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Corn: supply, supply everywhere

On the eve of the release of the November USDA crop report, the Chinese government issued historical revisions for the country's corn production dating back to the 2007-08 marketing year all the way through 2017-18. Output was increased by a staggering 266 million tonnes over the period. The USDA incorporated this revision into the November crop report. To make some sense of it, the USDA also made upward adjustments to some demand categories. Cumulative Chinese consumption for the past three years was raised by 70 million tonnes. The impact of the "found" production on the Chinese corn balance sheet, however, was still gargantuan. The estimate for 2018-19 Chinese ending stocks grows to 207.49 million tonnes, 149 million tonnes above the October estimate! That amounts to 75% of usage, compared with 23.3% in October.

So what does it all mean? While "finding" all that corn *seems* to be overwhelmingly bearish, in fact it's a neutral factor. China does not export corn, or import any for that matter. All that corn was always in existence. If China had wanted to export corn, it could have done so when prices spiked to $8 per bushel in 2012 and at still very attractive prices in subsequent years. Corn cargoes leaving the country would be transparent. So it is hard to see what, if any, effect – other than balance sheet optics – this announcement will have on world trade.

The market yawned through the Chinese news and instead focused on the revised bushel-per-acre (bpa) yield of the recently harvested US 2018-19 crop. Poor harvest weather hurt yields. In September, the estimate was as high as 181.3 bpa. That would have been a record by far, exceeding the previous high yield set in 2017-18 of 176.6 bpa. The average street guesstimate called for a downtick to 180 bpa, but the actual number came in at 178.9 bpa. Initially, prices moved higher on the news, but the rally soon faded (Chart 1).

We believe that the market is in the process of turning its attention to upcoming crops.

South America

Both Brazil and Argentina had an off year for the 2017-18 crop harvested this past spring. For Brazil, output fell from 98.5 million tonnes in 2016-17, to 82 million tonnes. Argentinean production dropped to 32 million tonnes, from 41 million tonnes. It is still several months before any 2018-19 corn will be harvested in South America, but weather permitting, the crops are expected to bounce back. Brazilian production is forecast at 94.5 million tonnes. The November crop report raised the estimate for Argentina by 1.5 million tonnes from the October estimate, to a record 42.5 million tonnes.

US

The outlook for the US 2019-20 crop – planted in the spring and harvested in the fall – presents a potentially extremely bearish situation. Unless some progress is achieved in trade talks between the Administration and the Chinese government, US exporters are going to be stuck with a lot of soybeans and are going to slash soybean acreage dramatically. At least part of that acreage will be planted with corn. Early USDA forecasts – not to be updated until the USDA Forum in February – call for 82.5 million soybean acres, down from 89.1 million acres planted in 2018-19. Corn area is estimated to expand to 92 million acres, from 89.1 million acres this past season. Using 2018-19 yields, that represents a roughly 12-million-tonne jump in output.

The crisis for US farmers is already in full swing. Total soybean export commitments for the 2018-19 marketing year are 32% below last year at this time (more specifics on soybeans in an upcoming issue of *Focus on Futures*). China has been completely absent for several months now.

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Meanwhile, foreign demand for corn has been robust with commitments 3 million tonnes ahead of last year's pace. However, this does not by any means paint a bullish picture for corn. The 3-million-acre increase in corn area is in all likelihood a conservative estimate, as farmers will feel more comfortable planting corn than they will soybeans.

With the world's three largest corn-exporting nations anticipating bumper crops in calendar year 2019, the market will be abundantly supplied – strong and growing demand notwithstanding.

Establish short positions in December 2019 corn, currently trading at just below $4 per bushel. Place initial protective buy stops at $4.25, close only.

[By Sholom Sanik, November 22, 2018]

Chart 1 – CBOT December corn

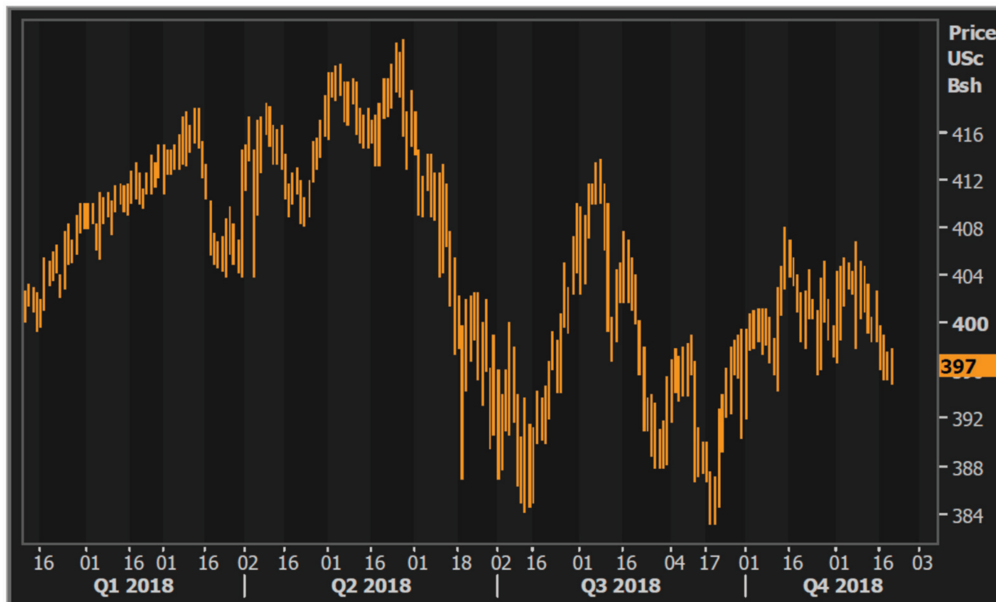

Chart courtesy Reuters

SOYBEANS

Chinese tariffs alter the soybean landscape

The 25% tariff that the Chinese government slapped on imports of US soybeans is in the process of devastating US soybean farmers. Chinese export commitments of US soybeans for the 2018-19 marketing year, which began on September 1, stand at a laughable 648,000 tonnes (all pre-tariff saber rattling). Last year at this time, that figure was 18.646 million tonnes.

Other importing nations have picked up some of the slack, increasing purchases over last year by about 6.5 million tonnes. For at least one country, it does not signify a trend. Argentina bought 1.5 million tonnes of soybeans from the US this marketing year to meet its own export commitments. But that was only because it suffered a crop failure due to inclement weather that saw output fall by 17 million tonnes from 2016-17. According to the USDA, the current Argentinian crop – to be harvested in several months – is expected to return to trendline production (see below).

Even with broader global participation, total US export commitments have reached only 22.6 million tonnes, compared with 33.4 million tonnes last year at this time. After a soggy harvest season, the USDA provided a bit of bullish news in the November crop report. The bushel-per-acre (bpa) yield was revised lower, to 52.1 bpa, down from 53.1 bpa and lower than the average of analysts' guesstimates of 52.9 bpa. The poor finish for the 2018-19 crop, however, is largely meaningless when considering that it was still a record crop and that at 23.2% of consumption (10.2% last year), US ending stocks will be the largest in history.

China grows barely 15% of its soybean needs. In 2017-18, total Chinese imports reached 94 million tonnes, of which 28 million tonnes came from the US. How will the growing Chinese hog population survive? Conceivably, Brazil and Argentina could fill in the gap in the short term. The USDA estimate for 2018-19 Brazilian production is estimated at

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120.5 million tonnes, up slightly from 119.8 million in 2017-18. Argentina, as mentioned above, is slated to make a full recovery from the previous season's disastrous 37.5 million tonnes, to 55.5 million tonnes. In addition, and more significantly, at the end of the 2017-18 season, the two countries had a combined carryout of 60 million tonnes.

Over the past few months, year-over-year Brazilian sales to China have increased materially.

The early USDA forecast for US soybean acreage to be planted this coming spring indicates that the US farmers are preparing for the loss of the customer that has historically purchased close to 25% of total US output. US soybean area for the 2019-20 crop is estimated to fall to 82 million acres, down 7 million acres, or 7.8%, from 2018-19. That would amount to a drop of about 10 million tonnes. So if the acreage estimate is anywhere near correct, without Chinese buying, the US would still be swimming in soybeans.

We're not going to weigh in on the political angle of the probabilities of any breakthrough in US/China trade talks. One thing is for certain, though. A breakthrough that would lead to China eliminating the tariff would spark a furious rally. In the meantime, planned US acreage is still much too high, and we therefore anticipate much lower prices.

In our July 19 issue we advised selling March soybeans on a 50¢-per-bushel rally. Should you have adhered to that recommendation, place protective buy stops at $9.20 per bushel, close only.

[By Sholom Sanik, November 27, 2018]

Chart 2 – CBOT March soybeans

Chart courtesy Reuters

SUGAR

Global sugar surplus dissolving

Sugar prices rallied sharply during October (Chart 3). The market bolted to seven-month highs. One of the key factors that drove the market and sent commodity funds scrambling to cover shorts was a shift in the ethanol/sugar crush ratio in Brazil. For most of this year, crude oil prices were strong, which sparked increased demand for lower-priced ethanol. Producers opted to accelerate ethanol output over sugar which resulted in a 65/35 ratio in favor of ethanol output. At one point in the 2017-18 marketing year, the ratio was as low as 53/47.

We believe the subsequent pullback in sugar prices could be accounted for by the abrupt shift in the ethanol dynamics in Brazil. The recent dramatic drop in crude oil prices has cast doubt on whether that ratio can continue to tilt heavily in favor of ethanol. And the lag time in the relationship between large movement in crude oil prices and ethanol output targets does not seem to be very long – over the past few weeks we've already seen ethanol production slip in year-over-year

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comparisons. One analyst sees Brazilian ethanol output falling by close to 10% in the 2019-20 marketing year and the output ratio slipping to 60/40.

In any case, we're at the tail end of the crushing season in Brazil, and the damage to sugar output has been done. Center-South output for 2018-19 will reach just over 26 million tonnes, about 9 million tonnes lower than in 2017-18 – the lowest in 10 years.

Indian output for 2018-19 was originally estimated at about 35 million tonnes, up about 3 million tonnes from the previous season. Then the June-through-September monsoon disappointed, estimated at 91% of the historical norm. That compares with 95% last season. The two largest producing provinces, Uttar Pradesh and Maharashtra, received substantially less rainfall than in a normal year, resulting in poor yields.

The estimate for total Indian output has been revised downwards several times and now stands closer to 30 million tonnes. Output should still be the second highest on record, leaving ample carryover stocks.

The government has created incentives to whittle down inventories by allowing out-of-quota exports of 5 million tonnes, as well as by raising ethanol prices to stimulate growth in that industry. Bears believe that Indian exports should compensate, at least in part, for Brazil's poor showing.

The problem with that theory is that exporters have been reluctant to sell abroad while world prices languish near multi year lows, so they are content to hang on. Since the marketing year began, only 850,000 tonnes have been contracted for sale. World prices need to rise to see any material gains in Indian exports.

The EU ended its sugar output quota system in 2017. It was widely believed that production would rise to the point that the EU would become an important participant in world trade. Output jumped to 21 million tonnes in the 2017-18 marketing year. That compares with an average 16.5 million tonnes in the previous five seasons. Exports, which hovered at 1.5 million tonnes for years, jumped to 3.7 million tonnes.

The EU factor, however, was short lived. Farmers continued to plant a larger crop than they did in the output-quota years, and the intention was to achieve yields similar to 2017-18. But the weather was uncooperative. Output estimates are now as low as 17 million tonnes, which means we're all but back to exports of 1.5 million tonnes. That's only half the problem. Planting is expected to fall sharply for the upcoming 2019-20 season, as traders are disappointed with prices and are turning to alternative crops. As a result, the EU slips back into sugar-export obscurity.

With smaller output in Brazil and the EU and questionable Indian exports, the period of burdensome global surpluses has ended. We've moved from a 10-million-tonne surplus in 2017-18 to a 3-million-tonne surplus in 2018-19. Early forecasts for 2019-20 are looking for a balanced or deficit market. Prices are too low to expect producers to increase production.

Remain long March 12¢ calls, first recommended on August 17.

[By Sholom Sanik, November 30, 2018]

Chart 3 – ICE March sugar

Chart courtesy Reuters

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COCOA

The Ivory Coast headed for a third consecutive bumper crop

Cocoa prices have been trading in a $2,000- to $2,400-per-tonne range since the close of the West African 2017-18 marketing year (Chart 4). The Ivory Coast is coming off two consecutive bumper crops – a record of just over 2 million tonnes in 2016-17, followed by just below 2 million tonnes in 2017-18.

Since exporters began reporting port arrivals in September, the results have been extraordinary, leading the market to believe that reaching last year's levels could be a shoo in. Until late December, arrivals were running about 15% ahead of 2017-18. The most recent report showed arrivals at 1.195 million tonnes, down from the earlier torrid pace, but still 11.5% above the previous season.

In terms of the other West African producers – Ghana, Nigeria, and Cameroon – the available data are sketchy.

After struggling early in the season, Ghana, the second-largest producing nation, had a surprisingly strong finish in 2017-18, with over 900,000 tonnes. The government agency responsible for cocoa oversight has stated that it certainly intends to keep output strong to maintain global market share.

There have been weather concerns and talk about poor quality, but as long as we continue to see strong arrivals, we do not see any serious issues on the supply side.

The demand side has been disappointing. Product prices have been slipping. The butter ratio was steady at 3 times the London spot bean price for all of 2018, but has recently fallen back to 2.75. Powder prices have been weak as well. As can be seen in Chart 5, the combined ratio has tumbled to 18-month lows.

Fourth-quarter grind results are starting to file in. Analysts were expecting the EU, the world's largest grinding region, to be up 3% year-over-year, but the figure came in up only 1.6%. The Ivory Coast was up 9%. While grinding activity in origin countries continues to gain market share, the Ivory Coast still processes less than 40% of the volume in the EU. Traders are still waiting for the results of the North American grind. But, like the Ivory Coast, the North American grind is roughly a third the size of the EU grind, so even decent growth will be overshadowed by the disappointing 1.6% increase for the EU.

Consistent with the sluggish grind data, Barry Callebaut, a leading manufacturer of chocolate, said in its annual report released late last year that global chocolate demand is growing by 1% to 2% per annum.

The global balance sheet showed a 20,000-tonne surplus for the outgoing 2017-18 marketing year. Estimates for 2018-19 call for another surplus of about 70,000 tonnes.

We believe the current rally will fail. Maintain short positions first recommended on May 20, 2018 with the market trading at $2,678 per tonne. Keep suggested stop at $2,450, basis the spot month.

[By Sholom Sanik, January 17, 2019]

Chart 4 – March ICE cocoa

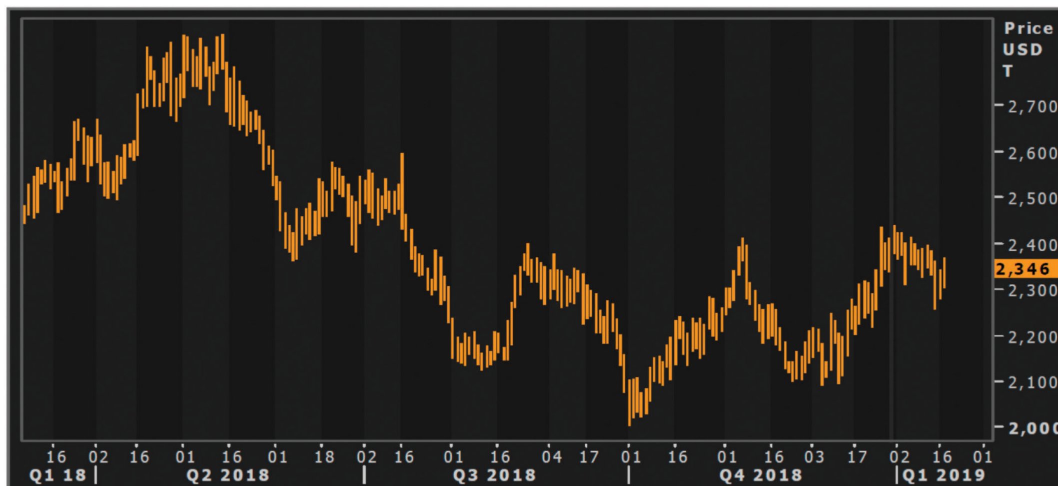

Chart courtesy Reuters

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Chart 5 – Combined cocoa butter/powder ratio

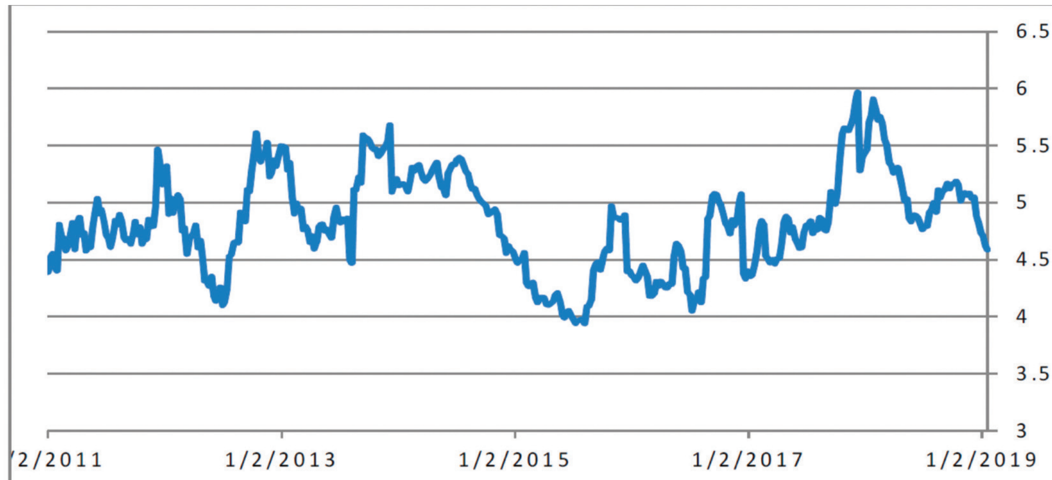

Chart source: Reuters

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Subscription Enquiries for
Friedberg's Focus on Futures
Suite 250
181 Bay Street
Toronto, Ontario, Canada
M5J 2T3
416-364-1171

All enquiries concerning trading accounts should be directed to:
Friedberg Mercantile Group Ltd.
Suite 250
181 Bay Street
Toronto, Ontario M5J 2T3
416-350-2903
Attn: Sholom Sanik

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