

# FRIEDBERG'S

## FOCUS ON FUTURES

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## Coffee: a lot of noise, but going nowhere in a hurry

Inspired by dry weather in Brazil that threatened to reduce yields, traders drove coffee prices up by 10¢ per pound in September. It turned out to be a false alarm, and prices quickly retreated way back to the bottom of the range, in the process taking out the June lows (Chart 1). This volatile and directionless action underscores the fact that at this point in the season there is very little in the way of near-term fundamental issues important enough to move prices out of the 60¢ to 70¢-per pound range. The frost season has come and gone. A couple of dry days will spark a rally, only to be quashed by forecasts for showers. Until we get some concrete estimates for the 2004-05 crop, only long spells of drought-like conditions would matter, but that does not seem to be in the cards this year.

On the demand side, The International Coffee Organization (ICO) estimates 2002 global consumption at 108.9 million bags, unchanged from the previous season. This is about 5 million bags more than the previous two seasons.

This is encouraging for bulls, but it pays to bear in mind that the only real growth in usage can be found in Third World countries, which represent only 25% of the global market. Coffee demand is often measured in per-capita, kilogram consumption. As such, consumption in developed countries is actually in long-term decline. Per-capita consumption since the beginning of this decade has averaged 4.55 kilograms, compared with 4.69 kilograms in the 1990s.

Certainly, cultural globalization will increase usage of traditionally Western goods such as coffee, but we are not looking at the kind of adjustments in demand that will alone be sufficient to create or sustain a bull market, or for that matter a bear market. Rather, bull markets in coffee have always been associated with supply fluctuations, such as the two killer frosts in the 1990s that sent prices soaring. The bubble in 2002-03 Brazilian production sent world prices to their lowest level in a decade.

The sharp, cyclically induced drop in Brazilian output, from 48.5 million bags in 2002-03 to 34 million bags (recent ICO estimate) in 2003-04 has been accounted for by the market. A final estimate of the 2003-04 crop is due in December.

The primary issue that is likely to be the predominant

force in determining price levels in the coming months is the size of the current 2004-05 crop. Estimates vary. In August, the Brazilian Agriculture Ministry forecasted the crop to reach 40 million bags. Some analysts are forecasting a much stronger recovery. Others, still, point out that Brazilian production has rarely bounced back fully in the year following its off year and are therefore not nearly as optimistic. With the effects of not-so-perfect weather during the growing season still an unknown, we won't have any reasonable ideas about the size of the crop for another month or so.

The long-term direction of price will also be governed by the fact that coffee prices are trading well below the cost of production. The effects on yield of curtailed use of fertilizer and other cost-intensive, crop-enhancing materials is difficult to assess until we actually see smaller crops. Planting of alternative crops or abandonment of plantations altogether because of frustration over low prices is another factor. Vietnam, for example, has announced that it will idle some coffee acreage. The amount is not significant in terms

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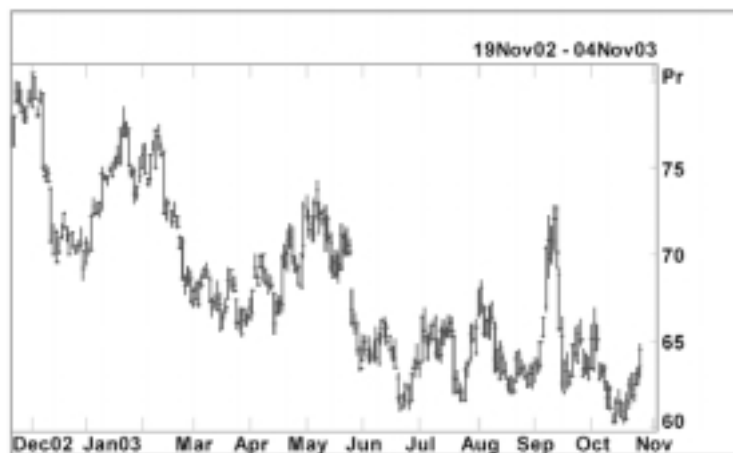
of its total production, but it provides some evidence that with low world prices production levels are vulnerable.

We do not believe that there is necessarily any immediacy to a bull market. Indeed, if estimates for the 2004-05 Brazilian crop surprise to the upside, the market is likely to clean out all sell stops below recent lows. But we also believe that prices have been too low for too long and that

this multi-year bear market will ultimately clear the way for a bull market much the same as we've seen in commodities such as cotton and cocoa. We recommend modest and comfortable long positions. *[October 28, 2003]*

**CURRENT STRATEGY:** *Liquidated our long coffee position as per Flash Update of Oct. 30.*

Chart 1 – December coffee



Courtesy Reuters

## CORN

# Strong demand overshadows a bumper US crop

For the second consecutive month, the USDA supply/demand situation report proved to be a disappointment for corn bulls. With the primary focus on the size of the 2003-04 US crop, the higher-than-expected estimate was particularly disheartening when compared with continued downwards revisions for soybeans. The comparison with beans is not merely a desperate expression of disappointment for those of us who missed the extraordinary rally in beans. Weather has historically affected the two commodities' crops in essentially the same manner. The dry weather across the US Midwest this summer was thought – even by the most sophisticated of analysts – to have reduced yields in corn as it did in soybeans. But, as illustrated in Table 1, that was not the case this year. The US corn crop was revised upwards by close to 7 million tonnes, or 2.7%, to 259.2 million tonnes, while the soybean crop was lowered yet again by almost 5 million tonnes, or 7%, to 67.18 million tonnes.

The news wasn't all bearish. The Chinese crop was revised downwards by 4 million tonnes. As a result, global ending stocks were revised upwards by 3 million tonnes, to 77 million tonnes, or 12.2% of consumption. This compares with September's 11.8% of consumption and last year's 15.8% of consumption. Still on the tight side from a historical perspective, but with a bumper US crop heading for the silos, it seemed that corn prices would remain weak.

Table 1

millions of tonnes	Corn	Soybeans
<b>USDA October estimate (03-04)</b>	259.27	67.18
<b>Average trade estimate</b>	255	70.2
<b>USDA September estimate (03-04)</b>	252.6	71.92
<b>USDA 2002-03</b>	228.8	74.83

The bull market in soybeans has the benefit of both bullish supply and demand side fundamentals. It seems that the corn market is amply supplied. What about demand? A number of developments sparked the powerful rally we are currently enjoying.

First, on October 23, a story emerged that state-controlled Chinese export prices were being hiked by \$15 per tonne. Domestic demand had been strong, and internal prices were rising. This move amounted to a *de facto* curtailment of exports. Of course, this was excellent news for US exporters, who had been facing competition from Chinese exporters over the past couple of seasons. In 2002-03, Chinese exports jumped to 14.5 million tonnes from 8.6 million tonnes in 2001-02.

The USDA estimated that 2003-04 Chinese exports would drop to 8.5 million tonnes, but that figure may have to be revised even lower. As we pointed out in previous discus-

sions, it was unlikely for China to be able to maintain export activity at these levels with domestic consumption on the rise and a crop that may be as much as 10 million tonnes, or 8%, smaller than last season's.

Then – perhaps as something of a confirmation that activity is shifting to the US – we saw some very solid export data. Average commitments over the past four weeks totaled 1.22 million tonnes. Commitments for the marketing year now stand at 16.1 million tonnes, 3.9 million tonnes, or 31% ahead of last year at this time.

Naturally, it is impossible to know if this pace is sustainable, but the USDA is looking for a modest 12.5% increase in US exports over last year's rather pathetic 40.5-million-tonne final tally. That was a six-year low and was exacerbated by the availability of reasonably price feed wheat. We expect that exports should easily be able to reach levels we saw two and three years ago, which are above the USDA's

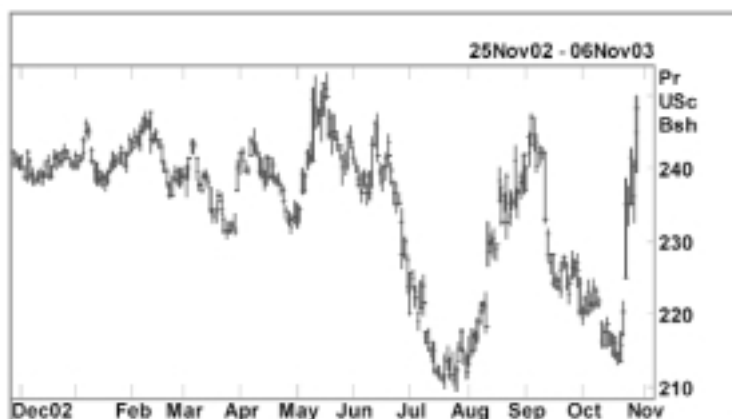
cautious estimate, particularly since evidence of strong demand exists in the form of the excellent start to the season.

Recent Commitment of Trader data show that both commodity funds and small speculators are short this market. The last big rally we saw in corn – in August – to about these price levels could be characterized as a short-covering rally. As soon as the huge short positions were whittled down, the rally died. At the time, the operative bullish fundamental that was driving the rally was the assumption – mistaken, as it turned out – that estimates of the size of the US crop would be reduced.

We believe that the demand side fundamentals driving the rally now are more substantial, but we will be vigilant in attempting to identify whether this bull run has staying power beyond short covering. *[October 30, 2003]*

**STRATEGY:** *Remain long December corn as per Flash Update of October 23. Raise stops to 233, close only.*

Chart 2 – December corn



Courtesy Reuters

## COCOA

### Fading bullish fundamentals, but a very oversold market

Here's a tough one. We have a bearish fundamental view, but we're long the market.

The bull market in cocoa that would eventually see prices more than triple began in 2001 with a huge global supply/demand deficit of more than 250,000 tonnes for the 2000-01 season. That was followed by a 150,000-tonne deficit in 2001-02. As the deficit shrank and we moved towards a balanced market in 2002-03, civil strife in the Ivory Coast dominated cocoa headlines. Forecasts for a dramatically smaller 2002-03 Ivorian crop seemed very plausible amid daily reports of violence. Arrival figures for the critical months of November and December – when roughly half the crop is shipped to ports – were running 15% behind 2001-02. A worst-case scenario was developing. A Third World country responsible for output of almost 50% of a commodity was falling apart and would not be able to meet the market's needs.

But it never happened. The French brokered a truce, and the rebel groups were included in the formation of a government. Arrivals picked up following that, and the Ivorian crop reached a healthy 1.32 million tonnes, about 80,000 tonnes larger the 2001-02 crop. E.D.&F. Man's October report, estimates that rather than running into a third consecutive year of deficit, the global supply/demand balance will move to a 70,000 surplus.

As it became clear that the 2002-03 Ivorian crop was going to make it through in fine form, the market responded accordingly. The market peaked way back in February and has been tumbling since.

On September 23 news broke out of the Ivory Coast that rebel groups were leaving the government. Prices responded with a 3-day, \$200-per-tonne rally. But the market wasn't having any of it. The rally faded almost as quick-

ly as it came, and the market proceeded to make lows not seen since February 2002.

The current fundamental picture is not that bullish. Over the past year there has been anticipation of improved demand. Unfortunately, though, grind data have been disappointing. While there has been growth, it has generally been below expectations. The pan-European grind for the third quarter rose 1.8%. The US grind increased 1.6%, at the low end of the range of estimates of 1% to 10%.

Man's early look at the new 2003-04 crop year shows a balanced market. After 2002-03 Ivorian output was virtually unaffected by the chaos, market analysts will probably be more cautious about downgrading crop prospects whenever there are flare ups between warring factions. We've already seen stories about poor quality and arrival rates being below last year's levels, but they've failed to generate much enthusiasm.

The December/March spread has been moving further into backwardation and is cited by bulls a sign of a tightness. But both the slow port arrivals and the developing inversion on the board may very well be related to the fact that farmers have been holding back supplies in an attempt to drive prices higher. This, however, is a temporary situation and does not affect actual supply. The beans will emerge soon enough, same as they did last year.

So why are we long? Typically, we formulate our trading ideas through fundamental analysis. We do look at some technical indicators, but only as a guide for entering or exiting a market in which we have a fundamentally based view. These indicators are flashing a monumentally oversold market. Sentiment surveys that we look at show that market participants have a more bearish outlook on cocoa prices now than they did when we were trading at the \$750-per-tonne low in early 2001.

Open interest has ballooned to 110,000 contracts. Over the past few weeks commodity funds have established a 15,000-contract net-short position. The small-specs are net short as well. The latter group was long throughout the bear market that ended in 2001 and liquidated their net-long position right through the bull market. Now, after missing the ride

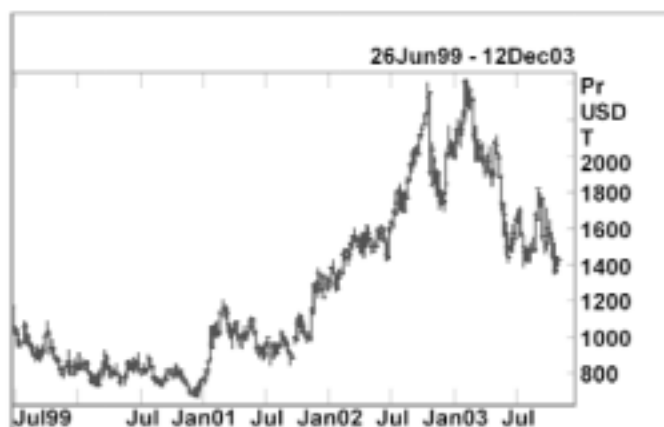
down from the \$2,400-per-tonne level, the speculative community is short.

Of course, this is a trade that has to be monitored meticulously. If open interest continues to build and Commitment of Traders data continue show that large and small specs are increasing or maintaining their short position, but are not successful in penetrating the lows convincingly, then they will ultimately be forced into covering their shorts, causing an important rally. In technical parlance, this is known as a bear trap. Otherwise, the fundamentals will prevail, and the market will continue to drift lower.

In conclusion, although the bullish fundamentals that sparked the bull market have faded considerably, this market remains vulnerable to supply interruptions. We are not hunkering down with a decidedly bullish view. Rather we are attempting to take advantage of a market that overshot the downside and may have a counter-trend rally significant enough to profit from. *[October 31, 2003]*

**STRATEGY:** *Remain long March cocoa as per Flash Update of October 2. Maintain initial stops at 13.15, close only.*

Chart 3 – Weekly cocoa



Courtesy Reuters

## COTTON

### Prices soar, but stall after record export data

In classic buy-the-rumor-sell-the-news fashion, cotton prices greeted the news of record weekly US export commitments with a "limit down" close. The market first sprinted to a 2¢-per-pound gain on the USDA weekly export report that showed that US exporters sold 1.475 million bales of cotton. To appreciate just how extraordinary this is for a single week and the kind of numbers we've been chalking up on the export front, consider this: This was the second consecutive week that export sales far exceeded street estimates. Last week, the high end of analysts estimates was 325,000 bales, but the figure came in at 645,000 bales. This week, the polled analysts

rammed up the high end of expectations to 600,000 bales, but were once again left in the dust, only in much grander fashion. Normally, a 300,000-bale weekly sales tally is considered very impressive.

For the 2003-04 marketing year so far, commitments stand at 6.17 million bales, compared with 5.05 million bales last year at this time. This is a marked difference from the 2002-03 season when we were running well behind the previous season. Last season, bulls were challenged to have confidence in the USDA's forecast for impressive numbers towards the end of the marketing year to meet its estimate for annual

exports. We're only 3 months into the marketing year, and over half the 12 million bales the USDA is estimating for 2003-04 have been sold.

Now let's try to figure out why the market has had back-to-back "limit down" days after the blockbuster export figure was released. The dramatic runup in prices we've seen over the past few weeks was triggered by a September 10 announcement by China that its crop was hurt by inclement weather and estimates would have to be reduced, perhaps by as much as 15%, to 23 to 24 million bales – according to the local estimate – from early season forecasts that were a high as 27 million bales. So it shouldn't have been any great surprise that China, where consumption is forecast by the USDA to grow to a record 30.4 million bales this season, was a big buyer. In fact, Chinese purchases accounted for better than 80% of the 2.12 million bales sold over the past 2 weeks.

While these developments are obviously very bullish, the October USDA monthly supply/demand situation report was slightly bearish, but was completely ignored by the market. First, the US crop was revised upwards by 620,000 bales. Then, the USDA maintained its September 25.5-million-bale estimate for Chinese output, at least 1.5 million bales higher than the Chinese Agriculture Ministry revision. The September estimate for 2003-04 global ending stocks sank to multi-year lows of 32.22 million bales, or 32.6% of consumption, but inventories were revised up by 1.5 million bales in the October report, to 33.73 million bales, or 34.3% of consumption.

While anything below 35% of consumption is still very bullish – considering that the average carryout in recent years ran between 45% and 50% of consumption – we have to keep in mind that we have seen a dramatic runup in prices.

Although inventories have dropped sharply over the past two seasons, speculative enthusiasm may have caused prices to overshoot a fair representation of the fundamentals. Commodity funds have gone berserk with a record net-long position of close to 50,000 contracts. It's probably time for a good old-fashioned liquidation.

What should we be looking for to determine whether this market has a shot at attaining mid-1990s price levels once a liquidation of weak hands is complete?

China has already committed to 2.18 million bales of US exports, compared with 1.9 million bales of sales for all of last year. The Chinese crop, even using the low end of the range of estimates, will still be about the same size as last year's crop. Domestic consumption is estimated to grow by about 1.5 million bales. This means that they will need to purchase, perhaps, another 1 to 1.5 million bales from the US.

If we figured this out, so could anyone with a calculator. It's not news, and at over 70¢ per pound, we can assume "it's in the market." The USDA may not have had time to respond to the new Chinese crop data in its October report, and if the November estimate comes in below 23 million bales, that would be news. Issues surrounding the Chinese crop and its purchasing patterns will be then be the key to this market's direction.

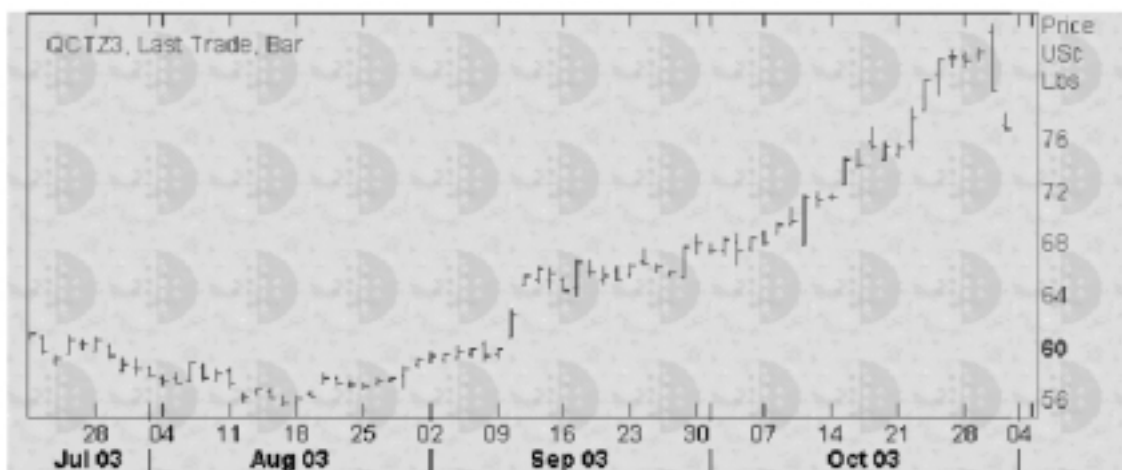
The export data will not continue at this pace. Nevertheless, if we continue with just average sales, we're in fairly good shape to exceed the USDA 12-million-bale forecast for US exports.

We missed this one. We will wait patiently for the market to settle down, and reassess the fundamentals.

[October 31, 2003]

**STRATEGY:** Remained sidelined.

Chart 4 – December cotton



Courtesy Reuters

## HOTLINE UPDATE

### Friday, September 26, 2003:

Good afternoon for Friday, September 26, 4:30 pm. The following is a recap of our latest recommendations and stop levels: We are currently long December corn at 213.5, with our stop at 220; and long December gold at 354, with our stop at 370. All stops are close only.

### Flash Update – Tuesday, September 30, 2003:

Good morning for Tuesday, September 30, 9:25 am. This is a Flash Update. We have purchased December crude oil at 28.35, placing our initial stop at 27.30, close only.

### Flash Update – Wednesday, October 1, 2003:

Good afternoon for Wednesday, October 1, 12:45 pm. This is a Flash Update. We have liquidated our long December corn position at 219.5.

### Flash Update – Thursday, October 2, 2003:

Good afternoon for Thursday, October 2, 12:25 pm. This is a Flash Update. We have purchased December coffee at 64, placing our initial stop at 60, close only.

### Flash Update – Friday, October 3, 2003:

Good morning for Friday, October 3, 8:30 am. This is a Flash Update. We have purchased December cocoa at 1567, placing our initial stop at 1450, close only.

### Monday, October 6, 2003:

Good afternoon for Monday, October 6, 12:00 pm. The following is a recap of last week's trade recommendation history, and our latest recommendations and stop levels: On September 30, we purchased December crude oil at 28.35; on October 1, we liquidated our long December corn position at 219.5; on October 2, we purchased December coffee at 64; on October 3 we purchased December cocoa at 1567, and liquidated our long December gold position at 370.

We are currently long December crude oil at 28.35, with our stop revised to 28.00; long December coffee at 64, with our initial stop at 60; and long December cocoa at 1567, with our initial stop at 1450. All stops are close only.

### Flash Update – Wednesday, October 8, 2003:

Good morning for Wednesday, October 8, 11:45 am. This is a Flash Update. We have liquidated our long December cocoa position at 1452.

### Friday, October 10, 2003:

Good afternoon for Friday, October 10, 3:30 pm. The following is a recap of last week's trade recommendation history, and our latest recommendations and stop levels: On October 8 we liquidated our long December cocoa position at 1452. We are currently long December crude oil at 28.35, with our stop revised to 29.75; and long December coffee at 64, with our stop at 60. All stops are close only.

### Friday, October 17, 2003:

Good afternoon for Friday, October 17, 4:10 pm. The following is a recap of our latest recommendations and stop levels: We are currently long December crude oil at 28.35, with our stop at 29.75; and long December coffee at 64, with our stop at 60. All stops are close only.

### Flash Update – Tuesday, October 21, 2003:

Good afternoon for Tuesday, October 21, 5:30 pm. This is a Flash Update. We have sold short December mini S&P at 1043.50, placing our initial stop at 1060, close only.

### Flash Update – Wednesday, October 22, 2003:

Good morning for Wednesday, October 22, 10:30 am. This is a Flash Update. We have purchased December gold at 382, placing our initial stop at 369, close only. We have also liquidated our long December crude oil position at 30.20.

### Flash Update – Thursday, October 23, 2003:

Good morning for Thursday, October 23, 9:50 am. This is a Flash Update. We have purchased December corn at 220.25, placing our initial stop at 212.5, close only.

### Friday, October 24, 2003:

Good afternoon for Friday, October 24 4:30 pm. The following is a recap of last week's trade recommendation history, and our latest recommendations and stop levels: On October 21, we sold short December mini S&P at 1043.50; on October 22, we purchased December gold at 382, and liquidated our long December crude oil position at 30.20; on October 23, we purchased December corn at 220.25.

We are currently long December coffee at 64, with our stop at 60; short December mini S&P at 1043.50, with our initial stop at 1060; long December gold at 382, with our initial stop at 369; and long December corn at 220.25, with our initial stop at 212.5. All stops are close only.

### Flash Update – Tuesday, October 28, 2003:

Good morning for Tuesday, October 28, 9:45 am. This is a Flash Update. We have purchased March cocoa at 1398, placing our initial stop at 1315, close only.

### Flash Update – Thursday, October 30, 2003:

Good afternoon for Thursday, October 30, 12:25 pm. This is a Flash Update. We have liquidated our long December coffee position at 60.10.

### Friday, October 31, 2003:

Good afternoon for Friday, October 31 3:45 pm. The following is a recap of last week's trade recommendation history, and our latest recommendations and stop levels: On October 28, we purchased March cocoa at 1398; on October 30, we liquidated our long December coffee position at 60.10.

We are currently short December mini S&P at 1043.50, with our stop revised to 1056; long December gold at 382, with our stop revised to 375; long December corn at 220.25, with our stop revised to 233; and long March cocoa at 1398, with our initial stop at 1315. All stops are close only.

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