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## FOCUS ON FUTURES

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## Soybeans: the bull trap unraveled

The late-summer rally that took the soybean market to multi-year highs was not completely unwarranted. There were several bullish developments.

The most significant market mover was dry weather in the US Midwest. The most recent crop-condition progress report highlights how the dry conditions have affected the crop. The good-to-excellent portion of the crop was revised down significantly from the previous week – by three percentage points – to 53%. That compares with 63% last year at this time.

The second bullish supply-side factor is the potential for problematic weather in South America. The La Niña weather pattern could delay the rainy season in Brazil and force late plantings. That would push the beginning of the harvest off for a month. In the interim, the Chinese would continue to buy from the US later than they normally would, and US supplies would be drawn down to dangerously low levels, the way they were in 2008-09 and 2009-10.

The September 12 monthly USDA crop report confused traders, who were anticipating a bullish report that would reflect deteriorating crop conditions. Analysts were looking for downward revisions for the 2011-12 crop estimate. Acreage and the harvested/planted ratio were left unchanged from the August estimate. That was unexpected, but the yield estimate was a bigger surprise. The average guesstimate called for a downward revision from the August estimate of 41.4 bushels per acre (bpa), to 41.039 bpa. The USDA actually raised the estimate to 41.8 bpa.

The average guesstimate for ending stocks was for a decline from the August estimate of 168 million bushels, to 151 million bushels, but the actual figure was a small downward revision to 165 million bushels.

The market reacted swiftly to end the drought-induced rally with a 30¢-per-bushel decline during the trading session following the release of the report and with a further 65¢-per-bushel decline over the following week.

At 5.2% of consumption, US ending stocks are still near historic lows, but with one major difference between now and other years of low US inventories – the perpetual growth of South American crops.

In 2010-11, combined Brazilian and Argentinean soybean output was 124.50 million tonnes. Corn prices have

risen at a much faster pace than soybeans since 2009, and as a result, we could see somewhat of an acreage shift in South America, away from soybeans and towards corn. Forecasts for the upcoming crops in Brazil and Argentina reflect this, with estimates of 73.50 million tonnes and 53 million tonnes, respectively. The Brazilian estimate is down 2 million tonnes from 2010-11. The Argentinean crop is expected to be 4 million tonnes above the previous season, but only because of very poor weather. Two seasons ago, in 2009-10, production was 54.50 million tonnes. So in trendline terms, the Argentinean soybean crop has actually reached a plateau.

US ending-stock levels can no longer be measured relative to historical levels. Looking at the global picture then, production will be down 6.5 million tonnes, mainly because of the smaller US crop. Consumption is forecast to increase by 10 million tonnes, to 262 million tonnes. Ending stocks will be drawn down to 23.85% of usage, down from 27.2% in 2010-11.

Still, the pool of available supplies for world trade is ample, barring unforeseen glitches. South American production is still huge. At worst the phenomenal growth rate has ended. Uncertainty remains regarding the size of the US crop and how long La Niña will delay the South American harvest. Once Brazilian and Argentinean beans

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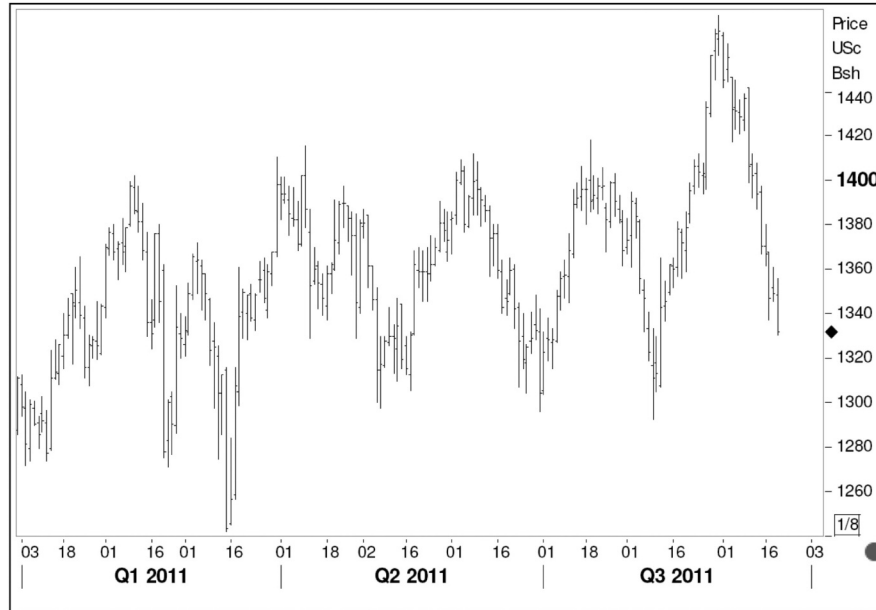
begin to flow, it is difficult to see prices holding at these levels.

Our August 4 short-sale recommendation was stopped

out at \$14.25. Pity. We recommend patience, but do sell January soybeans on any decent-sized rally.

[September 22, 2011]

Chart 1 – January soybeans



Courtesy Reuters

## SUGAR

### Is the bull dead or just wounded?

Commodity prices across the board have been sliding in unison. The degree of loss varies, but everything has been beaten up – energies, grains, precious and base metals, and softs. It may seem as though commodity-specific fundamentals have no relevance to falling prices, but that may not be the case.

Considering what the equity markets are telling us about the global economy, particularly the bleak outlook for the eurozone, the demand side of the balance sheets may indeed have changed. Forecasts for consumption for many commodities were made under the assumption of slow but steady growth in both the developed and developing world. Now we're talking recession and demand destruction.

The sugar market has been no exception, but it's questionable how much a basic staple such as sugar would be affected by recession – if there were one. Prices have fallen 5¢ per pound over the past few weeks and triggered our 26¢-per-pound sell stop. There have not been too many apparent developments on the fundamental side, but traders are factoring in the potential for a drop in usage estimates.

Estimates for 2011-12 Brazilian output, which have been slipping throughout the crushing season, have stabilized. Volatile weather reduced yields, leaving total production about 6% below last year's output. Late in the crush season, the sugar-to-ethanol ratio favored sugar, but that provided only an insignificant uptick for total sugar output. Output of about 34.5 million tonnes is still a major disappointment when compared with early season estimates that reached as high as 40 million tonnes, which would have been a record.

Aside from Brazil, though, the other key producing/exporting countries have taken advantage of high prices.

Thailand will harvest another bumper cane crop. Until 2009-10, sugar output averaged about 7 million tonnes. In 2010-11, output jumped to 9.5 million tonnes, and the forecast for 2011-12 calls for further gains to 10.2 million tonnes. Domestic consumption is about 2.5 million tonnes, which leaves the balance available for export. Foreign sales will therefore continue to be 3 to 4 million tonnes above historical norm.

India is in its second year of recovery after two consecutive years of weak monsoons, which devastated cane

crops. Output is expected to top last year's 24.5 million tonnes, but there is no consensus on 2011-12. Estimates range from 24.5 million tonnes to over 26 million tonnes. The industry is pushing for 4 million tonnes of unrestricted export licences.

Domestic consumption is very strong in India – traditionally accounting for almost the entire crop. Despite being the world's second largest producer behind Brazil, India was absent from international sugar headlines until the 2008-09 season. It was self sufficient and did not participate in world trade, which allowed it to build inventories that were typically equal to roughly 50% of consumption. An Indian foray into the export market will leave its ending stocks at about 4 million tonnes, or about 20% of consumption.

We believe, however, that exports could leave India vulnerable. Domestic demand is not very elastic. Current ending stocks estimates are based on static domestic consumption growth to between 22 million and 23 million tonnes. We've seen estimates that put consumption at considerably higher levels for 2011-12, which means that India would be left with insignificant inventories.

The last time Indian stocks were that low the government had to intervene by restricting sugar purchases to food manufacturers and engineering a decline in demand. Before India got a grip on the situation by slashing import tariffs as well, sugar prices had their first trip to the 30¢-per-pound level.

With strong crops in Thailand and Australia, in addition to the unusual Indian contribution to the export market, the Asian import markets will be comfortable in 2011-12. Higher output in Asia, however, is compromised by the unexpected fall in Brazilian output. Sugar analysts are forecasting a global sugar surplus for 2011-12 of about 5 million tonnes, but they have all slashed their estimates by several million tonnes to account for the drop in Brazilian output. Nevertheless, with a surplus, the fundamentals are not bullish.

Our concern about India, while hardly frivolous, is certainly premature and would really come into play only if there was a weak monsoon next spring. Nevertheless, we list it amongst potentially bullish factors.

Industrial commodities may have further to fall, but sugar is different. Prices – particularly in Brazil – are perilously close to the cost of production, which means there will be no incentive to expand acreage yet again for 2012-13.

By any technical measure, the market has become oversold. Open interest has shed 140,000 contracts since the market peaked in mid-August. Open interest continued to drop even after prices began to consolidate two weeks ago. That's a classic indication of effective commercial support. In fact, Commitment of Trader figures show that commercials have been strong buyers. We believe that there is an excellent, low-risk opportunity to probe the long side for a trade – not a marriage. Buy March sugar, risking 24¢ per pound, close only.

[October 6, 2011]

Chart 2 – March sugar



Courtesy Reuters

**COPPER**

**Deserving of the thrashing?**

Even after the S&P 500 index had fallen by 17% back in August, on the doorstep of “officially” ushering in a bear market, copper prices maintained the \$4-per-pound level through mid-September (Chart 3). But when the market broke in mid-September, it broke with a fury. By the time prices found support at \$3-per-pound, December copper was trading 34% below its August 1 inter-day peak of \$4.55 per pound.

Chinese imports are arguably the single largest factor affecting global copper prices, so sustainability of Chinese economic growth is of foremost concern. Economic data and moves by the government on monetary policy are carefully scrutinized.

Meanwhile, the most recent data, released on September 21, suggest that after tumbling from historic highs, Chinese imports have stabilized. August imports of refined copper rose 21% from the previous month. While still 11.9% below August 2010, Chart 4 shows that monthly import levels bottomed in February and have actually been trending upwards since.

For that matter, the balance of copper-specific fundamental factors is not terribly bearish. The massive selloff was triggered by fears of a double-dip recession in the US and Europe, as well as anticipation of weakness in China. In terms of impact on copper production and consumption, there has been no obvious effect – yet.

Copper output continues to trend downwards. Chilean production has been particularly weak. The large mines took some time to recover from unusually harsh winter weather in July, in addition to on-and-off labor strife. Furthermore, ore grades have deteriorated. Year-over-year monthly production in June, July, and August fell by 8.5%, 18%, and 8.7% respectively. Indonesian mines have dealt with the same set of temporary and permanent production setbacks.

According to the International Copper Study Group’s

(ICSG) September 20 report, the global copper market showed a 130,000-tonne deficit for its January through June study period. That was a slightly smaller deficit than the previous month’s report and much smaller than the 286,000-tonne deficit at the same time last year. However, ICSG’s forecast for 2011 calls for a 377,000-tonne deficit and a 250,000-tonne deficit for 2012. It says that not until 2013 will we see a sufficiently potent combination of production recovery and slower demand growth to bring the global market into balance.

Cumulative global exchange warehouse stocks, which include LME, COMEX, and Shanghai, stand at 650,000 tonnes and have been drifting lower. They peaked at 700,000 tonnes in April.

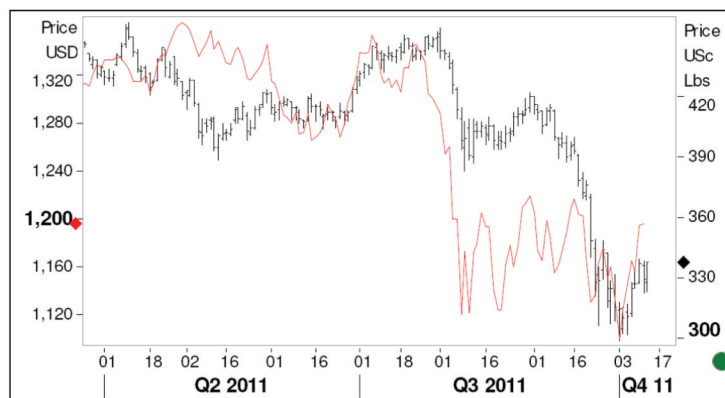
Recent US economic data have surprised to the upside, most notably the September non-farm payroll report, which was better than expected, and contained a significant upwards revision of over 50,000 jobs for the August data. To be sure, bearish economists have warned that it was a temporary respite.

At best, the positive economic data represent anemic growth, and at worst, it will all be short-lived. The hopeful signs of problem-solving in Europe may indeed be nothing more than a mirage.

Nevertheless, from a trading perspective, the market may be oversold. The most recent Commitment of Trader data show that commodity funds have gone from a net-long position of 27,000 contracts in August to a net-short position of over 5,000 contracts. Sentiment readings sank to a seven-year low, last seen when the market first broke out over the \$1-per-pound level. Sentiment last fell nearly as low in early-2009 when copper bottomed at \$1.20 per pound bottom.

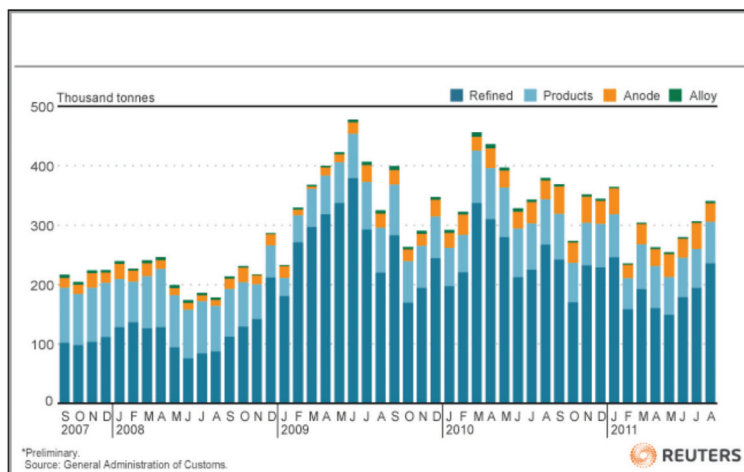
Protect profits on short positions with a \$3.40 per pound stop, close only. [October 12, 2011]

Chart 3 – December copper (bar), S&P 500 index (line)



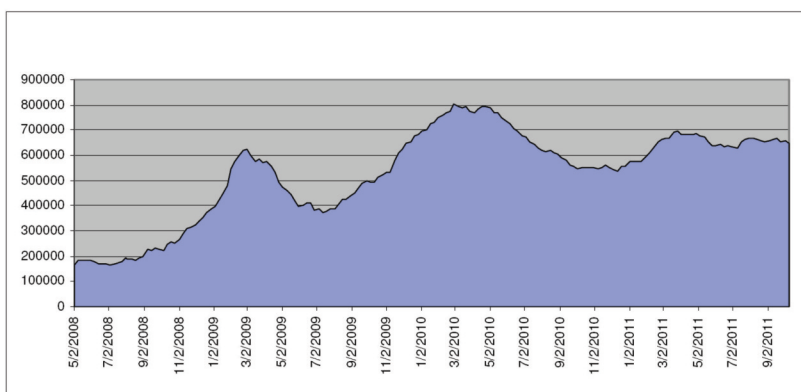
Courtesy Reuters

Chart 4 – Chinese copper imports



Courtesy Reuters

Chart 5 – Global warehouse stocks



Courtesy Reuters

## CORN

# Will the Chinese buy enough corn to halt the slide?

The corn market had a miserable September, tumbling sharply from all-time highs that reached almost the \$8-per-bushel level (Chart 6). On the eve of the October USDA crop report all the US grain markets had an explosive rally, which sent corn prices up their 40¢-per-bushel limit. Uncertainty regarding what the USDA would do with acreage and yield estimates spooked the shorts, and a massive short-covering rally ensued. After all, the USDA estimates were very volatile for 2011-12, and after falling by \$2 per bushel in such a short period of time, the market could easily respond with a powerful corrective rally on bullish news.

On the supply side, the estimate for US 2011-12 planted area was lowered by 400,000 acres. The yield estimate was unchanged from September, at 148.1 bushels per acre. The yield estimate was an ever so slightly bullish factor, because

the average trade guesstimate was for an increase to 148.7 bushels per acre. As a result of the acreage revision, the crop estimate was lowered by 64 million bushels, to 12.433 billion bushels.

The bearish demand-side revisions, however, dwarfed the smaller crop estimate. The main item was a large revision to last year's balance sheet. The feed estimate for 2010-11 was lowered by close to 200 million bushels. This should not have come as much of a shock. The quarterly stocks report, released on September 30, showed September 1 stocks at 165 million bushels above expectations.

Then, exports for 2011-12 were lowered by 50 million bushels. That was a bit of a surprise, because although US export commitments are running behind last year's pace, there were a couple of solid weeks of sales in September.

In addition, there has been a fair amount of discussion about China becoming a significant importer of corn this marketing year. The USDA kept its estimate for total Chinese imports at 2 million tonnes. There have been estimates that put the potential for Chinese imports as high as 10 million tonnes, reflecting surging feed requirements.

Moreover, before the North American trading day began and prior to the release of the crop report, China announced that it is in the market to buy 1.5 million tonnes of corn from the US or Argentina.

The guesstimate for 2011-12 ending stocks was for a jump to 806 million bushels from the September estimate of 672 million bushels. The actual number came in at 866 million bushels.

On the global front, the estimate for Chinese output was raised by 4 million tonnes, but the demand estimate was raised by the same amount. Primarily as a result of the increase in US ending stocks, the estimate for global 2011-12 will move up from 13.6% of consumption, to 14.2%. That is still very low in historical terms.

The US crop was a colossal disappointment. Although

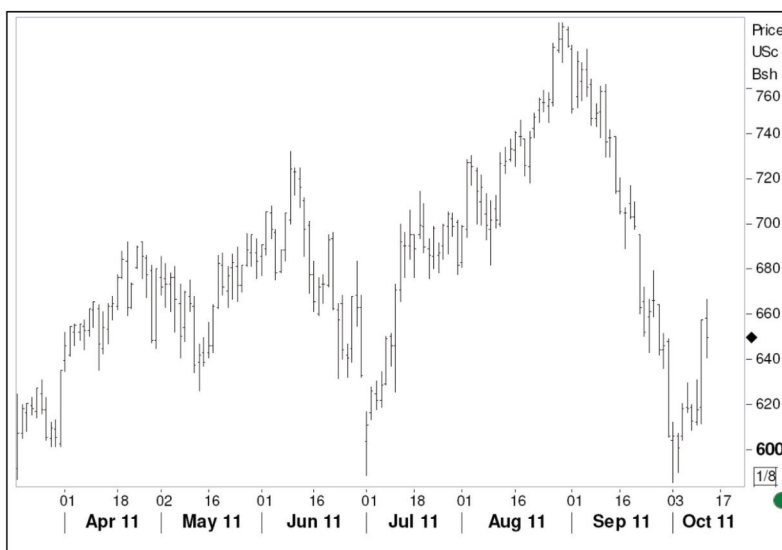
the crop was planted on an area that was close to 4 million acres larger than for the 2010-11 crop, the harvest will be no larger. Other countries compensated. Brazil and Argentina are expected to grow record-size crops. Every significant producing region, including the EU and the FSU, is in the midst of harvesting much larger crops than it did in 2010-11.

The game changer will be the intensity of Chinese imports. For example, if estimates for Chinese imports are indeed in the neighborhood of 10 million tonnes, and turn out not to be merely idle chatter, that would put global ending stocks at 13.2% of usage – a record low.

In our last discussion regarding corn (see *Focus on Futures*, September 13) we did not offer a very specific recommendation, but spoke of trading corn from the short side. We definitely recommend covering any short positions at this time. We also recommend wading into the long side with a conservative-sized long position. If the Chinese have begun a *bona fide* restocking program, this sharp dip in the market presents an excellent, low-risk opportunity. Buy March corn, place initial sell stops at \$5.75 per bushel, close only.

[October 17, 2011]

Chart 6 – March corn



Courtesy Reuters

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