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A bearish formula for corn: more supply, less demand

Heavy flooding in the US Midwest will leave soggy fields that could result in delayed spring planting for corn crops. Planting is just getting underway in southern regions, so it's still quite early to draw any conclusions for the heart of the Midwest corn belt.

However, this is where the bullish news for corn begins – and ends. Virtually all other recent developments are solidly in the bear camp.

The March 29 USDA planting intentions report showed that US farmers hope to plant 92.792 million acres of corn. That was above the USDA's February Forum estimate of 92 million acres and substantially higher than the average of analysts' guesstimates of 91.332 million acres.

March 1 quarterly stocks were reported at 8.605 billion bushels, also materially higher than the 8.335-million-bushel average of analysts' guesstimates. The April crop report showed – at least in part – the source of the stock build. The USDA took the axe to all key demand categories for the current 2018-19 marketing year, which runs until August 31. Once again, ethanol usage was cut by the corn equivalent of 50 million bushels. Domestic feed and exports were each slashed by 75 million bushels.

Exports are the biggest disappointment. When we last discussed corn (see *Focus on Futures*, March 5), we pointed out that US export commitments were running neck and neck with the previous season's tally. At the time, it seemed that meeting the USDA target for record exports for 2018-19 was achievable. No longer. As of the most recent weekly export update, commitments have reached only 43.7 million tonnes, compared with 48.2 million tonnes at this time last year. That indicates a 9.3% drop in exports from 2017-18. The USDA estimate, even after this month's revision, still shows a drop of only 3.2%.

These revisions altered the US balance sheet. The estimate for ending stocks jumps from 12.4% to 14%.

On the global front, output estimates for virtually all major exporting nations – Brazil, Argentina, and the FSU – were revised upwards. Most notable, Brazilian production jumped by 1.5 million tonnes, to 96.5 million tonnes. Argentina was increased by 1 million tonnes, to 47 million tonnes.

On March 5 we noted that it would be absurd for US farmers to plant as many acres to soybeans as the street was forecasting, at least while the trade war between the US and China was ongoing. In fact, soybean acreage was 1.5 million acres below the average guesstimate.

Not that increasing corn area seemed necessary, but at least global demand was humming along at trendline growth rates. Now that demand has taken a hit, the larger-than-expected planting area for corn crops will only exacerbate what was already a bearish corn market.

Maintain short positions in July corn recommended on March 5. Lower protective buy stops, from $4.05 per bushel, to $3.92, close only.

[By Sholom Sanik, April 12, 2019]

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Chart 1 – CBOT July corn

Chart courtesy Reuters

COCOA

An upside surprise for grindings, but still no match for robust crops

Cocoa prices have been trending higher (Chart 2). Traders are focused on two developments, one each from the supply and demand sides.

On the supply side, dry weather in key West African growing regions has softened prospects for the March-though-September mid-crops. On the demand side, first-quarter grinding results were slightly better than expected.

Supply

Year-to-date output figures, however, would seem to indicate that the weather situation would have to be in the disaster camp to create any appreciable impact on global production.

We're one month into the mid-crop in the Ivory Coast, and the gap between this year's output and last year's continues to widen. Port arrivals stand at 1.841 million tonnes, 14.3% ahead of last year at this time. One month ago that figure was at 12.3%.

Analysts have been downgrading their forecasts for neighboring Ghana, the world's second-largest producer. The current estimate calls for production of 850,000 tonnes, down from 900,000 tonnes last season. The most recent arrival figure is 698,000 tonnes, 6.2% above last year at this time.

Up-and-coming producer Cameroon is enjoying a bumper crop that should lead to record output. At present, arrivals are 250,000 tonnes, 19% ahead of 2017-18.

With many months remaining for mid-crop beans to grow – as mentioned above – only a prolonged drought will keep output for these three producing nations from reaching record levels.

Demand

Global demand – measured by grinding activity in the major processing countries – showed some strength in the first quarter. Despite a gradual shift of processing to origin countries, European processors still grind the most beans. On April 17, news of a 3.3% year-over-year jump in grindings sparked a rally that drove prices close to the high of the range. The North American grind continued to show the weakest growth rate with a gain of 1.98%.

Both origin regions experienced stellar growth. The Ivory Coast rose by 5.5%, while the Asian grind grew by 9.5%.

The issue at hand is whether this upward trend in grindings is sustainable. Product prices continue to languish. The cocoa butter ratio has been falling since 2017 (Chart 3). The combined product ratio – the prices of butter and powder versus the London spot bean price – is at a two-and-a-half-year low, which leaves slim profit margins (Chart 4).

The traditional metric for global cocoa demand has always been grinding activity. It pays, however, to study end-user demand. Some of the major chocolate manufacturers have forecast only 2% growth in global chocolate consumption for 2019, leading us to believe that we are looking at a potential glut of butter and powder.

The producing nations cited earlier account for roughly 75% of the world's cocoa bean output. Even with the uptick in grinding activity, it is clear that bean production outstrips grindings by a wide margin. One analyst forecasts the global production/consumption balance at 130,000 tonnes, but

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given the most recent data, we believe that figure will rise materially as we draw closer to the end of the season and more comprehensive estimates become available.

Remain short cocoa, first recommended on May 20, 2018. Maintain protective buy stops suggested on March 8, at $2,450 per tonne, basis the most active trading month, close only.

[By Sholom Sanik, April 30, 2019]

Chart 2 – ICE July cocoa

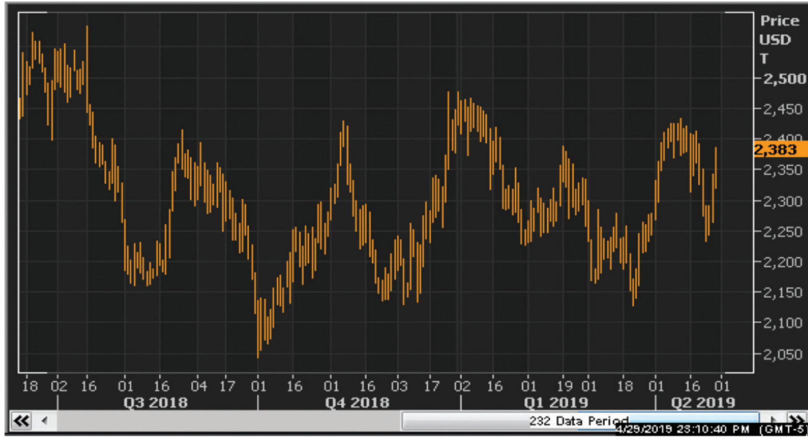


Chart courtesy Reuters

Chart 3 – Cocoa butter ratio

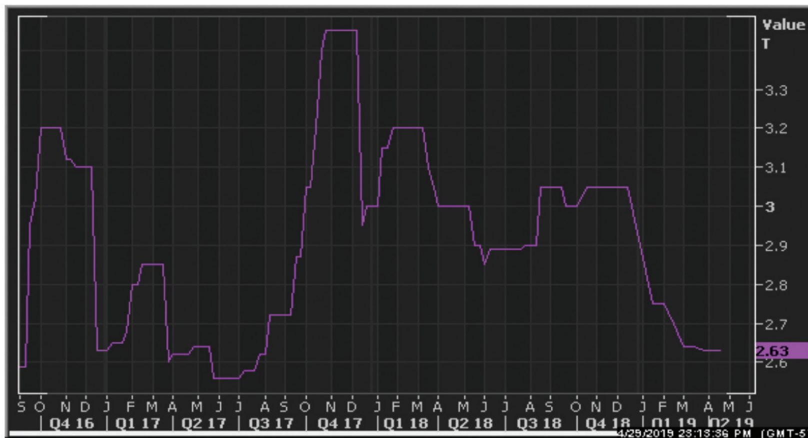
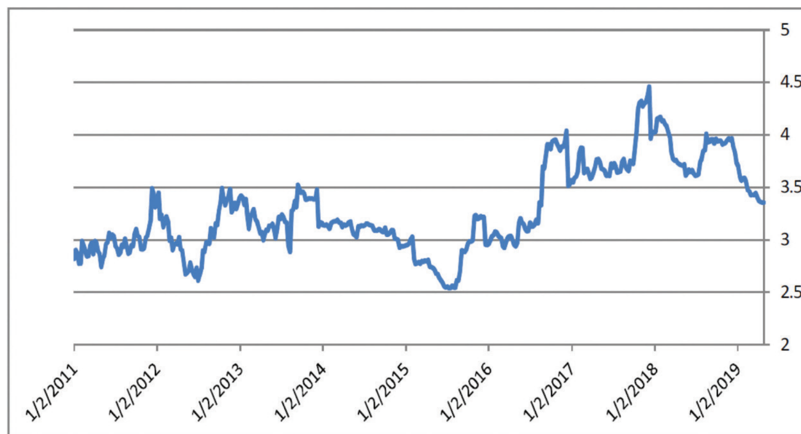


Chart courtesy Reuters

Chart 4 – Combined cocoa butter/powder ratio



Source: Reuters

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COTTON

Crops are getting bigger, demand is stagnant

The most recent market-moving news for the cotton market was the March 29 USDA planting intentions report for the 2019-20 US crop. Traders were expecting planted area to grow from last season. The average of analysts' guesstimates was 14.498 million acres, up from 2018-19 area of 14.10 million acres. The actual figure came in at 13.78 million acres. Prices had been firming off the lows since February, and the rally continued over the following two weeks, taking the market to a three-and-a-half-month high (Chart 5).

While the headline number was viewed as bullish, it should be taken in context. Planted area was below last year's level, but was still the second-highest area since the 2011-12 season. Moreover, barring weather problems, it should yield a very decent crop. Last season was plagued with weather issues and saw extraordinary abandonment. Farmers harvested only 74.4% of planted area, down sharply from the 5-year average of 87%. With trendline abandonment and the 5-year average 843 pounds-per-acre yield, the crop should reach 21.05 million bales, sharply higher than last year's 18.39-million-bale final output tally and the second-largest crop since the 2006-07 marketing year.

Thus far there have been no material weather issues for planting. In addition, as shown in Chart 6, cotton prices have been trending higher *vis-à-vis* soybeans, corn, and wheat, so it is quite possible that the survey upon which the USDA's intentions forecast was based is dated. The final figure could very well be revised higher over the coming months.

The market has since drifted lower with traders turning their attention to other developments.

Further on the supply side, the top two producing nations are expecting to harvest larger crops in 2019-20. The US attaché in India estimates that output will rise by 7%, to 29.7 million bales. That would be India's largest output since the 2013-14 season. An early USDA estimate puts Chinese output at 28 million bales, 1.8% above 2018-19.

US mill demand has been contracting for years – all part of the massive shift of the manufacturing base for finished goods to developing countries where labor costs are a fraction of those in North America. So it's no great surprise that in the April crop report, the USDA revised its estimate for 2018-19 domestic consumption to a modern-day record low of 3.1 million bales.

Naturally, the expectation is that disappearance of the US crop would shift from domestic usage to export demand. And while that has happened, the trend may be faltering. The estimate for 2018-19 exports was maintained at 15 million bales, which would be 5.4% below last year. This may not be achievable. Export commitments stand at 13.6 million bales, 13% below last year at this time. Historically, weekly export sales for cotton head into a rapid decline from this point through the end of the marketing year. And this year could be even worse because of China's sparse presence. Chinese purchases of US cotton to date (shipped and unshipped) are 1.62 million bales, compared with 2.42 million bales last year. Prices cannot be sustained at these levels if farmers continue to grow large crops in a weak demand environment.

After falling sharply from absurd levels that reached over 100% of usage, global inventories have declined over the past several seasons. However, that decline seems to be slowing. Ending stocks are estimated at 62% of consumption, compared with 69% and 66% at the end of 2016-17 and 2017-18, respectively. An early USDA estimate for 2019-20 puts ending stocks at 61% of consumption.

We attribute the rally that began earlier this year to optimism surrounding an impending trade deal with China, which continues to be a risk factor for bears – at least in the short run. It is unlikely that the storied Chinese stockpile – still listed at 33 million bales – has eliminated the need for imports. As such, a trade deal that reduces or eliminates the tariff imposed on US cotton should result in a spike that would take prices above recent highs.

Our February 28 short-sale recommendation was stopped at 78¢, basis July. Remain sidelined for now, but stay tuned. *[By Sholom Sanik, May 2, 2019]*

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Chart 5
ICE July cotton

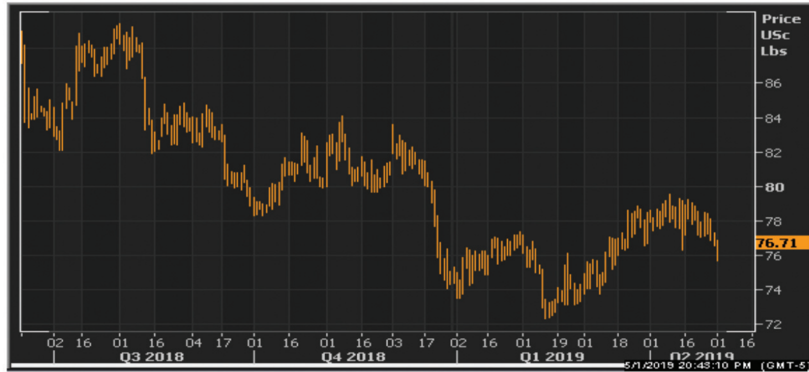

Chart courtesy Reuters

Chart 6
New-crop cotton vs. new crop soybeans, corn, and wheat

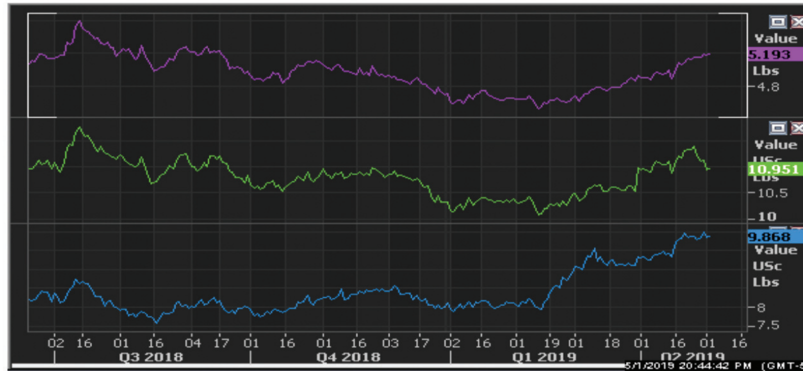

Chart courtesy Reuters

SUGAR

Sugar headed into deficit…can that be correct?

As statistics for the 2019-20 marketing year start filing in, it is becoming increasingly clear that low prices are affecting sugar production. While hard to imagine even a few months ago, it seems that the global production/consumption balance will be slipping into deficit territory.

Brazil

Arguably the single most influential factor for the global sugar market is the Brazilian ethanol/sugar production ratio. In 2018-19 the ratio favored ethanol by 65/35. Most analysts agreed that 2019-20 would see a bounce in Center South sugar output, from 26 million tonnes, to closer to 30 million tonnes, and an ethanol/sugar ratio of 60/40. With the crushing season underway, that outlook has changed dramatically. Now, some estimates put sugar output as low as 26.5 million tonnes.

Albeit quite early in the season, the ethanol/sugar output ratio is at 70/30, the highest we've ever seen it. This level is an extreme, and as sucrose levels rise later in the season, the ratio should slant toward more sugar production. However, crude oil prices are maintaining their $20-per-barrel rally for now, and consequently ethanol demand should remain strong. Sugar production is not competitive with ethanol below 13¢ per pound. We therefore anticipate that there cannot be a material recovery in Brazilian sugar output without a drop in crude prices and/or a rally in sugar prices.

Thailand

The effect of low prices is also evident in Thailand – the world's second-largest exporter behind Brazil. After two consecutive seasons of 14-million-tonne-plus crops, output is expected to drop to below 13 million tonnes for 2019-20.

India

Indian ending stocks account for about 30% of global inventories. Aside from Thailand, no other exporting nation owns any meaningful amount of inventories. All the fuss about burdensome global inventories will continue to be a moot point as long as there is no indication that Indian exporters are going to sell abroad. Exports for the current 2018-19 marketing year total about 3 million tonnes. That's shy of the 5-million-tonne government target.

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China

Chinese output is estimated at just under 11 million tonnes, about the same as in 2018-19. With demand estimated at about 16 million tonnes, this still leaves a wide production/consumption deficit equal roughly to carryover stocks. The Chinese can whittle inventories down, but potential imports may be a variable that will surprise the market one day. All of the major analysts are forecasting a global production/consumption deficit for the 2019-20 marketing year. Most of the estimates are looking for a deficit of about 2 million tonnes, with one leading agricultural trader forecasting a 6.7-million-tonne deficit! CFTC data show that commodity funds retain their short bias (Chart 7). Every rally is met with increased selling. The market's recent slide was accompanied by a 20% spike in open interest (Chart 8).

There is a blind trust that the bear market will live in perpetuity. We believe that the supply/demand fundamentals will soon dictate otherwise.

Maintain long positions via October 13.5¢ calls, recommended on January 30. *[By Sholom Sanik, May 15, 2019]*

Chart 7 – CFTC net-short fund position (bar)

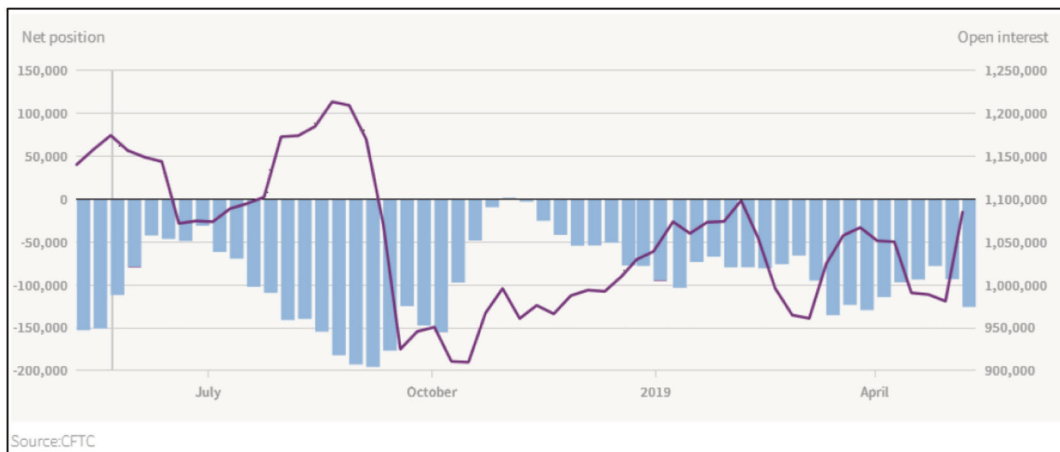

Chart courtesy Reuters

Chart 8 – Weekly nearest contract ICE sugar

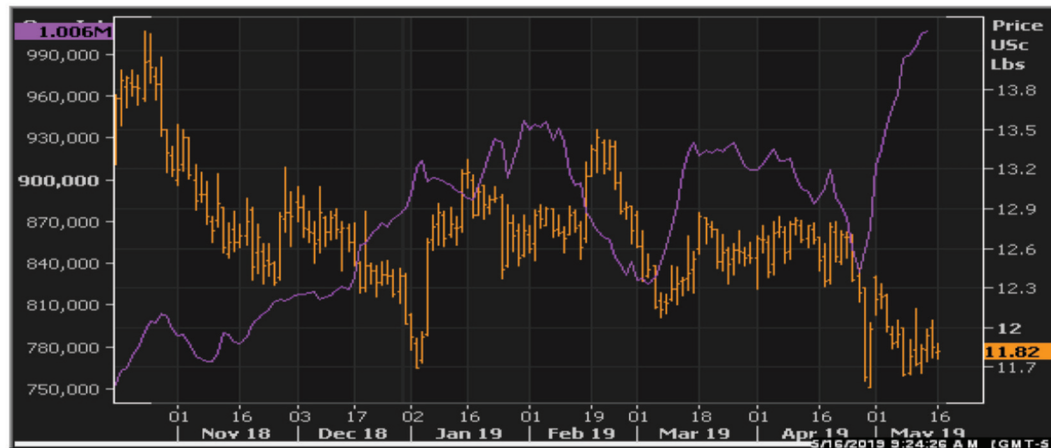

Chart courtesy Reuters

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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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