

# FRIEDBERG'S

## FOCUS ON FUTURES

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## A potential crop disaster vs. weak demand for US corn

Grain market participants were completely baffled by the June USDA planting estimate, believing that monumental planting delays that resulted from an extremely wet planting season would restrict the number of corn acres that could be planted before the insurance deadline kicked in. The average of analysts' estimates was 86.662 million acres, but the USDA figure came in at 91.7 million acres. Prices plunged.

With poor early-growing weather, the market attempted a mid-July recovery, but that fizzled as well, and now – on the eve of the August 12 crop report – prices have retreated to the breakout level we saw back in May (Chart 1).

The USDA made it clear that the June acreage report was based on dated data and that it would revise the planted area in the August crop report. Analysts are taking a somewhat more cautious approach, with the average guesstimate currently at 87.998 million acres.

All categories of crop development monitored by the USDA and reported in the weekly crop progress report are well behind historical norms. Only 23% of the crop is doughing, compared with the 5-year average of 42%, and 78% is silking, compared with the 93% 5-year average. The portion of the crop rated good-to-excellent is 58%, down from 71% at this time last year.

As such, analysts are more pessimistic about yield. The July USDA bushel-per-acre (bpa) yield estimate was already slashed dramatically, to 166 bpa, down from 176.4 bpa in 2018-19. The average of analysts' guesstimates is 164.9 bpa.

If the street's guesstimates on area and yield are anywhere close to accurate, we will see a sharp drop in 2019-20 ending stocks to materially below 10% of consumption. That compares with the July estimate of over 14% of consumption and 16.4% in 2018-19.

While this all seems very bullish, the fly in the ointment is demand. The reality is that the US is losing market share. In 2017-18 the US sold 61.92 million tonnes of corn abroad,

which comprised 71% of world trade. The USDA estimate for the 2018-19 marketing year calls for a drop in exports to 53.5 million tonnes. But with export commitments to date at 50 million tonnes and only one month remaining in the marketing year, we're not even going to hit the USDA target. The US share of world trade will fall below 50%. For 2019-20, the USDA has already discounted the fall from grace for US exporters, forecasting exports of only 54.5 million tonnes.

The shift has largely been to South America. For 2018-19, Brazil and Argentina are expected to export 35 million tonnes each, a leap of 12.5 and 9.8 million tonnes, respectively.

In terms of strategy, it's a bit tricky. The USDA punctured the bullish exuberance with its acreage report. But it did leave the field wide open by issuing an unambiguous note that its estimate was too high and is subject to revision in the August crop report. Market action, however, has not followed the very bullish guesstimates. If the USDA comes in with higher acreage and yield, and considering the new paradigm in which the US has been displaced as the supplier of last resort, look out below.

On the other hand, if the crop progress diagnostics are a true reflection of the state of the crop and the USDA comes through with a report that is even more bullish than

### Inside

<b>Cocoa:</b> Strong demand, stronger supply .....	2
<b>Soybeans:</b> Prices subject to Chinese demand .....	4
<b>Sugar:</b> Low price discourages production .....	5

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expected, weak demand for US corn will be overlooked. After all, global trade will still be reliant on US supplies that cannot be fully compensated for by other producer/exporter nations.

Buy December corn, currently trading just below \$4.20 per bushel. Place tight stops at \$4.05, good anytime. *[By Sholom Sanik, August 9, 2019]*

Chart 1 – CBOT December corn



Chart courtesy Reuters

## COCOA

### Strong demand, stronger supply

Cocoa prices rose to one-year highs in July. Two bullish items on the supply side were floating around at the time.

#### Supply

A joint effort was introduced by the Ivory Coast and Ghana – which account for about two thirds of global output – to raise minimum prices paid to farmers in an effort to improve living standards for farming families. To the extent that prices rose because of this scheme, it was short sighted because more money paid to farmers – aside from the obvious outcome of providing an incentive to raise production – translates into more funds available for fertilizer and pesticides, which eventually results in higher supply.

The other issue arose from reports that crop disease would cut Ghanaian output materially from early-season targets of between 850,000 and 900,000 tonnes. By the end of July, however, the ministry had reported that production stood at 794,000 tonnes and was expected to reach 900,000 tonnes by the end of the season.

The market has since turned its focus to the reality of extraordinary production in the Ivory Coast. With the 2018-19 marketing year drawing to a close, Ivory Coast port arrivals have reached a record 2.135 million tonnes, 11.6% higher than the previous year. Mid-crop arrivals slowed

towards the end of the season, but total main- and mid-crop output exceeded earlier estimates.

#### Demand

Powder prices have firmed up (Chart 2), while butter prices have remained sluggish (Chart 3). The combined ratio of product prices *vis-à-vis* the spot price for London beans – the industry standard for measuring the direction of product prices – shows some improvement (Chart 4). The theory is that bean processing should escalate when processing profitability rises because of higher product prices. The most recent grinding numbers reported throughout July indicate progress on that front.

Most regions showed strong numbers. At 345,000 tonnes, the second-quarter European grind was down 3.7%, year-over-year. However, all other major regions, primarily Asia, compensated. Asia was up 16.3%, at 214,000 tonnes. North America was 3.7% higher, at 124,000 tonnes. Finally, Ivory Coast grinding rose by 3.5%, to 177,000 tonnes. Cumulatively, that would indicate grinding growth of 3.3%.

Even if demand continues to grow at a faster pace than it has over the past few years, the overwhelming factor for this market is the bumper harvest in the Ivory Coast.

We have not seen much in the way of global balance sheet estimates. This past spring the International Cocoa Organization (ICCO) forecasted a 36,000-tonne global surplus. We believe that the next ICCO estimate will show a considerably larger surplus, partly because of the Ivory Coast and partly because it was widely believed that Ghana's mid-crop would be more than 100,000 tonnes smaller than last year's.

Prices have fallen by \$400 per tonne since mid-July (Chart 5). Alas, our April 30 short-sale recommendation was stopped near the high of the market. We would like to reenter the short side. We advise looking for a rally of about \$100 per tonne, which would put December cocoa at roughly \$2,300.

[By Sholom Sanik, August 22, 2019]

Chart 2 – Cocoa powder prices (US\$)

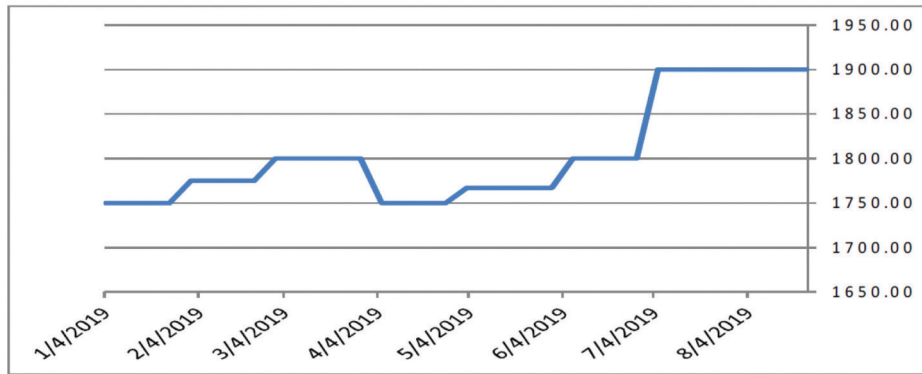


Chart source: Reuters

Chart 3 – Cocoa butter prices (US\$)

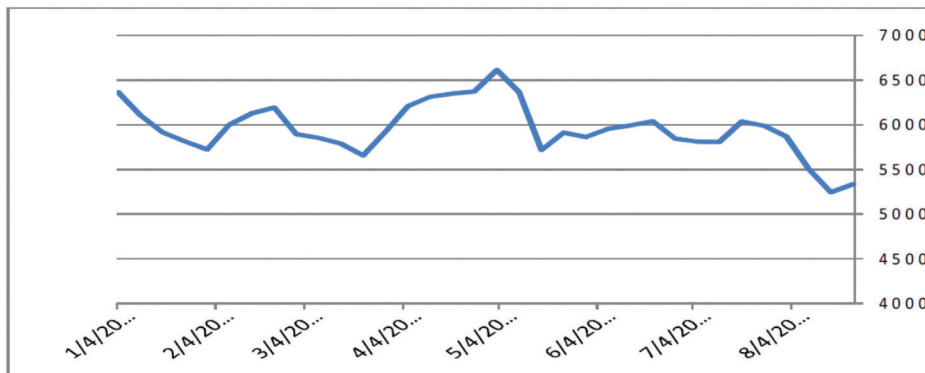


Chart source: Reuters

Chart 4 – Combined cocoa butter/powder ratio (US\$)

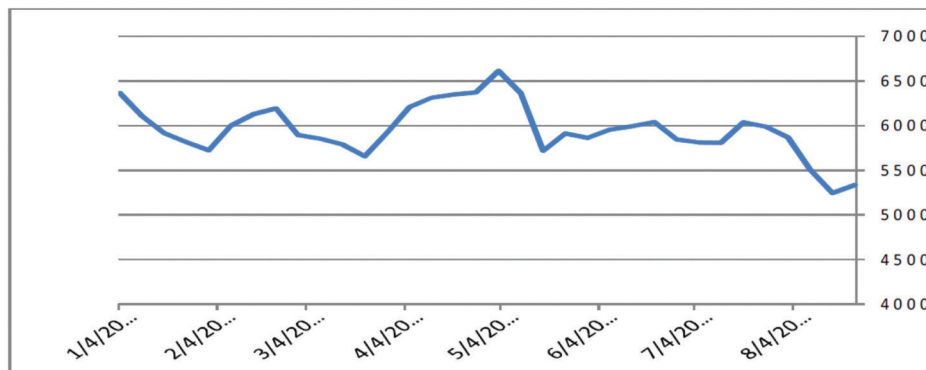


Chart source: Reuters

Chart 5 – Weekly cocoa, nearest contract



Chart courtesy Reuters

## **SOYBEANS**

# Chinese demand to determine fate of soybean prices

The USDA was full of surprises in its August crop report. US planted corn area was estimated at 90 million acres, down 1.7 million acres from the July estimate, but 2 million acres above the average of traders' guesstimates. The bushel-per-acre (bpa) yield was a whopping 4.6 bushels bpa above expectations (see *Focus on Futures*, August 22).

For soybeans, the yield estimate was just 0.9 bpa higher than trade guesstimates, but the planted acreage estimate came in at 76.7 million acres, 3.3 million acres below the July estimate and 4.3 million acres lower than expectations.

The corn area picture left many market participants scratching their heads, wondering how the late-planted and very-slow-to-mature crop could be so large and in such good shape. When it comes to the soybean crop, however, it was far more logical to see farmers cut back on planted area. US exporters are still saddled with silos full of unsold beans.

As the trade war between the US and China drags on, prohibitive tariffs have restricted Chinese imports. Consider that for 2018-19, total Chinese imports from the US, shipped and unshipped, stand at 14.07 million tonnes. That compares with 2017-18 sales of 27.92 million tonnes. Last year 300,000 tonnes remained unshipped at this date. This year there are 2.37 million tonnes unshipped, which will either be canceled or added to the 2019-20 export tally.

As a result of the curtailed Chinese purchases, US 2018-19 ending stocks are estimated at 29.13 million tonnes, or 27.2% of consumption. That compares with a 5.85% average for the previous 20-year period. The closest we've come to inventories of such magnitude in the past 35 years was in the 2005-06 marketing year when ending stocks were 18.6% of usage. So that's the bearish case.

The African swine fever in China is expected to cut pork production for 2019 to 38 million tonnes, down rather dra-

matically from 54 million tonnes in 2018. One estimate puts the loss of soybean meal demand at 10 million tonnes, or down about 15% from normal usage. But that still leaves a formidable gap between Chinese supply and demand. The USDA August estimate for 2018-19 Chinese soybean demand was 102.1 million tonnes, down from 106.3 million tonnes in 2017-18. Domestic soybean output this past year was 15.9 million tonnes and is forecast to climb to 17 million tonnes in 2019-20, still exposing the Chinese to a huge shortfall that needs to be met by imports.

In 2017-18, total Chinese soybean imports were 94.1 million tonnes. That figure dropped to 83 million tonnes in 2018-19 because of the cutback in imports from the US. The reality is that if China depleted its entire carryover – estimated by the USDA at 20 million tonnes – and Brazil sold its 27.2-million-tonne year-end inventory to China, the Chinese livestock industry would still be short. Argentina can fill some of the void, but there are virtually no other producing nations that grow enough soybeans to be a meaningful player in meeting Chinese requirements.

Burdensome US ending stocks make for a compelling bearish case. We are reluctant to establish a short position for several reasons. First, US farmers certainly mitigated the situation to some degree by planting the fewest number of acres in nine seasons. Then, while it may not seem too likely at the moment, the risk of a deal between the US and China that would lower or eliminate tariffs is always a possibility. Finally, as illustrated, ultimately, whatever the cost, China must buy more soybeans from the US than it did over the past 12 months which will slowly but surely whittle down US inventories.

Remained sidelined.

*[By Sholom Sanik, August 27, 2019]*

Chart 6 – CBOT November soybeans

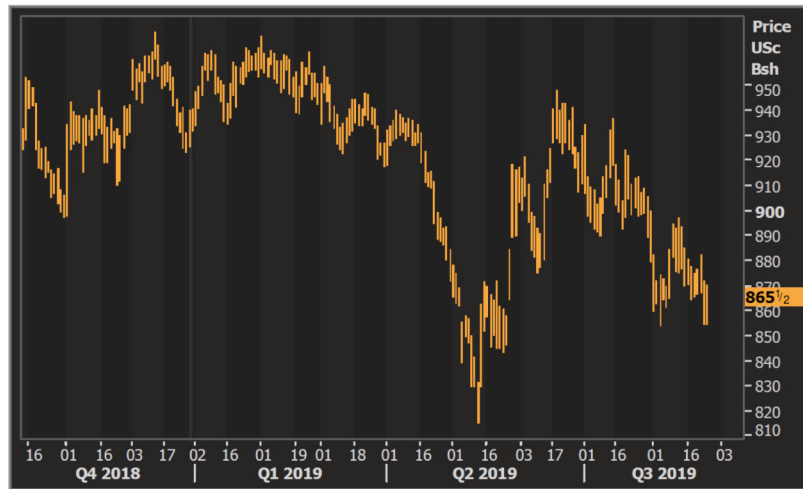


Chart courtesy Reuters

## **SUGAR**

### **Low price discourages production**

Sugar prices have been in a steady downtrend since June and have just traded down to one-year lows (Chart 7). Two recent bearish developments exacerbated the selling.

A strong dollar has kept the Brazilian real under pressure. With sugar denominated in US dollars, increased producer selling has been cited.

Perhaps the principal issue has been Indian export subsidies for the upcoming 2019-20 marketing year. Traders focused on an impending government announcement of the number of tonnes that would be available under the incentive program. Five million tonnes were made eligible for subsidies in 2018-19. As of earlier this month, and with the marketing year almost over, only 3.4 million tonnes were sold abroad. On August 28 the government said that it would expand the export ceiling under subsidy for 2019-20 to six million tonnes.

Initially, in inter-day trading, the market sold off. By the end of the session, however, the market closed stronger. Buy the rumor, sell the news. Quite logical, we believe. Why would Indian export subsidies become a fresh bearish force when Indian exporters were not highly motivated by the first round of incentives in the current marketing year? Rather, holders of inventory are looking for higher prices.

With half the 2019-20 crushing season past in Brazil, the expected recovery in the ratio of sugar produced *vis-à-vis* ethanol has not materialized. Only 35.38% of the cane crop has been processed into sugar, compared with 36.30% last year at this time. Before crushing got underway, forecasts called for 40% of the crop to be used for sugar.

Crude oil prices peaked at \$66 per barrel at about the same

time the Brazilian cane crush got underway in April and remained weak until early August. It was believed that ethanol would be less competitive, as has traditionally been the case, and sugar would capture a larger share of the crush than it did in 2018-19. Recent estimates for Center-South output have been revised downwards from early-season forecasts that at one point reached over 30 million tonnes. One recent estimate puts sugar production as low as 25 million tonnes. That would be a 14-year low.

As a result, after several years of surplus, the outlook for the 2019-20 global production/consumption balance has slipped into deficit. A few months ago the consensus was that we would see somewhere between a balanced market to a 2-million-tonne deficit. The average of the most recent estimates calls for a deficit of 5 million tonnes.

As we've pointed out many times in the past, estimates of a large global carryout are misleading. Roughly one third of those inventories are Indian, and as we illustrated above, Indian exporters are not likely to be forthcoming if prices do not rise.

Chart 8 shows that open interest has risen to an all-time high. Commodity funds are net-short 173,000 contracts, also close to an all-time high.

Low prices are discouraging production – a slow process, but it is happening. It's been a painful ride for bulls. We maintain our view that the correct way to trade this market is to buy and hold on to long-term call options. We are currently long March 14¢ calls, as per our June 20 recommendation. For new positions, buy July 13¢ calls, currently trading around 0.60¢.

[By Sholom Sanik, August 29, 2019]

Chart 7 – ICE October sugar

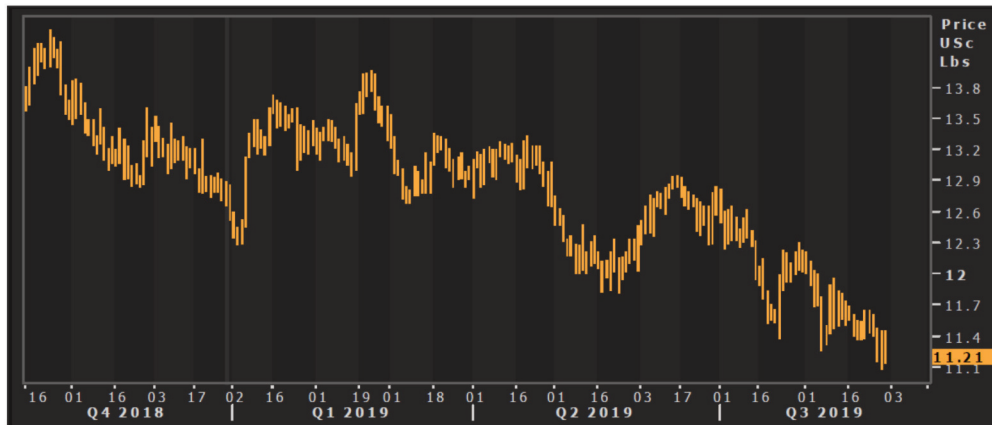


Chart courtesy Reuters

Chart 8 – ICE sugar open interest

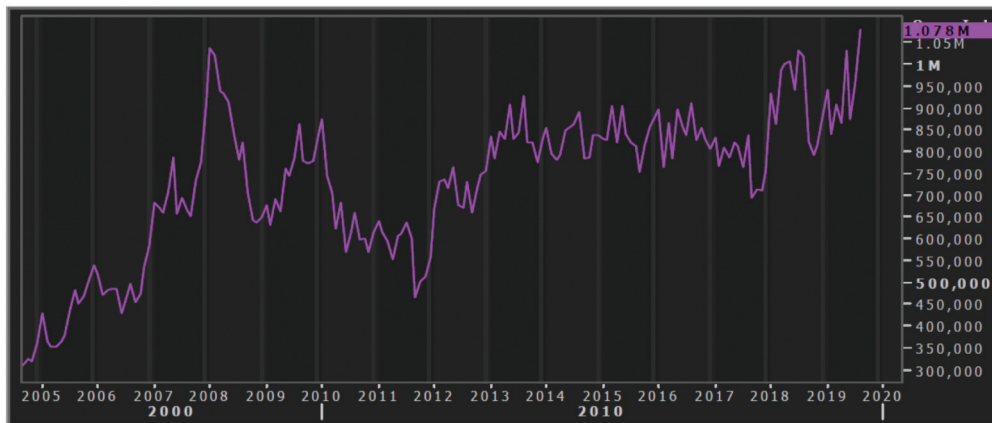


Chart courtesy Reuters

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