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Corn: Wet behind the ears

Market participants were broadly sceptical of the USDA's August estimate for US corn yields of 175.1 bushels per acre (bpa). That was an upward revision from July's 168.5 bpa estimate. Leading up to the September crop report, the average of analysts' guesstimates was 173.5 bpa, but the USDA lowered its estimate just a tad, to 174.4 bpa.

The reaction was muted, though. In the days following the new yield estimate, the market sold off somewhat, but did not challenge the early-September lows (Chart 1). Instead, traders turned their attention to the weather.

It has been raining across the US corn belt since July. Moisture is beneficial for developing crops, but the precipitation has overstayed its welcome. Key growing states such as Iowa, Illinois, Indiana, and Minnesota are experiencing their wettest summer in decades. Aside from harvest delays, it is so wet in some regions that stock rot and disease have become a legitimate concern. It has also been a particularly humid summer, and excessive moisture combined with humidity leave plants even more vulnerable.

Over the years, we have seen US corn crops muddle through tough conditions of many sorts, so we're not predicting a crop failure. There has not been any indication from official statistics that there is even a hint of a problem. Weekly USDA progress reports show the good-to-excellent portion of the crop at 74%, which is just one percentage point off the high of this growing season. That compares with 68% at this time last year and the five-year average of 55%.

With the wet weather, however, there are grounds for questioning a 174.4 bpa yield, at least until we're well through the harvest. There are still well-regarded analysts who believe that the USDA remains much too optimistic with its bpa yield estimate, and the rain has exacerbated these concerns.

Looking ahead, the wet weather could have ramifications for the 2017-18 crop as well. Unusually wet soil that lasts through the summer and into the harvest season limits the root depth for the crop that is planted the following spring. The summer of 2009 saw similar conditions to this year's, and 2010-11 output was close to 5% smaller than the previous season's. Although there were other problems with 2010-11 crop, the wet soil conditions were considered a contributing factor.

As we mentioned in our previous article on corn (see *Focus on Futures*, August 22), the USDA wasted no time in cranking up its estimate for Argentinean corn production that will be planted in the coming months. As we already saw in late-season plantings for the 2015-16 crop, Argentinean farmers planted as much corn as they could to take advantage of the elimination of the export tax. The early estimate for 2015-16 Argentinean production was as low as 24 million tonnes, but the final number was 28 million tonnes. So it's a good bet that planted area will expand. The current forecast for 2016-17 is for an output increase of 30%, to 36.5 million tonnes.

Given favorable weather conditions, we have no reason to doubt that this is achievable. The problem is that with growing demand, the bumper crops in the US and Argentina have had no appreciable effect on global inventories. In fact, the USDA estimate for 2016-17 global ending stocks is 21.6% of consumption, down from 21.8% in 2015-16.

Prices are trading near two-year lows. Commodity funds remain heavily short, and if any supply surprises pop up, the market will rally. And we believe – as illustrated above – there is a strong possibility that the size of the US crop is overstated.

We were stopped out of our long position in December corn at $3.25 per bushel, as per our August 22 recommendation. We continue to view the long side as a low-risk opportunity. Buy December corn, presently trading at about $3.32 per bushel. Place initial sell stops at $3.10, close only.

[Sholom Sanik, Sept. 23, 2016]

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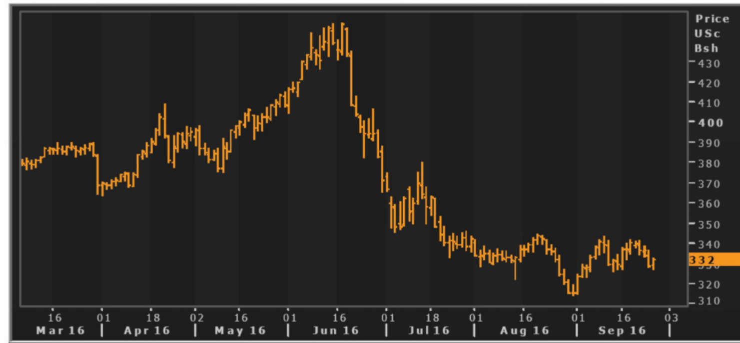
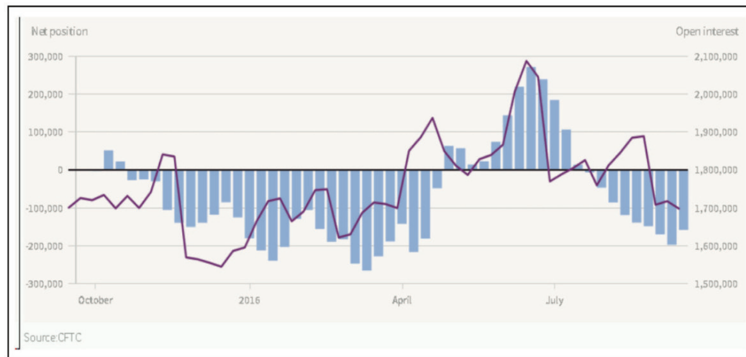
Chart 1 – December corn



Courtesy Reuters

Chart 2 – Commodity fund net-short position



Source: CFTC

COPPER

China vs. Chile

This year's high in copper prices was set in mid-March near $2.30 per pound (Chart 3) and coincided with the March peak in Chinese imports (Chart 4). The market has been volatile, but has been confined to a $2.00 to $2.30 per pound range.

After Chinese copper imports touched their record monthly high this past March, they dropped for four consecutive months (month-over-month and year-over-year), before recording a tiny uptick in August. It took some time, but the bears were probably correct in assessing the situation and predicting that – sooner or later – imports would taper off. If the volume of collateral deals had been falling and Chinese economic growth was sputtering, why would they be buying so much copper? The argument that imports would falter has come to fruition.

Warehouses have been filling up. Chart 5 shows that combined LME, Shanghai, and COMEX stocks have bounced back and are close to the year's high. But that does not tell us much about the future.

Chile is by far the world's largest producer of copper. Estimates for 2106 output keep dropping. At one point several months ago, the government was forecasting a slight increase. As recently as July, the forecast fell to a 0.5% decrease. Monthly output data are available through the end of July and show that average year-over-year monthly production is down 4.9%. Earlier in the year, rains resulting from the tail end of El Niño were blamed for the slow pace of output. Other arguments focus on targeted cutbacks in response to weak prices. But notes accompanying the monthly reports are indicating falling ore grades, which could mean that the ability to increase production is limited, at least until new projects come on line.

As it happens, the volume of the drop in Chilean output is roughly the same as the fall in Chinese imports. Which explains – at least to some degree – why prices have been trading inside a relatively narrow range of about $0.25 per pound.

The most recent International Copper Study Group (ICSG) report – released on September 20, but is somewhat stale as it only covers the period between January and June – shows that the global supply/demand stands at a 306,000-tonne deficit. This compares with a 54,000-tonne deficit in the same period in 2015.

Chinese demand and Chilean production – at 40% and

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35% of world totals, respectively – are the two single most important factors in the copper market. The prospect of a continued slide in Chinese imports – in isolation – certainly does not bode well for maintaining these price levels. The flip side, of course, is that tumbling output in Chile could keep the market balanced.

On June 17, December copper was trading around $2.06 per pound. We recommended establishing a long position, with a stop close of $1.99. At the time, both Chinese imports and Chilean output were well into their decline.

But the dollar was near a one-year low, and crude oil and other commodities were on the rise. So there was no compelling, fundamentally-based reason to be long copper, other than the belief that it was out of sync with the board. While it was not a strong bullish case, with December copper now trading at $2.18, the strategy was successful. The matter will be decided by whether Chinese copper imports or Chilean output declines at a faster pace.

Commodity funds are heavily short and open interest has fallen sharply during the recent rally, indicating perhaps that a strong short-covering rally is underway.

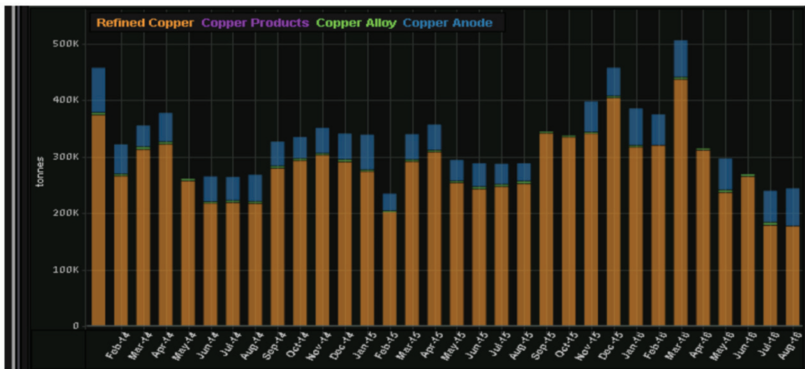
Remain long, but raise stops to $2.10 per pound, basis the nearest trading month, close only.

[By Sholom Sanik, Sept. 30, 2016]

Chart 3 – December copper

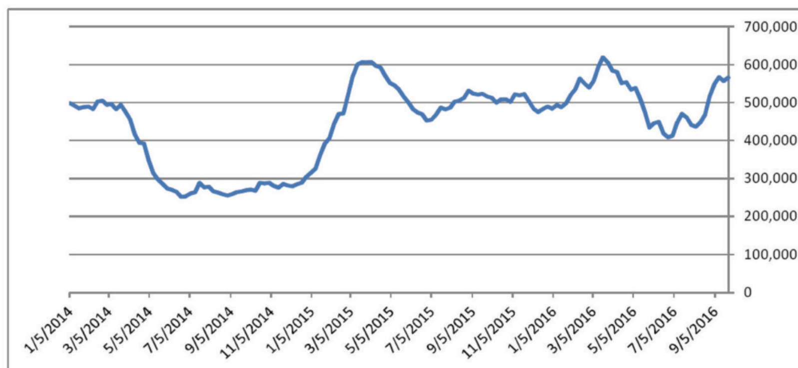
Courtesy Reuters

Chart 4 – Chinese copper imports



Courtesy Reuters

Chart 5 – Combined LME, Shanghai, COMEX warehouse stocks



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COCOA

New crops make way for the bear

"We are intrigued by the recent price weakness in the face of the generally bullish supply/demand fundamentals. Should the funds decide that this market is overvalued – as we believe it is – the liquidation that would ensue should trigger a dramatic fall in prices."

That's a quote from the concluding paragraph of *Focus on Futures*, July 21. Cocoa prices were trading at $2,910 per tonne at the time. Although cocoa prices have tumbled to three-year lows (Chart 6), the forecast was not quite as prescient as it seems on the surface, because the market first rallied to over $3,100 per tonne.

The apparent fundamentals were indeed bullish, but prospects for the new crops have improved, and the market has turned.

The biggest story of the season was the disappointing harvests by West African producing nations – particularly for the smaller, secondary mid-crops, which were affected by El Niño-related dryness. The most recent government figure for 2015-16 Ivory Coast output puts port arrivals at 1.56 million tonnes, down 12% from 2014-15.

The other West African producing nations were no help, all growing sub-par crops as well. Ghanaian production reached some 750,000 tonnes, about equal to 2014-15, but below the 850,000-tonne output achieved in 2013-14. The third and fourth West African producing nations – Nigeria and Cameroon – also grew smaller crops than the previous year.

Rounding out the world's major producers, Indonesian output was also below standard.

The demand side provided more reason for the bull's longevity. Product prices have been very strong, which presumably provided incentive for processors to buy beans and take advantage of high butter and powder prices. Chart 7 shows that the combined butter/powder ratio is at one-year highs.

Certainly the second-quarter European and North American grinding results released this past July indicated that processing activity was on the rise, with year-over-year increases of 4.9% and 3.4%, respectively. Third-quarter results for Europe are out and show that the grind grew, but at a slower pace of 2.9%.

So the fundamentals for the 2015-16 marketing year were mostly bullish. There will be a global production/consumption deficit of about 200,000 tonnes. According to the International Cocoa Organization's September 13 balance sheet update, global ending stocks have fallen to 33.1% of usage, down from its previous estimate of 34.2%, and materially lower than the 38.2% we saw in 2014-15.

Why then is the market collapsing? Traders are now focusing their attention on the new Ivorian crop. Early results tell us absolutely nothing about the size of the main crop – last year the weather was favorable at this time of year, and the crop was a bust. Still, with El Niño gone, there is no reason to assume that the 2016-17 season will not pop back to trendline yields. Thus far, precipitation has been adequate, and more rain is expected over the coming weeks. We expect that the other West African producing nations will follow a similar pattern.

Bulls were counting on rapid demand growth to keep prices north of $3,000 per tonne. When the major world crops got into trouble, the bullish sentiment heated up, with several explosive moves in the net-long position this year. But we're through the negative supply news. Even a modest recovery in West African crops would mean a 5% to 6% increase in world production. Coupled with demand growth rates of 3% to 5%, that would leave the global market with perhaps a small deficit. Analysts are looking for a 100,000-tonne surplus, but that may be a tad premature. Unless processing activity really heats up, the balance sheet will move towards a balanced market, and quite possibly a surplus.

Chart 8 shows that the funds are still stuck in long position, and as the liquidation intensifies – as we believe it will – prices will continue to drift lower.

Remain long as per our July 21 recommendation. Lower stops from $3,250 per tonne, to $2,950, close only.

[By Sholom Sanik, Oct. 14, 2016]

Chart 6 – Weekly nearest contract ICE cocoa

Courtesy Reuters

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Chart 7 – Combined cocoa butter/powder ratio

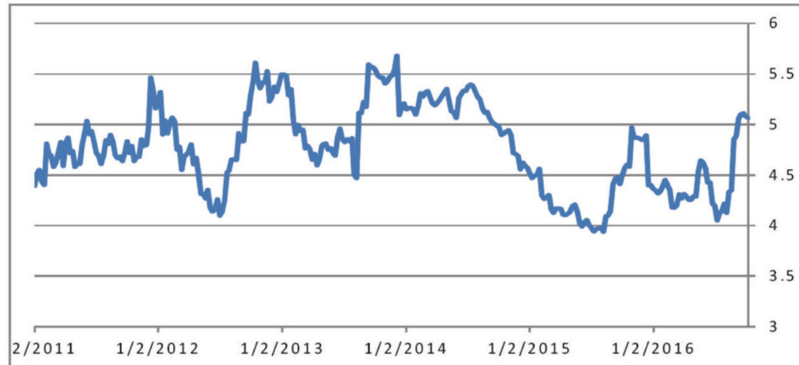
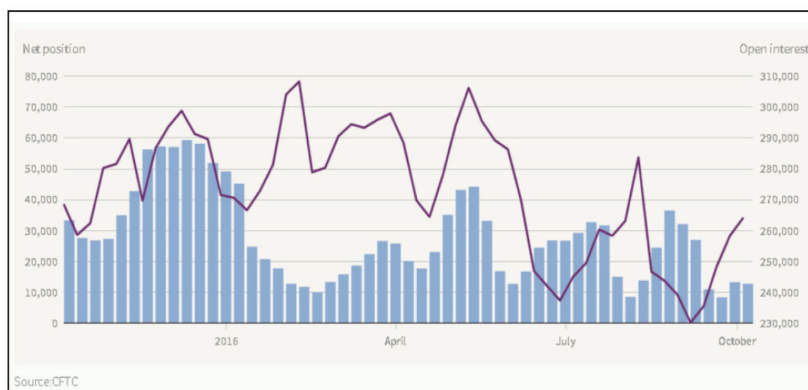


Chart 8 – CFTC net-long fund position (bar chart)



Source: CFTC

COTTON

Bigger crops, but inventories dropping

Cotton crops for the 2016-17 marketing year are now in harvest. Global output is expected to climb by 6% over 2015-16. The bear market, however, has already done its job by disincentivizing excessive planting and – albeit slowly – making a dent in burdensome stockpiles. The outgoing 2015-16 crop year marked the fourth consecutive year of global output decline. Even with competition from petroleum-based synthetic fibers, global usage is entering its fifth consecutive season of moderate growth. Despite the larger crops this year, we will be looking at a second year of production/consumption deficits (Chart 9).

The October USDA crop report gave the market a boost with bullish revisions for both the US and China for the new 2016-17 marketing year.

For the US, on the supply side, the yield estimate was lowered by 5 pounds per acre, to 797 pounds per acre, which translates into output of 16.03 million bales, down 110,000 bales from the September estimate. Not a very meaningful change, particularly in light of the huge jump from last year's output of 12.89 million bales.

But what caught the eye of traders was the 500,000-bale upward revision to exports, to 12 million bales. In an era of Chinese destocking – and it is sort of an "era" because it's going to take some time for the Chinese to whittle down their inventories – it was refreshing to see an outlook for stronger international demand. US exports peaked in 2010-11 at 14.4 million bales and, at 9.5 million bales, last year's sales were dismal. So even with onl light Chinese purchases, demand seems to be recovering.

Total Chinese imports peaked in 2010-11 at 24.5 million bales and have fallen precipitously since. Imports for 2016-17 are estimated at 4.5 million bales, about the same as last year. As the government continues to make cotton available to mills from storage, we cannot expect Chinese imports to play any major role in world trade the way they used to – as illustrated.

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The good news for bulls, however, is that over the past few months, the USDA crop report shows that ending-stock levels have declined meaningfully.

The USDA's first estimate for 2016-17 Chinese ending stocks back in May was 56.72 million bales, or 170% of usage. Now it's down to 48.1 million bales, or 135% of usage. At the global level, the May estimate was 96.48 million bales, or 87% of usage. The current estimate is 89.8 million bales, or 77.9% of usage.

Those figures are still staggering when compared with any other tradeable commodity, but it is unlikely that USDA data are current. According to official Chinese data, there have been large sales out of reserves over the summer, and there are plans for the sale of an additional 12 million bales in the new marketing year.

Of course, this means that China will not be the one to pad US exports for the foreseeable future, but as pointed out above, expectations for very small Chinese imports have already been discounted. One idea that has been presented in press reports is that Chinese mill consumption has been underestimated by the USDA, so the reduction in ending stocks could represent *bona fide* disappearance.

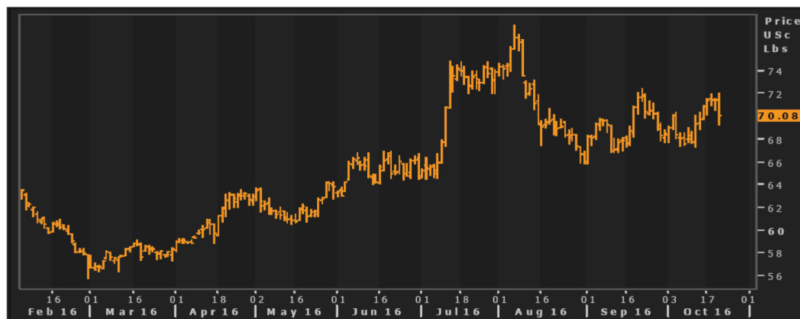
Our July 19 recommendation to protect long December cotton positions with a 66¢-per pound stop close was triggered. Unfortunate, because that was the low of the move. We continue to believe, however, that the market is forming a base and that the supply and demand fundamentals have turned bullish. Reinstate long positions in March cotton, now trading at about 70¢. Place initial stops at 65¢, close only.

[By Sholom Sanik, Oct. 21, 2016]

Chart 9 – Global cotton balance sheet (USDA)

	production	consumption	surplus/deficit
2011-12	127.61	104.26	*23.35*
2012-23	123.94	108.45	*15.49*
2013-14	120.37	109.78	*10.59*
2014-15	119.10	110.13	*8.97*
2015-16	96.44	110.09	*-13.65*
2016-17	102.47	111.23	*-8.76*

Chart 10 – March cotton



Courtesy Reuters

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