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Soybeans: the bull resumes the run

Soybean prices took a 70¢-per-bushel plunge this fall, roughly a 50% correction of the powerful bull run that began early this past summer. A good chunk of the downdraft was triggered by the USDA quarterly stocks report, released on September 30, that showed US inventories of soybeans stood at 208 million bushels (5.67 million tonnes) on September 1. Although down from last year's 248 million bushels (6.75 million tonnes), the figure was above analysts' estimates of 198 million bushels (5.4 million tonnes). With additional pressure from harvest-related selling, November beans continued to tumble all the way back to the \$5.22-per-bushel level (Chart 1).

The monthly USDA supply/demand situation report brought support. The US crop estimate came in at 2.654 billion bushels (72.22 million tonnes), below the average analysts' estimate of 2.678 billion bushels (72.97 million tonnes). Although the report carried the first uptick in the estimate for 2002-03 US ending stocks since June – from 160 million bushels (4.49 million tonnes) last month to 175 million bushels (4.77 million tonnes) – it was yesterday's news. Just about the entire increase in stocks from last month's report consisted of the surprise estimate released in the quarterly stocks report, 10 days before the monthly report. Overall, the report was considered friendly, and with the market oversold, we began to inch back up.

Two primary issues should be monitored to determine if we will build on the 30¢-per-bushel rally we've seen over the past 10 days. The prospects for 2002-03 South American production will dominate the supply side, and US export activity is the key on the demand side.

Soybean output of only four countries – the US, Brazil, Argentina, and China – represents 90% of global production. Brazil and Argentina make up 43%. This concentration is acceptable if the climate behaves. The USDA is forecasting that Brazilian 2002-03 production will skyrocket to 48 million tonnes. Local analysts are talking about a crop of over 49 million tonnes. This compares with 43.50 million tonnes in 2001-02 and 39.00 million tonnes in 2000-01. Argentina is expected to produce 31 million tonnes, compared with 29.5 and 27.8 million tonnes in the previous two seasons.

In our July 28 issue we predicted that the combined production of these two South American producers would over-

take US production by the 2003-04 season. But that was before the summer drought in the US Midwest shaved prospects for the US crop by 6%, to 72.22 million tonnes. With combined output of 79 million tonnes, the South American pair will have pushed the US out of the top spot by the end of this season.

A chink in the armor of seemingly unstoppable South American supplies has emerged, though.

On October 23, *Oilworld* estimated that Brazilian farmers would increase their planting area by 1.1 million hectares over 2001-02 to 19.4 million hectares. To achieve the fantastic output estimates being forecasted, planting and growing conditions will have to be ideal. Getting a crop planted requires a perfect balance of dry and wet weather – wet weather first and then several dry days of dry weather to get the actual field work done. Brazilian growing regions have been excessively dry, with only sparse and scattered showers in key areas.

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Argentina has had the opposite problem. Persistent rains have not allowed for the required number of dry days to get the seeds in the ground. The recent strength in price is largely a result of these weather issues.

Then there is the consumption factor, which has enjoyed strong growth over the past few years. Indeed, global consumption is expected to grow by 3.5% this year against only a marginal increase in production. The problem for US farmers is that South American supplies have cut into the US market. With sliding local currencies South American commodities can be sold below US prices, thus crimping demand for US beans.

The USDA estimates US exports for 2002-03 at 23.13 million tonnes, down sharply from 2001-02 exports of 28.98 million tonnes. Thus far, export commitment totals show that the USDA is on track with this forecast. As of this week, US exporters have sold 9.8 million tonnes compared with 11.1 million tonnes at this juncture of the season last year.

Actually, the most recent data point to a bit of a turnaround. This week's export sales of 1.207 million tonnes were the strongest we've seen this marketing year. Average sales for the past 4 weeks were just 532,000 tonnes, so perhaps things are looking up.

In conclusion, it is too early to predict smaller-than-forecasted crops in South America, because soybeans can be planted until the middle of November. As we approach that deadline and until we're past it, however, this will draw the close attention of traders. Despite the small increase in ending stocks, global inventories of 26.11 million tonnes, or 7.3% of consumption, are at their lowest level since the mid-1990s, when soybean prices soared to \$9 per bushel. Having backed off its early-autumn highs, we believe the market is well priced for a probe at the long side. [Oct. 24, 2002]

STRATEGY: Buy March soybeans as per Flash Update of October 22. Place initial stops at 5.25, close only.

Chart 1 – November soybeans



SUGAR

Just a bear market rally

Sugar prices have advanced by close to 1¢ per pound since we presented a bearish argument in our September 20 issue (“What’s so sweet about sugar?”). There have been several bullish developments that might explain the continued strength.

The most bearish factor in this market has been forecasts for a mammoth 2002-03 crop in Brazil that was expected to reach a record 23 million tonnes. This compares with crops of 20 million tonnes in 20001-02 and 17 million tonnes in 2000-01. However, output estimates for Brazil’s principal production region, the Centre/South, have fallen by 7% or 8% over the past month or so, which could chop over 1 million tonnes from early season estimates.

There’s been some tightness in the market, particularly for white sugar, and it’s been reflected in the backwardation that has developed in both New York and London futures (Charts 2 and 3). Analysts seem to agree, however, that this is likely to be alleviated once European crops that are currently being harvested become available. Estimates for the 2002-03 EU crop have been inching up and should come in at about

18.5 million tonnes, 2.5 million tonnes more than last season.

We believe that while there are temporary pockets of tightness, the balance of evidence paints a bearish picture. China, already slated for a bumper crop of 9 million tonnes, has seen estimates climb in recent weeks, to as high as 10 million tonnes. This puts a damper on hopes that the Chinese will show any greater presence in the import market than they have to date.

The most recent look at the global production/consumption balance comes from sugar analyst F.O. Licht. On October 16, it released its first estimate for the 2002-03 crop year. Licht forecasts that production will jump to 143 million tonnes, close to 8 million tonnes more than 2001-02 production. With consumption of 137 million tonnes, this will leave a surplus of 6 million tonnes to be tacked on to already burdensome inventories. Licht’s surplus estimate is substantially larger than the International Sugar Organization’s September 17 estimate of 3.5 million tonnes.

The configuration of the open interest leads us to believe that the speculative community has pushed prices up and, as illustrat-

ed, that the bull run cannot possibly be a reflection of supply/demand balances. Speculative long positions stand at record levels. Commodity funds are net long 62,021 contracts, and small speculators are net long 43,889 contracts (Charts 4 and 5).

The obvious reaction would be to adopt a contrarian viewpoint in the belief that the commercial group that holds the other side of the trade will always be right, sooner or later.

The October 21 issue of *Bullish Review* – a publication dedicated solely to analysis of the weekly Commitment of Traders report – takes a different approach. Based on raw data, its monitoring system – which we should add has an excellent track record of calling important turns in futures markets – has assigned a major sell signal to the current sugar market. Nevertheless, in its accompanying comments, the letter observes, “In a similar setup in May 2000 (near the same price level) commercials were forced to capitulate and their buying helped propel prices above 11¢. When commercials get caught on the wrong side of a major breakout, the result can be explosive.”

We take issue with this analysis because the two periods cannot be justifiably compared. In 2000, key exporters such as Australia and Brazil were having dismal crops and there was a production/consumption deficit that at one point was believed to be as high as 5 million tonnes. In the current environment, the fundamentals seem to be on the side of the commercial trader, and we choose to take the more traditional stance of betting with the commercials and against the speculator.

We recognize that the very same momentum that carried the market from 5¢ to 7¢ per pound can carry it further as well, whether the fundamentals justify it or not. We have therefore established a short position with a rather tight stop. We believe, as we always do, that eventually the realities of supply/demand balances will prevail. We’re still asking: “What’s so sweet about sugar?” [Oct. 29, 2002]

STRATEGY: Sell March sugar as per Flash update of October 25. Place initial stops at 7.50, close only.

Chart 2 – Comex March/May spread

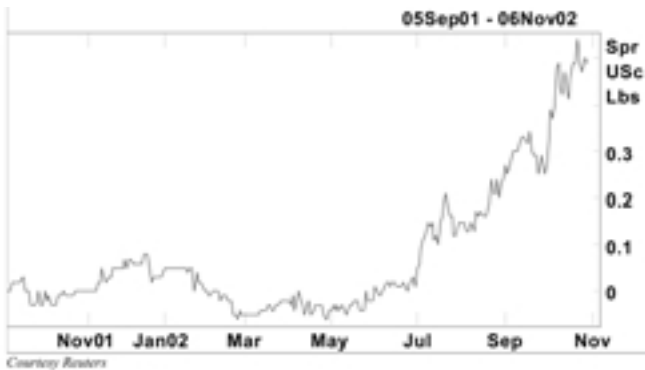


Chart 3 – London December/March spread



Chart 4 – Commodity funds net long position

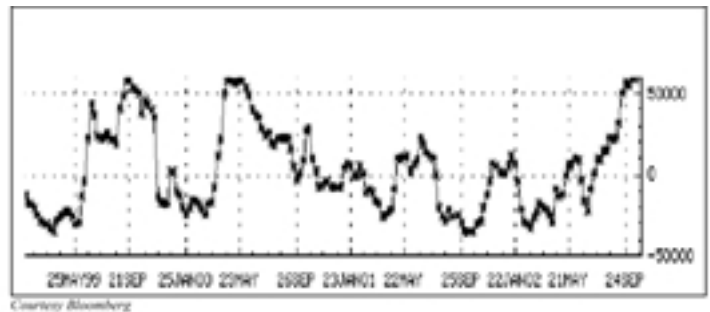
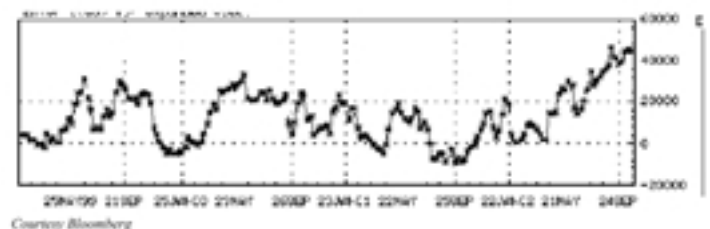


Chart 5 – Small speculators net long position



COCOA

Is the cocoa bull dead?

In mid-September, fears usually expressed in any comprehensive analysis of the cocoa market became reality when there was a coup in the Ivory Coast. There have been plenty of coups in that country, but this one actually caused some interruption to the operations of the cocoa industry. The fighting

between government and rebel forces forced many workers, fearing for their lives, to flee plantations just when the harvest of the main crop was getting under way. According to press reports, plantations were neglected, and weeds began to cover the plants. The resulting humidity facilitated the development

of pod diseases.

At this point it is impossible to know whether the crop was affected in a significant way. The only information available is that early arrivals have been well below average and that some exporters are reporting that the beans they've seen arriving at the ports contained an uncomfortable number of poor quality beans.

It would be quite convenient to take the position that the market has topped out and that these rich prices are not warranted. Reports from the Ivory Coast indicate that the rival forces have sat down to iron out their differences. The market rose \$400 per tonne from the time the strife began. Since the fighting has died down, the market has erased that gain and is now trading below the level from which that leg of the bull run began (Chart 6).

In addition, until recently, developments on the demand side have been bearish as well. While the fighting raged in the Ivory Coast, the market almost completely ignored the release of a series of bearish grind reports. Third-quarter US, German, and pan-European grindings were all down yet again by 12.75%, 9.4%, and 4.9% respectively.

The weak grind data were reflected in the collapse of the backwardation that characterized this bull market from the \$700-per-tonne bottom through the rally to the \$1,600-per-tonne level it reached this past spring (Chart 6 and 7). After that point – uncharacteristically – the spreads dropped from a backwardation of \$250 per tonne to a contango of \$60 per tonne, even as the market was scoring new contract highs on a daily basis.

At the retail end, two of the world's largest chocolate manufacturers, Hersheys and Nestlé, have reported lower sales of confectionary goods for the first three quarters of 2002.

These items gives credibility to the bears' theory that the run to \$2,400 per tonne was fluff, supported first by late-comer speculators and then by war headlines. Now that the dust has settled, where do we go from here?

This bull market was a supply-side affair, and there is no evidence that much has changed on that front. For that matter, the civil strife in the Ivory Coast has exacerbated the situation. We won't have any reliable statistics on the size of the new crop until we see a post Ivorian-crisis report from E.D.&F. Man. Until we do, it is unlikely that this market is going to collapse any time soon.

Even before the trouble began in the Ivory Coast, Man was forecasting a global production/consumption deficit of 135 million tonnes, which would draw stocks down closer to the dangerous 30% of consumption level. It's quite possible that crop losses associated with the Ivorian crisis were significant.

This is where the concentration of production in the Ivory Coast becomes a glaring issue. In 2001-02, combined output from Indonesia and Ghana – the number 2 and 3 producers – was only 65% of Ivorian output. Ghanaian production is

expected to jump by 90,000 tonnes this season, but Indonesian output is forecast to be 50,000 tonnes smaller. As Ivorian production goes, so will prices.

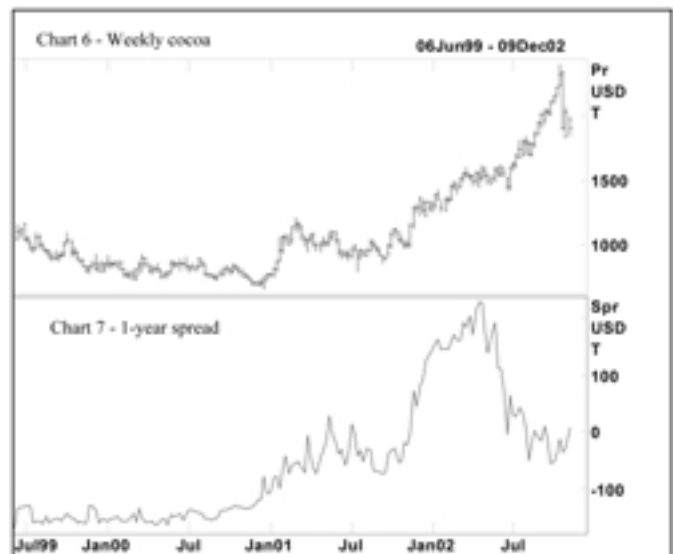
Although growth in chocolate consumption has been lackluster, the poor grinding statistics that we've seen for as many quarters as we can remember were also a reflection of unprofitable grinding margins. But the sharp drops in grinding statistics do not seem to be commensurate with the modest dropoff in chocolate sales. The slower grinding pace has resulted in a smaller supply of end products. Chocolate manufacturers have run down their inventories of cocoa butter. Recent press reports indicate that butter ratios in Asia have improved to 1.7 times the price of beans from a ratio of 1.1 times seen in early summer.

The relationship between skyrocketing prices and a collapsing spread was confusing for bulls. It has now become equally difficult to explain – if the market is indeed so well supplied and the rally was merely fear premium – why the spreads did not continue into a full contango during the \$500-per-tonne nosedive. In fact, the 1-year spread has firmed by \$65 per tonne since mid-September.

At this point, until the fundamentals become more clear, we are going to stop short of getting too bullish, because the price swings have been erratic, a very easy environment in which to get whipsawed. By the same token, we have not yet laid this bull market to rest. We prefer to be patient and to wait for the market to consolidate and establish a trading range. We maintain a bullish bias.

[Oct. 30, 2002]

STRATEGY: *Remain sidelined, but stay tuned.*



CORN

Whatever happened to the bull market in corn?

Corn prices have plunged by 50¢ per bushel since early September (Chart 8). During this period, corn's two sister agricultural products, wheat and soybeans, have clawed their way back close to their respective highs set late this past summer.

The principal growing regions of the US Midwest saw very hot and dry weather this past summer. These conditions threatened to reduce crops significantly from the excellent crops of the past few years, which helped drive corn prices below \$2 per bushel.

The October USDA supply/demand situation report was not friendly to corn prices. The key figure that traders were looking at, US production, came in at 8.97 billion bushels, 121 million bushels higher than the September estimate, and above the high end of analysts' guesstimates. A last minute recovery in some areas improved yields, and as a result, the production picture was not quite as bleak as it was believed to be earlier in the season.

Still, when looking at the big picture, it's a bit surprising that the corn market is lagging relative to both its own price range and the other markets. Global ending stocks were revised upwards by 1.65 million tonnes from the September estimate, to 91.48 million tonnes, as a result of the increase in the estimate of US production and an uptick in FSU and Eastern European output. However, owing to a 2-million-tonne increase in the estimate for usage, stocks as a percentage of consumption grew just a tad, to 14.67% from 14.46%. This hardly changes the fact that we would have to go back to the 1973-74 season to find a lower inventory level. Since then, the stocks-to-consumption ratio has not been below 20% (posted in 2001-02). The average of the previous 10-year period was 27% of consumption. So clearly, we are not out of the woods.

There are issues, however, that could be keeping prices at bay. The Chinese are slowly becoming a force in the export market. This season, with 9.5 million tonnes of exports, the country is expected to move ahead of Argentina as the world's second-largest exporter of corn.

Availability will not pose any problem. This year the Chinese will produce 125 million tonnes of corn, according to the USDA. One analyst has the number as high as 127 million tonnes. This compares with output of 114 and 106 million tonnes in the previous 2 years. Domestic consumption eats up all of this, but China still is expected to finish the season with 52 million tonnes of stocks, or 42% of consumption.

This week, Taiwan, which normally imports 90% of its

corn requirements from the US, announced that it would make its first purchase of corn from China in 50 years. The sale had more to do with the backlog resulting from the port lockout in the US than it did with signals of a warming of the politically charged relationship between China and Taiwan. And the amount – 12,000 tonnes – was small. But if the ice is broken, who knows what might follow? Besides, at \$123 per tonne, the corn is about 10% cheaper than US corn.

In addition, the miserable wheat crops in all the principal exporting countries were not only much smaller than previous years, but much of what was grown was not of milling quality and will make wheat available to be sold as feed.

The USDA is optimistic about prospects for US exports. It estimates that US exporters will sell 50.8 million tonnes of corn in 2002-03, or 2.6 million tonnes more than last season. Thus far, however, the available data do not support this optimism. Weekly commitment data show that the US has sold 12.2 million tonnes this marketing year, compared with 13.7 million tonnes at this time last season. Certainly not off to a good start.

Although we explained in part why the bull has gone limp, we don't believe that prices are going to fall apart altogether and return to the \$2 to \$2.20-per-bushel area. As illustrated, the global balance is in a tight position. It is difficult to believe that the market can make the adjustment quite so quickly from a carryout that was 27% of consumption in the 1990s to one that is below 20%.

Substitution of wheat for corn as feed does have its limitations, both in how much wheat farmers can feed poultry and in terms of cost. The wheat/corn ratio has exploded and, at 1.6 times corn (Chart 9), is at its highest level since 1995. It is likely that this ratio will move back into a historically normal range, because wheat is becoming too expensive as feed, although we obviously cannot predict when that will happen.

Our hunch is that the selling is overdone. Corn prices should recover to some degree and hover in a trading range. Because we remain very bullish on wheat, it is hard to see corn falling apart if wheat prices continue with a leg up to the \$5-per-bushel area. The crops are in, and the estimates will not materially change from here. The only factor that could put corn back on the bull course is a sharp recovery in US exports.

[Oct. 31, 2002]

STRATEGY: *Stand aside.*

Chart 8 – December corn

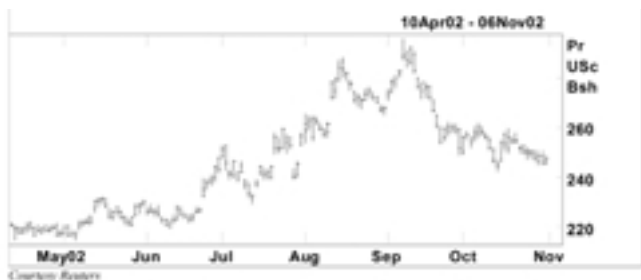
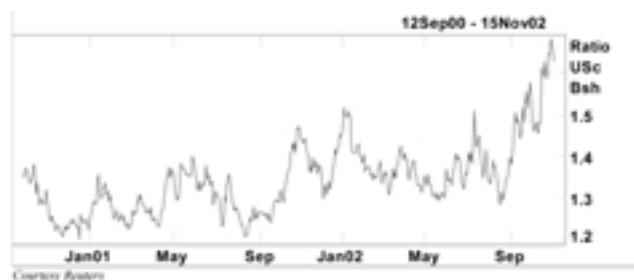


Chart 9 – Wheat/corn ratio



HOTLINE UPDATE

Friday, October 11, 2002:

Good afternoon for Friday October 11, 4:45 pm. The following is a recap of our current open position recommendations, and our latest stop levels: We are long December wheat, with our stop at 360; long December gold, with our stop at 305; and short December mini S&P, with our stop at 930. All stops are close only.

Flash Update – Tuesday, October 15, 2002:

Good afternoon for Tuesday, October 15, 1:40 pm. This is a Flash Update. We have liquidated our long December gold position at 313.60.

Flash Update – Friday, October 18, 2002:

Good morning for Friday, October 18, 10:45 am. This is a Flash Update. We have purchased March soybeans at 553.75, placing our initial stop at 525, close only.

Friday, October 18, 2002:

Good afternoon for Friday October 18, 4:45 pm. The following is a recap of our current open position recommendations, and our latest stop levels: We are long December wheat, with our stop at 360; short December mini S&P, with our stop at 930; and long March soybeans, with our initial stop at 525. All stops are close only.

Flash Update – Friday, October 25, 2002:

Good morning for Friday, October 25, 9:15 am. This is a Flash Update. We have sold short March sugar at 7.00, placing our initial stop at 7.50, close only.

Friday, October 25, 2002:

Good afternoon for Friday October 25, 4:40 pm. The following is a recap of our current open position recommendations,

and our latest stop levels. We are long December wheat, with our stop at 360; short December mini S&P, with our stop revised to 902; long March soybeans, with our stop at 525; and short March sugar, with our initial stop at 7.50. All stops are close only.

Friday, November 1, 2002:

Good morning for Friday, November 1, 8:00 am. Special message to clients who follow the general suggestions in the *Friedberg Currency & Commodity Comments*. In recent days the US dollar has come under light and restrained pressure. This is a new development that might presage a breaking out of the past multi-month range. We therefore advise that all long US dollar positions be immediately closed out. Traders may wish to establish long euro positions with well-protected stops around 98 cents. Thank you.

Friday, November 1, 2002:

Good afternoon for Friday November 1, 4:35 pm. The following is a recap of our current open position recommendations, and our latest stop levels: We are long December wheat, with our stop revised to 390; short December mini S&P, with our stop at 902; long March soybeans, with our stop at 525; and short March sugar, with our stop at 7.50. All stops are close only.

We repeat the special message from this morning: Special message to clients who follow the general suggestions in the *Friedberg Currency & Commodity Comments* newsletter. In recent days the US dollar has come under light and restrained pressure. This is a new development that might presage a breaking out of the past multi-month range. We therefore advise that all long US dollar positions be immediately closed out. Traders may wish to establish long euro positions with well protected stops around 98 cents. Thank you.

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