

# FRIEDBERG'S

## FOCUS ON FUTURES

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## Soybeans: in desperate need of a trade deal

The soybean rally is teetering. Disappointment centering on prospects of a trade deal between the US and China has been cited as the principal catalyst. For that matter, buying has been light even when other trade-deal-related markets reacted to what seemed to be progress on the trade front.

The US 2019-20 harvest is just about complete. The November USDA crop report maintained its October estimate for production, at 3.55 billion bushels. That is down from early-season optimistic forecasts that were as high as 4.15 billion bushels. US farmers, facing the prospect of dramatically lower Chinese buying for a second consecutive year, slashed planted area by 14.2%, to 76.5 million acres.

Brazilian farmers have increased planted area for the 2019-20 crop that will be harvested in the spring. The USDA estimates output at 123 million tonnes, 5% higher than in 2018-19. With the US harvest out of the way and the South American crops just taking root, the focus will shift to demand.

While Chinese buying of US soybeans looks a whole lot better than it did at this time last year, it is well below the historical norm. Total export commitments year-to-date destined for China (shipped and unshipped) stand at 8.47 million tonnes, compared with 508,000 tonnes at this time last year – which sounds pretty good on the surface. But in 2017 that figure was 18.65 million tonnes.

After lagging behind last year by a wide margin just a few weeks ago, total US export commitments for 2019-20 have pulled ahead of last year's level. But the trend must continue. In 2017-18, before the trade war existed, total commitments at this time of year stood at 33.45 million tonnes.

At issue is that in 2018-19, while the US was losing Chinese business, it attracted new customers, mainly because US bean prices were trading at a sharp discount to Brazilian beans. However, prices have now converged, and whatever competitive edge the US had is now gone. US sales to customers other than China have merely returned to normal levels. Consider: 2019-20 commitments to date for customers other than China are 15.25 million tonnes, and in 2017-18 they were 14.8 million tonnes. Last year at this time, they were 22.63 million tonnes.

So it's all about the return of China to the market. Until something concrete emerges from trade negotiations that will ensure a path back to historical Chinese purchasing levels, market participants will remain skeptical.

Six months ago, commodity funds owned a massive net-short position (Chart 2). Since then, they have triggered a flurry of short-covering in reaction to any trade-talk progress. By mid-October, they were long, but over the past few weeks have been in liquidation mode. Without any movement on the trade front – indeed, the latest buzz is that so called “phase one” of a trade deal, which was expected to be signed before the end of the year, has been pushed off to 2020. A most likely scenario is that liquidation will continue.

We still believe in our argument that at some point the Chinese will return to the US bean market. The Chinese grow 15% of their domestic consumption, and continued purchases from South America will deplete South American inventories sooner or later (see *Focus on Futures*, August 27 and September 26). In the interim, however, commodity fund liquidation could very well drag prices down materially.

In terms of strategy, we advised establishing a long position in March soybeans on September 26, then trading at \$9.20 per bushel. We watched a decent profit evaporate to break even. At this time, we advise liquidating long positions at the market. Stay tuned.

*[By Sholom Sanik, November 22, 2019]*

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Chart 1 – CBOT March soybeans



Chart courtesy Reuters

Chart 2 – CFTC commodity fund net position

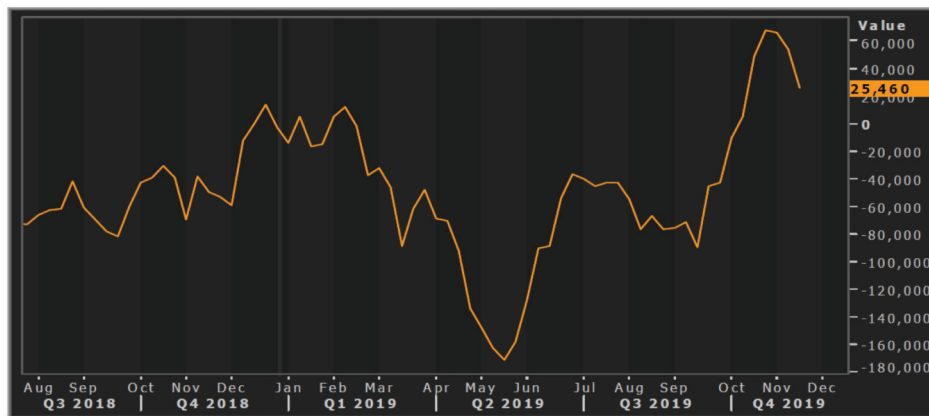


Chart courtesy Reuters

## COTTON

### No deal means no bull

Cotton prices have rallied by about 8¢ per pound, or 13%, since late summer. The primary issue revolves around when and if China will return as the US farmer’s best customer. A trade deal that will phase out or perhaps even eliminate the 25% import tariff is imperative.

At the moment, however, a trade deal does not seem imminent. We’ve gone from indications that something will happen before year end to a postponement to the new year. Then, in comments delivered at the NATO Summit on December 3, President Trump said that it might be best if they’d wait until after the Presidential election in November 2020.

When we last wrote about cotton (see *Focus on Futures*, September 19), we marveled that total Chinese purchases of US cotton for 2019-20 (shipped and unshipped) stood at 1.76 million bales. At the time, that was about 30% above year-

ago levels. Things were looking up. The problem is that since then, there has been very little movement. Current total Chinese commitments have increased to only 1.829 million bales, and shipments have been negligible.

Sales to other destinations have been moving at a healthy pace. Total US export commitments to date are 10.4 million bales, up from 9.7 million bales at this time last year. The USDA forecasts 2019-20 US exports at 16.50 million bales, 1.75 million bales higher than in 2018-19. If achieved, that would be a record. However, despite the healthy-looking commitments tally, we believe that in the absence of Chinese buying, this is nothing more than wishful thinking. This forecast assumes that a trade deal will be inked long before the end of the marketing year, which runs until July 31. In light of recent developments, the odds of that occurring are poor.

On the supply side, the USDA lowered production esti-

mates for recently harvested crops downwards for key cotton-producing nations.

A rough harvest season saw yields fall in the US. The estimate for yield was revised to 799 pounds per acre, down from the October estimate of 833 pounds. As a result, the output estimate fell by 900,000 bales, to 20.82 million bales.

Indian and Chinese output were both revised lower by 500,000 bales, to 30 million bales and 27.25 million bales, respectively. Finally, Pakistan, an important importer, saw its production estimate lowered by 600,000 bales.

Global demand has been stagnant over the past few years. The USDA estimates 2019-20 usage at 121.50 million bales, compared with 120.29 million bales in 2018-19, but

down from 122.76 million bales in 2017-18. But even with the USDA's material downward revision to 2019-20 output, as noted above, global production will be 2.7 million bales higher than in 2018-19, leaving a production/consumption surplus of 450,000 bales.

China will need to buy abroad, but it does not have to be from the US. Both India and Brazil have ample carryover stocks and can fill the void. As such, it's hard to see US prices building any further on this rally.

On September 19 we recommended establishing a long position in March cotton. We now advise liquidating that position, accepting a modest profit.

[By Sholom Sanik, December 4, 2019]

Chart 3 – ICE March cotton



Chart courtesy Reuters

## COCOA

### A cocoa cartel? Not quite.

Over the past few months we discussed the plan by cocoa boards in West African countries – the Ivory Coast, Ghana, Nigeria, and Cameroon – who grow more than 70% of the world's cocoa beans, to implement measures that would essentially put a cap on cocoa production (see *Focus on Futures*, August 22). The obvious objective of the ambitious program would be to increase prices. The higher income for farmers is expected to address poverty, and more specifically, eliminate child labor. We opined that the idea "...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."

We're about half-way through the September-through-March 2019-20 main-crop season, which should be sufficient

time to monitor how effective the initial stage of the program has been. Ivory Coast arrivals were running a bit behind last year's pace. The most recent data show that arrivals have now inched out in front to 883,000 tonnes, just below 878,000 tonnes last year at this time. At 257,000 tonnes, Ghanaian arrivals are just behind last year's 261,000 tonnes.

Underscoring our skepticism, a recent survey of Ivorian farmers by one of the news wires explains why the program may never work. Quoting verbatim from the summary of farmers' comments: "...a lack of business alternatives outside the cocoa industry leaves them with little choice but to expand output and make the most of improved prices. The farmers' comments raise questions about whether the world's number one cocoa producer can implement production cuts in a country that relies on a million small producers who

operate independently and have little incentive to cut back.”

Given the hard data and the attitude of farmers, it is difficult to see much reduction, if any, in 2019-20 production. For the moment, it would seem that despite the best intentions of the cocoa boards, they have not been able to apply a workable strategy.

Looking ahead to the balance of the main-crop season, the dry season in the Ivory Coast runs from November through March and, depending on its severity, could pose a challenge to this most crucial period. However, most regions have seen above-average precipitation for this time of year, which could fortify plantations with sufficient moisture to survive drier weather later in the season.

Product prices have remained stagnant, but demand, as measured by global grindings, has nonetheless been robust. According to The International Cocoa Association (ICCO), grinding activity grew by 4.6% in the outgoing 2018-19 marketing year. That would be the second-strongest growth rate over the past 10 years. Despite the huge crop in the Ivory Coast, the ICCO estimates a modest global production/consumption surplus of 21,000 tonnes.

The proposed plan by the producing nations to limit output has driven prices to a one-and-a-half year high. A study of open interest patterns shows a rather extraordinary level of speculative activity. Open interest is through the roof, to a record 330,000 contracts (Chart 4). Commodity funds have gone from short to long. The net-long position now held by commodity funds has flipped into an even larger net-long position (Chart 5).

There’s an old, but reliable open interest monitoring metric: When a large move in open interest continues to build (or fall) even after the accompanying movement in price stalls, it suggests that the new buyers (or sellers) are weak hands that cannot move the price any further. Chart 4 depicts just such a scenario.

The protective buy stop at \$2,600 per tonne on our short position, recommended on October 25, was triggered. We do believe, however, that market participants have over-reacted. As such, we advise reentering the short side. Sell July cocoa, currently trading near \$2,650. Place initial buy stops at \$2,700, close only.

[By Sholom Sanik, December 17, 2019]

Chart 4 – Weekly nearest contract cocoa (bar), open interest (line)

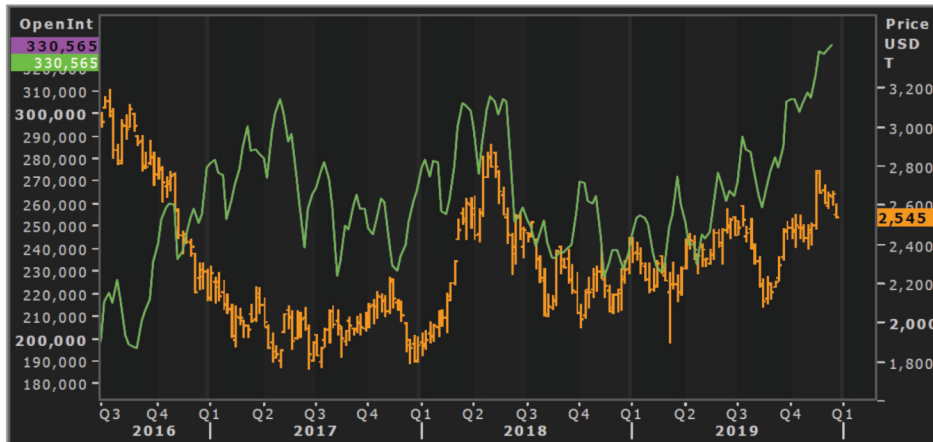


Chart courtesy Reuters

Chart 5 – CFTC net-long fund position

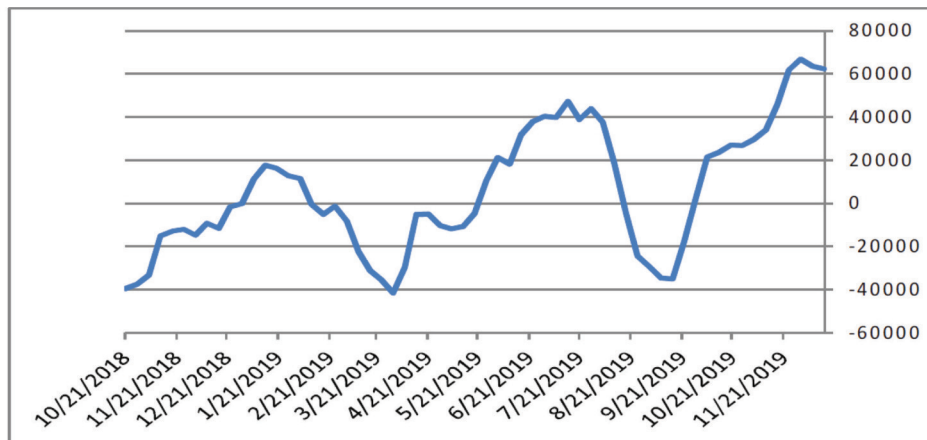


Chart source: Reuters

**SUGAR****A bull is born**

Sugar prices have been on the rise since September and are now trading at a 10-month high (Chart 6). Commodity funds held a record net-short position, which has now been all but covered (Chart 7). There have been several bullish supply/demand developments underpinning the short covering, which we believe will bring even higher prices as we move forward.

**India**

Flooding in India has delayed the crushing season, which began in November. Uttar Pradesh, India's largest producing state, has been affected, but not as severely as Maharashtra, the number-two producer. Last year at this time, output at plantations in Maharashtra stood at 7.05 million tonnes, but this year that figure has fallen to 4.58 million tonnes. Of course, it's still early, but yields from water-logged cane are reduced, so we expect to see original estimates of 26 million tonnes for total 2019-20 output revised downwards as the season bears on.

Indian exporters were largely unmotivated by government export subsidies over the past two seasons because prices were still too low to make the incentives attractive. As world prices begin to firm, however, there has been some movement on that front. Exporters have sold about 2 million tonnes since the marketing year began, and there are still 4 million tonnes that are eligible for the government subsidy. Last year at this time, only 850,000 tonnes were sold abroad.

Analysts are optimistic that the trend of Indian export sales will continue. We agree, if prices maintain current levels. While filling the gap left by Brazil could be considered bearish in the short term, India cannot be relied upon to be a long-term exporter of last resort. If all the sugar under the incentive program is exported, Indian ending stocks would fall below 10 million tonnes. And with a looming production/consumption deficit, we would be looking at the lowest stock level since 2016-17. In a previous article (see *Focus on Futures*, November 5) we noted this scenario as a possibility. But with the cur-

rent downgraded outlook for 2019-20 output, we believe that this is where we are headed.

**Brazil**

Output in the Center-South region, which produces 90% of Brazilian sugar, peaked at about 36 million tonnes in the 2016-17 and 2017-18 marketing years. Production fell to 26.7 million tonnes in the recently completed 2018-19 season. Based on early estimates of cultivated area, the cane crop is expected to grow by 2.9%, to 590 million tonnes, but sugar output is forecast to remain largely flat. The percentage of the cane crop to be crushed for sugar is forecast to fall to another record low of 34.29%, down from this past year's 35.77%.

Domestic ethanol stocks are tight, and with crude oil prices on the rise, ethanol demand is expected to continue to grow. As a result, a larger portion of the cane crop will be diverted to ethanol production. Ethanol output is forecast to rise by 7.1%, to 33.1 billion litres.

**Thailand**

Thailand exports close to 80% of its sugar production, making it the world's second-largest exporter after Brazil. Low world prices facilitated the pattern of falling production seen among the other exporting nations, although the downturn was not quite as stark. Output for 2019-20 is expected to slip to 13.2 million tonnes, down from a record 14.6 million tonnes in 2018-19.

Consensus of forecasts for the global production/consumption balance is nearing an 8-million-tonne deficit. In light of recent developments in Brazil and India, we estimate that we are closer to a 10-million-tonne deficit. We haven't seen anything like that since the last bull market in 2010 when prices reached 35¢.

Remain long July 13¢ calls, as per our August 30 recommendation. For new positions, buy October 14¢ calls, currently trading at about 0.75¢.

*[By Sholom Sanik, December 19, 2019]*

Chart 6 – Weekly nearest contract sugar

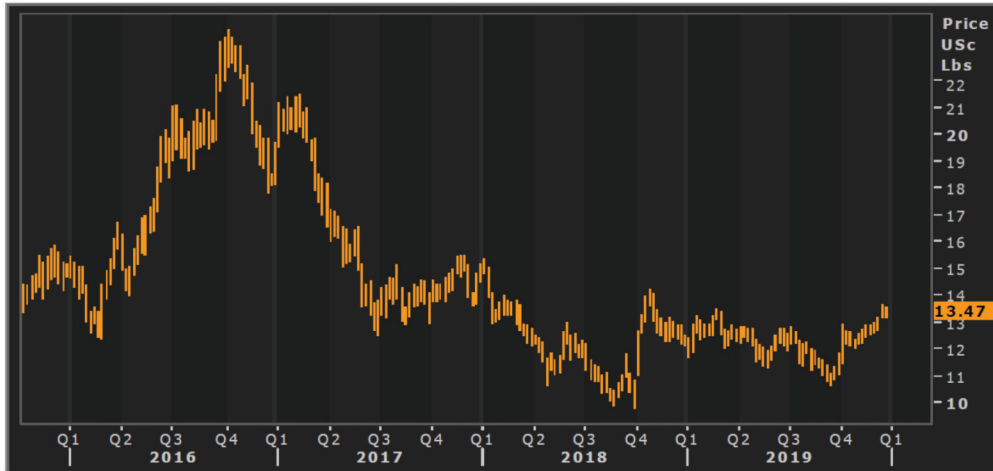


Chart courtesy Reuters

Chart 7 – CFTC net-short position

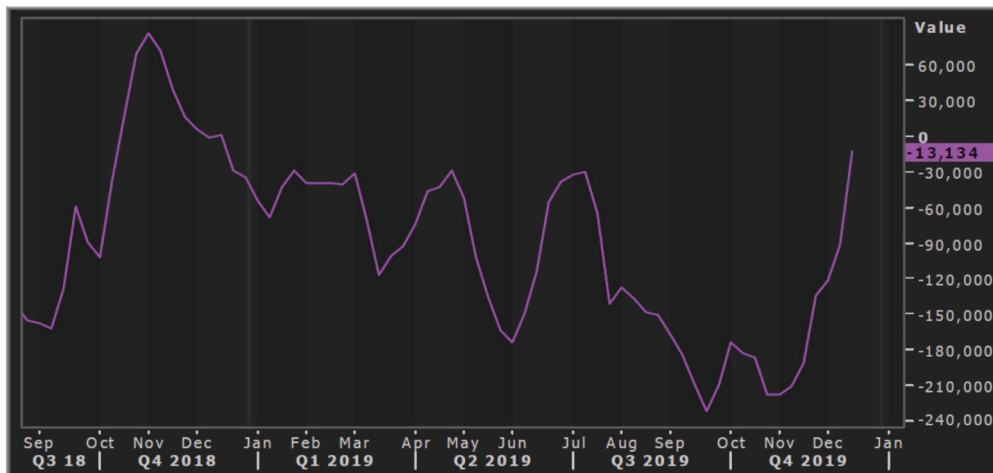


Chart courtesy Reuters

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