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Copper: Mixed signals

Over the past six months copper prices have been confined to a relatively narrow trading range (Chart 1). Labor strife in Chile has arguably been the single largest fundamental to influence prices over the past two years. The early-2017 mining strike saw Chilean production for 2017 go flat, with average monthly production 0.66% below 2016. As a result, prices spiked to \$3.25 and remained strong through mid-2018 until the recovery in output became consistent.

Average monthly output for 2018 through November is up 6.9% year-over-year. Chart 2 shows a surge in monthly production over the past several months. November output registered the largest single monthly tally in 13 years. The plunge in prices coincided with the recovery in Chilean production. This recovery is all against a backdrop of constant reminders by analysts about declining ore grades.

On the demand side, the primary issue, of course, is Chinese consumption. With slowing economic growth, import patterns are being closely monitored by market participants. For the moment, the data have not provided much clarity.

On the one hand the trade war with US has had an impact in one sector of the industry. The government slapped heavy tariffs on the import of scrap copper. China imported about \$6 billion worth of scrap copper from the US in 2017. As a result of the imposed tariffs, scrap copper imports for 2018 fell by 32%, to 2.4 million tonnes. However, imports of unwrought copper – from origins other than the US – rose by 13%, to 5.3 million tonnes, leaving no strong indication that copper demand has suffered any serious setback, at least as far as official Chinese customs data are concerned.

The overall global picture presents a somewhat bullish outlook. According to The International Copper Study

Group's (ICSG) Jan. 21 report, total output of refined copper to the end of October grew by 2.4%, while refined usage grew by 2.8%, leaving a year-to-date global deficit of 545,000 tonnes. We should note that the ICSG is dated and does not include the strong uptick in November Chilean production.

Further in the bullish camp, warehouse stocks have fallen materially. Combined inventories at three international warehouse systems – LME, Comex, and Shanghai – have fallen to multi-year lows (Chart 3). To be truthful, this is hard to explain.

Even a small downtick in Chinese copper demand coupled with a continuation of the kind of output growth we've been seeing in Chilean production could be quite bearish for this market.

We've been short this market since March 6 of last year when the spot price was at \$3.10 per pound. We've maintained a liberal stop at \$3.20. Lower buy stops to \$2.90, basis the spot month, close only.

[By Sholom Sanik, January 29, 2019]

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Chart 1 – March COMEX copper



Chart courtesy Reuters

Chart 2 – Monthly Chilean copper output (tonnes)

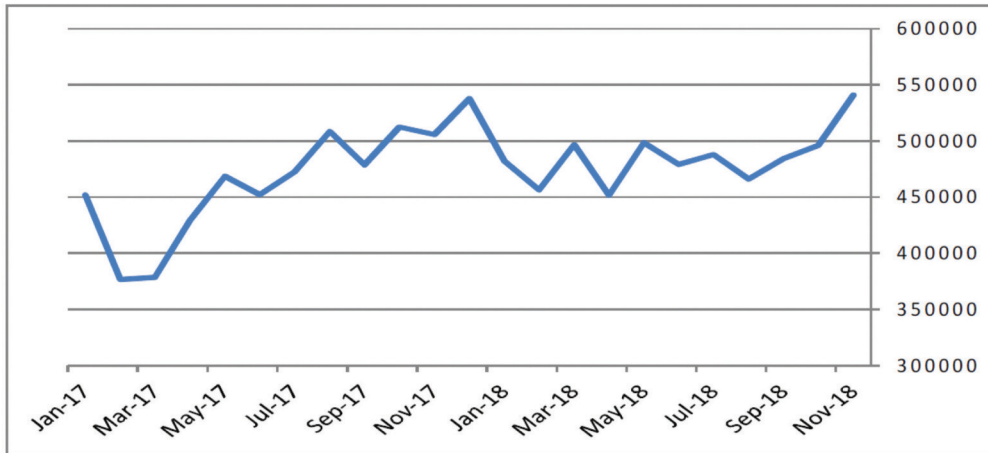


Chart source: Bloomberg

Chart 3 – Combined copper warehouse stocks at LME, COMEX, and Shanghai

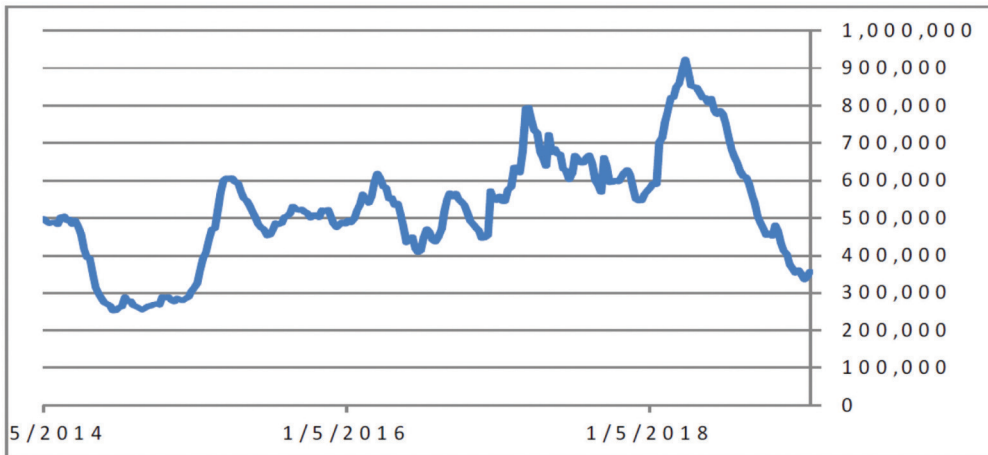


Chart source: Reuters

SUGAR

Going nowhere...for the moment

By and large, the supply/demand fundamentals for sugar do not *appear* to be bullish. A little analysis behind the headlines, however, reveals that we are looking at a very cheap commodity that is in a long-term bottoming process (Chart 4).

Brazil

In the 2018-19 marketing year, Brazil's Center South produced only 26 million tonnes, down close to 10 million tonnes from the previous season. However, early forecasts for the 2019-20 campaign, which begins in April, put output at over 30 million tonnes.

Actually, the increase in sugar output is not the result of a larger crop. In fact, the cane crop is expected to be slightly smaller than in 2018-19. Rather, it's all about crude oil prices. In 2018, crude prices traded between \$60 and \$75 per barrel. This made ethanol prices competitive with petroleum prices at the pump and increased demand for ethanol. With depressed sugar prices, processors eagerly increased ethanol output, which offered greater profitability. The ethanol/sugar output ratio jumped to a record 64.7/35.3.

The recent plunge in crude oil prices has changed the dynamics. Early estimates for the ratio have fallen to 59/41. The estimate for 2019-20 ethanol production has fallen to 26.8 billion liters, down from 30 billion liters in 2018-19.

Historically, the ratio is quick to respond to material changes in crude oil prices. Crude fell to \$43 per barrel in December, and the surveys that yielded projections for a sharp drop in ethanol output were likely conducted around that time. Crude prices have since rallied by 25%. The sloppy action in sugar prices would seem to indicate that crude prices have not rallied enough to create an incentive for Brazilian processors to change their production plans. However, we believe that monitoring crude prices

could be a key to determining the future direction of sugar prices. Brazil remains the largest exporter of sugar, and even small changes in sugar availability can affect the market.

India

The 2018-19 marketing year began in October. Production is estimated at just over 30 million tonnes, down from 32.5 million tonnes the previous season. That output level is still formidable considering the fact that domestic consumption has stagnated at about 26 million tonnes over the past few seasons, which in turn means that Indian ending stocks will continue to build.

The government has offered subsidies in an attempt to export the burdensome stocks. The target is to sell 5 million tonnes abroad. However, exporters are reluctant to sell with prices so low.

According to the latest available data, only 1.4 million tonnes have been sold for export, and only 650,000 tonnes have been shipped.

Drawing a connection between the sugar available for world trade and large Indian carryover stocks is therefore somewhat misleading. World prices need to rise to see Indian sugar move to the export market.

In conclusion, although Brazilian output should be larger than last year, it is several million tonnes below trendline growth. With global demand steady, the days of bulging global surpluses that we saw in recent years are gone. One recent estimate puts the 2018-19 global production/consumption balance at a 700,000 deficit, a downward revision from that analyst's November estimate for a 1-million-tonne surplus.

Roll long March 12¢ sugar calls, recommended on August 17, to October 13.5¢ calls, currently trading at 0.80¢.

[By Sholom Sanik, January 30, 2019]

Chart 4
Weekly ICE sugar
nearest contract



Chart courtesy Reuters

SOYBEANS**Deal or no deal?**

The USDA is catching up with reports it missed during the government shutdown. One of the first post-shutdown reports showed that December 1 quarterly stocks of soybeans stood at 3.736 billion bushels, or 101.65 million tonnes (MT). It came in somewhat lower than analysts' guesstimates, but generally in line with expectations. Seeing is believing, though. This figure compares with 3.16 billion bushels (85.98 MT) on December 1, 2017, confirming the devastating effect the abrupt halt of soybean imports by the Chinese had on the US soybean farmer. The difference of close to 600 million bushels (16.3 MT) is roughly the amount China would have bought from the US in a normal year at this juncture of the marketing year.

The weekly export reports have been filing in, but are still not up to date. The most recent data are as of January 3 and show that the olive-branch waving produced some sales to China – 3.5 million tonnes. That figure should actually be higher according to anecdotal evidence of several high-profile sales.

For all destinations, US export commitments for soybeans stand at 30.3 million tonnes, down 11 million tonnes, or 27%, from last year at this time. With talk of alternate countries picking up the slack, that figure will probably look a lot less ugly once the USDA gets caught up with an accurate figure on China and other countries.

There are other material issues that bear watching. Brazil and Argentina have been at the right place at the right time with their crop expansions. Now that we are close to harvest in South America, the US is no longer China's supplier of last resort. Regardless of how well trade talks proceed, US ending stocks at the end of the 2018-19 marketing year on August 31 are still likely to be the highest on record.

There is one potential little glitch, however. Before the government shutdown, the USDA forecast yet another record crop for Brazil of 122 million tonnes. Weather has not been cooperative, though, and in its first post-shutdown revision, Brazilian output was setback to 117 million tonnes. A recent poll of South American analysts puts the average estimate at 114.6 million tonnes. That would put us back to 2016-17 production levels.

After a crop disaster last year, Argentina saw output fall to 37.8 million tonnes, down from 55 million tonnes

in 2016-17. For 2018-19, USDA forecasts Argentina at 55.5 million tonnes.

But the USDA threw an unexpected curve ball for South America. There were historical revisions to Brazilian and Argentinean carryover stocks: Plus 3 million tonnes for Brazil, but *minus 11.75 million tonnes for Argentina*, to 29.55 million tonnes. The revisions came without a wealth of background information, other than to say that it reflected "... historical stocks revisions made in late 2018 by Argentina's Ministry of Agriculture and Brazil's Association of Vegetable Oil Industries."

The implication is that South America cannot afford crop disasters if it is to be a reliable supplier to China. In combining the two countries, ending stocks as a percentage of consumption will fall to 57%, down from 67%. It may still seem high, but it is not that high if we consider that these are the only countries that can supply soybeans to China if the trade problem is not fixed and the 25% tariff that China might continue to charge for US bean imports is not eliminated or at least reduced.

Finally, there has not been much talk about US acreage for the 2019-20 crop that will be planted this spring. The very preliminary USDA forecast in November called for a dramatic drop in soybean area, to 82.5 million acres, down from 89.1 million acres in 2017-18. At present – before we get completely current with the missing data – the US carryout for 2018-19 is 22% of usage, more than double the previous season. So it's hard to say that even such a large reduction in acreage is enough. We will get a fresh look at post-trade-problems acreage surveys on March 29 with the USDA's first comprehensive look at US acreage.

The indications are mixed. Normally, with poor Brazilian weather and the Argentina stock reduction, there would be a reasonable bullish case. A best-case scenario resolution to the trade talks would be bullish as well because the Chinese would likely mop up the soybean overhang in the US, at least to some degree. An inconclusive outcome would be very bearish because it would mean that US soybeans are stuck on its balance sheet, which might only be cured in the short term by a shockingly small planting figure.

Remain sideline. Stay tuned.

[By Sholom Sanik, February 20, 2019]

Chart 5 – CBOT May soybeans



Chart courtesy Reuters

COTTON

Inventories on the rise

All the USDA data withheld during the government shutdown has now all been released. There was not much bullish relief for falling cotton prices.

Through February 14, US export commitments for the 2018-19 marketing year stood at 11.8 million bales, down from 12.8 million bales at the same time last year. China is only partly to blame. In stark contrast to soybeans – the only other agricultural commodity that should have been affected by the 25% Chinese import tariff – cotton exports to China are actually not down that much. Chinese soybean purchases from the US, shipped and unshipped, stand at 28% of the previous season, compared with 72% for cotton.

Rather, the USDA slashed its estimate for global usage by 2 million bales, or 1.6%, in the first post-shutdown crop report released on February 8. After global consumption jumped in 2017-18 by 5.5%, this revision leaves the estimate for demand growth at less than 1% for 2018-19.

The USDA revised all major categories for China. Output for 2018-19 was raised by 500,000 bales, to 27.5 million bales. Domestic usage was revised downwards by 1 million bales. Surprisingly, imports were raised 500,000 bales, which means that Chinese importers have been active with origins outside the US. Still, net inventories were revised upwards by 2 million bales – the first such revision in quite some time.

Mostly as a result of the changes to the Chinese balance sheet, the estimate for 2018-19 global ending stocks rose by 2.3 million bales, to 61% of usage, up from the pre-shut-

down estimate of 58.2%. While still down from 69% and 66% in 2016-17 and 2017-18, respectively, it is the first meaningful increase in global ending stocks we have seen since inventories started coming down several years ago.

While not necessarily the start of a trend, it is somewhat disconcerting for bulls to see US farmers' planting intentions. The early USDA Forum estimate calls for 14.3 million acres to be planted for the 2019-20 crop. That compares with 14.1 million acres in 2018-19.

What is really worrisome, though, is that with any form of normal weather, we could see a much larger crop than last year. The harvested-to-planted ratio in 2018-19 was very low at 74.6% because of weather-related issues. Consider that the ratios for the two previous seasons were 94.4% and 87.3% in 2016-17 and 2017-18, respectively. Last year's poor showing was an extraordinary event, and with just average planting and growing conditions, we could see huge output for the US, the world's largest cotton exporter. With demand flat as it is, ending stocks could start piling up.

In conclusion, the ongoing trade talks between the US and China have inspired hope for Chinese import demand in some related markets. Not cotton. As illustrated above, the period of decline in burdensome global inventories may have ended.

Sell short July cotton, currently trading around 73.5¢ per pound. Place initial stops at 78¢, close only.

[By Sholom Sanik, February 28, 2019]

Chart 6 – ICE July cotton

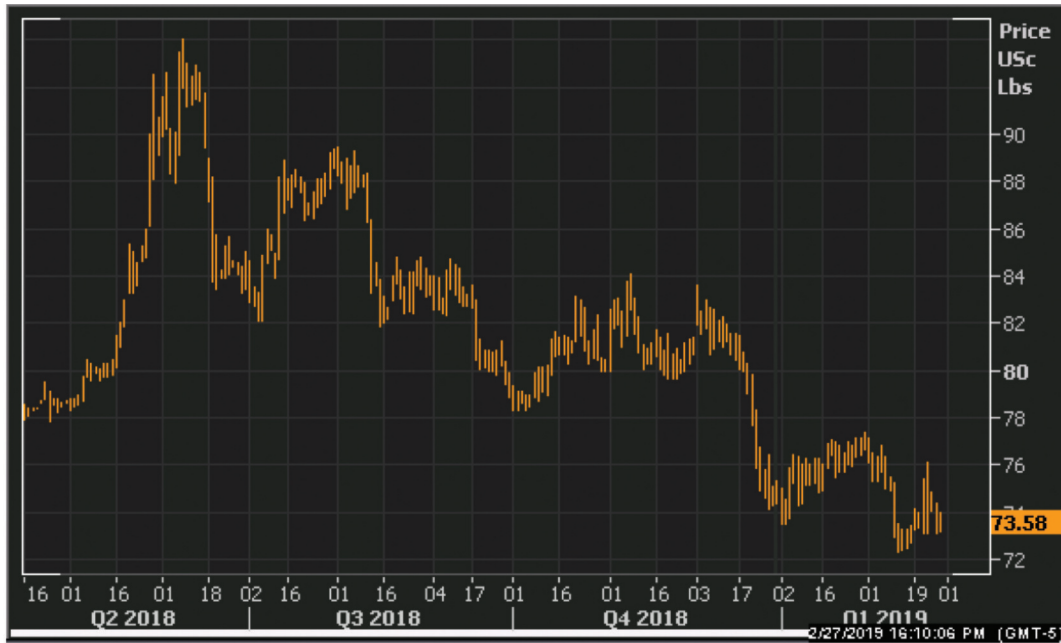


Chart courtesy Reuters

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