the 2010-11 crop year, which was affected mostly by the disastrous crops in the FSU and saw global output fall by 5% from the previous season. The bull market was extended because of the massive drought that saw FSU output and exports fall by 20% and 61%, respectively, from the previous season. Consumption, however, had stagnated along with output, and the global market remained amply supplied.

The Northern Hemisphere 2011-12 winter- and spring-wheat harvests are all in, so the supply picture for the current marketing year typically does not change much at this time of year. The two key Southern Hemisphere growing nations – Australia and Argentina – are harvesting their crops. The results can still impact the 2011-12 balance sheet.

Considering a planned 3% increase in Argentinean wheat area, the crop will be a disappointment. Dry weather delayed planting and restricted the amount of wheat that

could be sown. The poor weather persisted through much of the growing season. The USDA revised its estimate for the crop downwards by 500,000 tonnes in its November crop report, to 13 million tonnes. That compares with a bumper crop in 2010-11 of 15.5 million tonnes. Most recently, rain has returned and analysts are saying that it could be sufficient to improve the outlook for the crop.

The Australian crop should be about 26 million tonnes, about the same size as last year. The 2010-11 season was plagued by flooding, which reduced protein content, leaving only a much-smaller-than-normal percentage of high quality, milling-grade wheat. This year, there's been excessive precipitation since mid-November in both the Eastern and Western growing regions. Although it seems that protein levels will be compromised to some degree, it will not be anywhere near the problem it was in the previous season.

The Australian problem is relatively fresh, but for the moment anyway, involves a relatively small amount of wheat. As far as Argentina is concerned, it has been known for some time that the crop would be small and that exports would fall by close to 2 million tonnes. So we don't anticipate much fallout from the Southern hemisphere crop problems at this time.

US export commitments stand at 17.4 million tonnes, compared with 22.5 million tonnes last year at this time. That is no great surprise, because the USDA estimates that total

sales for 2011-12 will fall by 25%. In fact sales are a tad ahead of the USDA target. Global consumption is expected to rise to a record 675 million tonnes, but the US market share is shrinking.

Northern Hemisphere winter wheat acreage estimates for 2012-13 and the progress of the crops – which have already been planted – are the important items on the agenda that will set the tone for the wheat market in the coming months.

We will not get an accurate estimate for US acreage until the January planting intentions report. The weekly progress reports show that crop conditions in the early growing are not ideal. At 88%, the emergence rate is pretty much in line with the 5-year average. The good-to-excellent portion of the crop stands at 50%, above 47% we saw last year at this time, but significantly below the previous year's 63%. But it's very early.

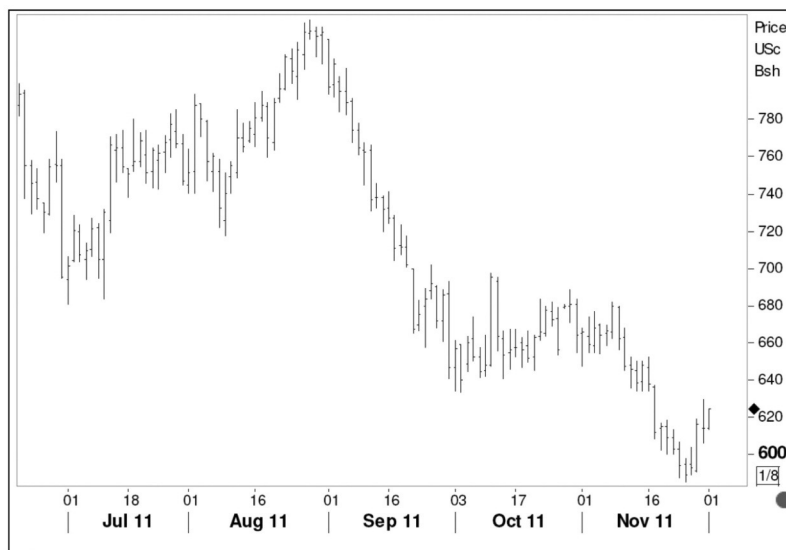
Chinese wheat acreage is expected to expand marginally, and there's been very little information available about planted area or planting progress in the FSU.

The estimate for 2011-12 global ending stocks is 203 million tonnes, or 29.9% of consumption. That is slightly lower than the two previous marketing years, but still well above the average of the mid-decade years of about 23% of usage that drove prices beyond \$12 per bushel in 2008.

Maintain short positions recommended on September 16. Lower stops to \$7 per bushel, close only.

[December 1, 2011]

Chart 7 – March wheat



Courtesy Reuters

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