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Corn: solid demand should be absorbed by large crops

Corn prices have been trading in a narrow, 25¢-per-bushel range since the US harvest was completed back in the fall. With China being self sufficient in corn, the trade war headlines had little impact on the market. Nevertheless, it is very possible that the outcome of trade talks could influence corn prices. Even if Chinese importers were to normalize their US soybean imports, US farmers are going to be laden with the largest soybean carryout in history, particularly if there is no complete resolution before 2018-19 South American supplies become available. It will be very risky for US farmers to plant soybeans in situations for which acreage can be substituted with other crops.

While the US soybean balance sheet is “off the charts” in terms of ending stocks, the corn balance sheet is moderate. The post-shutdown USDA crop report for corn shows the estimate for 2018-19 US ending stocks at 11.6% compared with 15.6% and 14.4% in 2016-17 and 2017-18, respectively. Soybean ending stocks are estimated at 22.2%, compared with 7.2% and 10.2 % in 2016-17 and 2017-18, respectively.

The mid-February USDA update for 2019-20 US planting estimates surprised us. The preliminary estimate in late 2018 put corn acres at 92.1 million acres and soy at 82 million acres. The February update kept corn at the same level, but the estimate for soy acres was increased to 85.1 million acres from 82 million acres. This would still be sharply lower than the record 89 million acres planted for the 2018-19 crop. We believe, however, it is still much too high of an estimate for soy. A more logical scenario would be an even larger shift to corn acres.

If the USDA is somewhere close to accurate on this, corn would become somewhat vulnerable. Ignoring the inexplicable explosive upward revision to historic Chinese ending stocks (see *Focus on Futures*, November 22), we still see some tightness on the global balance sheet for corn. In 2018-19 global consumption jumped by 4.4%, while output increased by only 2.2%. Global ending stocks for 2018-19 are estimated at 27.3% of usage, down from 32.3% and

31.4% in 2016-17 and 2017-18, respectively.

With US export commitment data now up to date, we see the flow of US exports were not interrupted by the US/China trade spat. Total sales stand at 39.5 million tonnes, just a tad higher than last year at this time and in line with the USDA forecasts for record exports of 62.3 million tonnes.

Strong demand notwithstanding, the balance of evidence suggests a well-supplied market. On the global front, South America is bouncing back from a drought-stricken 2017-18 season. Crops to be harvested for the 2018-19 marketing year in the coming months are strong. The USDA revised Argentina upwards by 3.5 million tonnes, to a record 46 million tonnes, up from 32 million tonnes the previous year. Brazilian output is expected to reach 94.5 million tonnes, compared with 82 million tonnes in 2017-18.

If we're correct in assuming that the US corn-area estimate for 2019-20 is too low, supplies will be ample to meet the robust demand described earlier – first from Brazil and Argentina, and then later in the year from the US.

Establish short positions in July corn, currently trading at \$3.84 per bushel. Place initial buy stops at \$4.05, close only.

[By Sholom Sanik, March 5, 2019]

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Chart 1 – CBOT July corn



Chart courtesy Reuters

COCOA

West African weather worries will not deter the bear

The West African cocoa main crops are near complete. Ivorian port arrivals stand at 1.547 million tonnes, 10% higher than last year at this time. Mid-crop harvesting begins around March 20, and market participants have expressed concern that recent weather could hamper its development. Extremely hot temperatures and below-average rainfall have left the ground dry. And that will remain a vulnerable factor going forward. The excellent performance of the main crop, however, provides a cushion. We're still in good shape to meet the 2-million-tonne level produced the past two years.

The situation in neighboring Ghana, the world's number-two producer, is similar. Arrival data are not as current as they are for the Ivory Coast. By late January, 644,000 tonnes were delivered to the marketing board, 10% ahead of the same time last year. Farmers are also combating hot and dry weather.

Very little information is available for Nigeria, but up-and-coming producer Cameroon is expected to see production rise by about 10%, to 275,000 tonnes. That would be a new high in output.

Global demand remains sluggish. As detailed in our previous report on cocoa (see *Focus on Futures*, January 17) fourth-quarter grind results for Europe and North America were sluggish. West African and Asian processing looked stronger, but only because grinding activity is slowly shifting to origin coun-

tries. On a net basis, global output is rising faster than demand. The International Cocoa Organization (ICCO) estimates that for the 2018-19 marketing year, production will grow by 3.2%, while demand will increase by 2.6%.

Product prices are weak. The butter ratio has slipped to 2.64 times London spot prices, down from a peak of 3.5 in the fourth quarter of 2018. Powder prices have remained steady, but at multi-year lows. The combined butter/powder continues to droop and is providing no incentive for processors to increase bean purchases (Chart 2).

The global market is in surplus, and the estimates are rising, albeit slowly for now. The ICCO recently raised its estimate a bit for 2017-18, to 22,000 tonnes. For 2018-19, it forecasts a global surplus of 39,000 tonnes, up from the previous estimate of 30,000 tonnes. One European processor puts the 2018-19 surplus at 130,000 tonnes.

Prices rallied toward the end of 2018 as commodity funds covered their short positions. Since January 1, however, the market has been in a steady downtrend (Chart 3). We do not believe the market is oversold. Chart 4 shows that funds have been reestablishing a short position, but it is still moderate compared with the position held back in October.

Maintain short positions with protective buy stops at \$2,450 per tonne, basis the spot month, close only.

[By Sholom Sanik, March 8, 2019]

Chart 2 – Combined cocoa butter/powder ratio

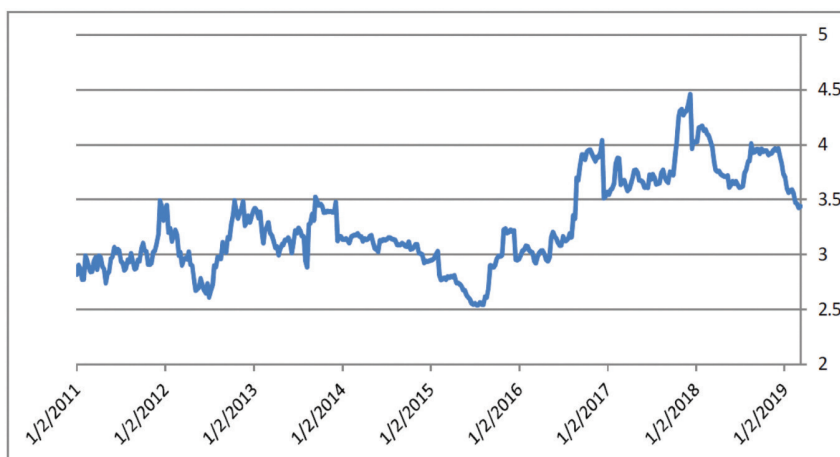


Chart source: Reuters

Chart 3 – ICE May cocoa

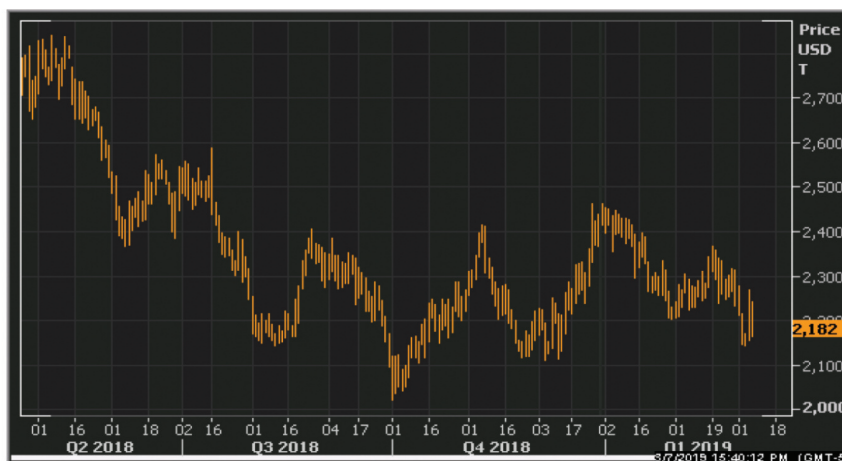


Chart courtesy Reuters

Chart 4 – CFTC commodity fund net position

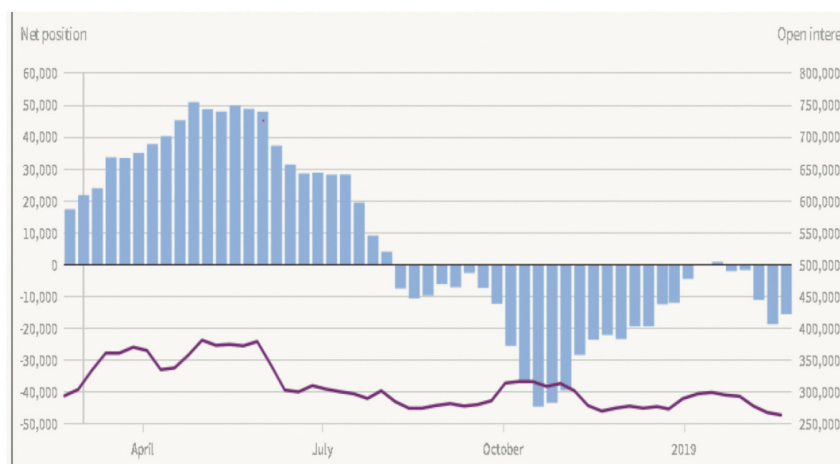


Chart source: Reuters

SUGAR

Sugar bears still in control – but not for long

Sugar prices remain depressed (Chart 5). Major producing/exporting countries will eventually pare back sugar output because profits are slim or non-existent. Bear markets beget bull markets. We believe that the supply side fundamentals are set to shift.

Brazil

Center South output for the 2018-19 season fell by more than 20% from the previous season, to 26.7 million tonnes, mainly because processors increased ethanol production at the expense of sugar. The cane crop is expected to be a bit larger than last year, and weather has been favorable. New-crop crushing for 2019-20 has begun, and sugar output is expected to bounce back. Early forecasts put output at close to 30 million tonnes. More recently, estimates have been slipping a bit, to below 29 million tonnes.

This past season was a testimonial to how sensitive the ethanol/sugar output ratio can be to a drop in the price of crude. Petroleum prices began to fall only towards the end of the cane crushing season, but it was enough to compromise sugar production. Crude prices have since rallied \$15 per barrel off their lows, and we believe that the optimistic sugar-output forecasts may have been premature. Early season crushing always favors ethanol because sucrose levels are lower in the early part of the harvest. So it will be several months before we can determine how the ratio is really performing. If crude prices maintain their rally, consumer demand for ethanol will grow *vis-à-vis* petroleum, and the industry should respond by increasing the ethanol/sugar output ratio as it did this past year.

India

The big question for India is exports. To be sure, sugar supplies are ample. Indian ending stocks for 2018-19 are at record levels. The government has offered export incentives for as much as 5 million tonnes, which to date have not been

particularly well received. For the current marketing year, exporters have contracted to sell 2 million tonnes. Shipments stand at 1 million tonnes.

A jump in sales to China is a strong probability. The 2 million tonnes under discussion would bring the Indian government's export target within sight, but we consider that to be in the market. Outside of this mega-deal there is no evidence that Indian exporters are going to sell abroad unless prices rise.

Looking ahead, after two seasons of plus-30-million-tonne crops, Indian 2019-20 output is set to fall to between 26 and 27 million tonnes, according to one European analyst. Anything below 27.5 million tonnes is of particular significance because domestic consumption for 2018 is estimated at 27.5 million tonnes. So a production/consumption deficit should begin the process of eating into burdensome inventories. While analyzing 2019-20 output might seem futuristic – that crop is not harvested until later in the year – the monsoon rains crucial to the crop are just a couple of months away.

Thailand

The Thai crop, affected by the same weather system as India's, is forecast to fall by 10% as well. Thailand is a key exporter to Asian countries.

At the moment there is enough sugar in the pipeline to keep bears bearish. And bearish they are. Commitment of Trader data show that commodity funds have rebuilt their short position (Chart 6). Perhaps they are somewhat overconfident. In 2017-18 there was a global production/consumption surplus of 10 million tonnes. For the current marketing year, most estimates hover on either side of a balanced market. Early forecasts for 2019-20 have at least one analyst pegging the global balance at a 4 million tonne deficit.

We maintain our January 30 recommendation to buy and hold October 13.5¢ calls, currently trading at about 0.80¢.

[By Sholom Sanik, March 18, 2019]

Chart 5
ICE October sugar

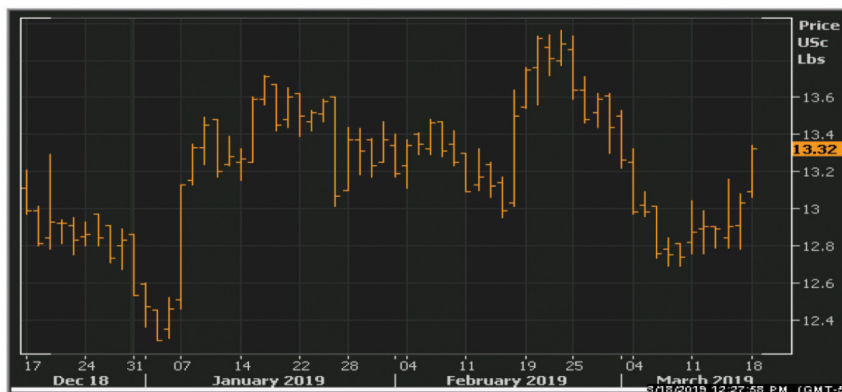


Chart courtesy Reuters

Chart 6 – CFTC commodity fund net short position

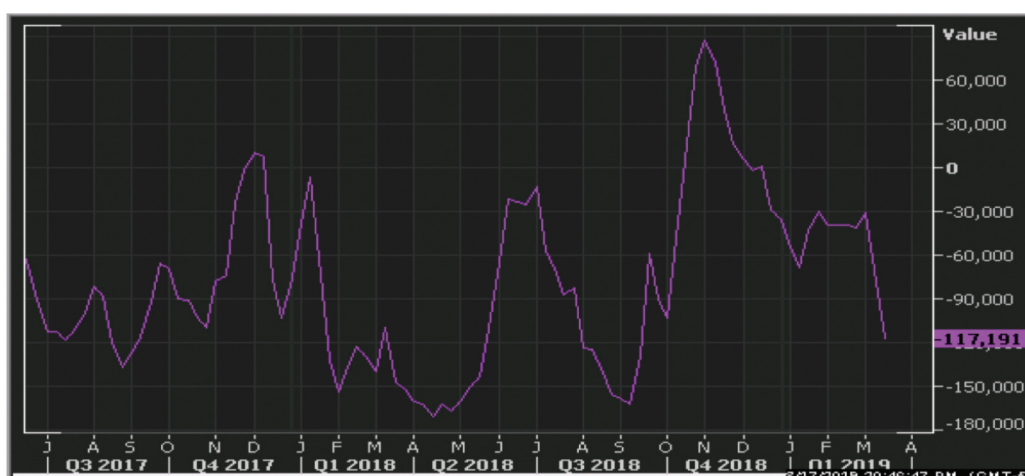


Chart courtesy Reuters

SOYBEANS

Too many acres will incite the bear

Several bullish issues have emerged for the soybean market over the past few weeks. And one bearish development threatens to overwhelm any of that bullishness.

Weather has not been too cooperative in Brazil, which has resulted in more downward revisions for the crop currently being harvested. Early forecasts based on planted area were as high as 122 million tonnes. That compares with 2018-19 output of 120.8 million tonnes and would have been a record. The March USDA crop report lowered its estimate to 117 million tonnes, and recent estimates are as low as 113.4 million tonnes.

The recent outbreak of African swine fever has reduced Chinese pork production by about 20%. Protein feed comprises roughly 20% of a hog's diet. And so traders assume that demand for soymeal could fall by a similar amount. It's a legitimate concern. The Chinese announcement that pork imports from the US would nearly double this year, to 300,000 tonnes, would seem to mitigate some of the damage to soymeal consumption, but that amount is a drop in the bucket. Chinese pork consumption is in the neighborhood of 75 million tonnes.

Finally, devastating floods in the US Midwest have rendered useless the significant amounts of soybeans in storage facilities. The range of estimates is very wide – between 50 and 150 million bushels. Even somewhere in the middle is a fairly large number. Furthermore, soon-to-be-planted soy-

bean fields will be soggy. At best this will delay planting, and at worst, it will leave some fields unplanted.

All of these bullish developments, however, could be whitewashed with the March 29 planting intentions report. When the US/China trade spat began last year, the USDA forecast that planted US soy acres would tumble to 82.5 million acres in 2019-20, from 89.2 million acres in 2018-19. That certainly seemed to make a lot of sense in light of the fact that the absence of Chinese buying pushed the US carryover estimate to a record-by-far 900 million bushels, or 22% of usage. The February USDA Forum estimate – curiously, in our opinion – raised the estimate to 85 million acres.

Now that we're on the eve of the USDA report, which arguably represents the most comprehensive survey data to date this season, analysts have ramped up the estimates. The average of analysts' guesstimates is 86.19 million acres, with one credible analyst looking for 87.7 million acres. It would be the third-largest US soybean area on record.

The Chinese trade delegation claims that there are 10 million tonnes of soybean purchases in the pipeline if there is any progress in the next round of trade negotiations. Even if this were accurate, the total amount of Chinese imports for the 2018-19 marketing year would still be dramatically shy of historic levels, which in turn would still leave a burdensome carryout for US exporters. But even 10 million

tonnes is an optimistic target with South American supplies coming to market.

At the heart of the issue is the lack of suitable planting alternatives. Farmers are not eager to plant too much corn. First, fertilizer and fuel costs are higher particularly if a field is planted with corn for two consecutive seasons. Second, while corn-based ethanol usage still represents one third of US corn consumption, the market is mature. We became accustomed to rapid growth rates, but 2018-19 will be the first time in five years that ethanol demand will actu-

ally fall from the previous season.

It will nevertheless be somewhat perplexing if US farmers do indeed plant that many acres to soybeans. Each 1 million acres at trendline yields would produce just over 50 million bushels of soybeans. All of which is over and above what the US needs to meet both domestic consumption and the *assumed* return of Chinese buying.

Sell November soybeans at the market. Place initial buy stops at \$9.60 per bushel, close only.

[By Sholom Sanik, March 28, 2019]

Chart 7 – CBOT November soybeans

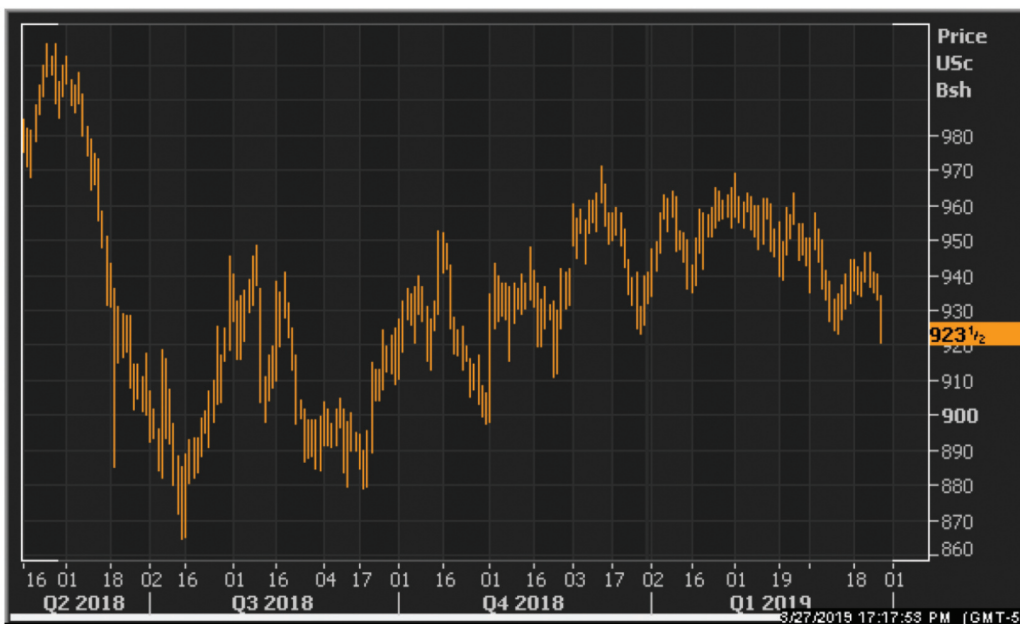


Chart courtesy Reuters

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