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Soybeans: "Phase One" disappoints

Soybean prices peaked on the first trading session of the year. The signing of "Phase One" of the US/China trade deal on January 15 was an anti-climactic event, and prices continued to retreat (Chart 1). Aside from the soybeans that were given a tariff exemption by China, the tariff regime still exists. This will continue to divert sales away from the US over to Brazil.

There has been some movement on the export front, but it is not yet normal by any means. US soybean export commitments to China for the current 2019-20 marketing year stand at 11.4 million tonnes (shipped and unshipped). Last year at this time, that figure was 3.5 million tonnes. However, in 2017-18, before the trade war began, total sales at this juncture of the season stood at 32.3 million tonnes.

Total export commitments (shipped and unshipped) to all destinations stands at 30.4, about the same as last year at this time. In 2017-18 that figure was 49.3 million tonnes. If China keeps its end of the deal, we should expect a pop in exports. While under tariffs though, it will be some time before we move back to normal levels. In addition, Chinese imports do not need to return all the way back to the historical norm to stabilize the global balance sheet.

As a result of African Swine Fever, which saw the hog population in China fall dramatically, Chinese pork imports have soared (Chart 2). This means that domestic meal consumption is down, but that demand has shifted to tariff-free countries that feed meal to hogs that will be shipped to China. So at least part of the meal demand lost in China has not disappeared.

A series of USDA reports released on January 10 was not particularly bullish and added to the negative sentiment.

Quarterly stocks in the US were 65 million bushels (1.8 million tonnes) higher than expected. In the monthly crop report, the USDA reduced harvested area by 600,000 acres, to 75 million acres. But the estimate for total output rose regardless because of a surprising upward revision to the bushel-per-acre (bpa) yield. Analysts were expecting 46.6 bpa, down from the November estimate of 46.9 bpa, but the actual figure came in at 47.4 bpa.

Although the US harvest has long been completed, the book is not closed on 2019-20 US production. The USDA indicated that it would resurvey five northern corn and soybean states because farmers reported a significant number of unharvested acres. Three of those states, Minnesota and the Dakotas, are among the top 10 soybean-producing states. The results will be published in the spring.

US ending stocks were unchanged from the December estimate, at 475 million bushels (12.92 million tonnes), or 11.8% of consumption. That is a material accomplishment when compared with a carryover of 908 million bushels (24.7 million tonnes), or 22.9% of usage, in 2018-19 and all due to smaller acreage. Nevertheless, it is still high when compared with the pre-trade-war years when US soybean ending stocks averaged about 6% of consumption.

The next significant event for the US soybean market is the USDA Forum, which begins on February 20. We will get the first look at spring planting for the upcoming 2020-21 marketing year. US farmers slashed 2019-20 soybean acreage by 14.6% in response to the anticipated drop in Chinese import demand on account of the trade war. So it will be crucial to see if the acreage level we saw this past year is a new paradigm or if optimism about an eventual settling of the trade dispute will prevail.

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In conclusion, even if the "cease fire" conditions in the trade war do generate increased Chinese purchases in the coming months, we're a long way from repairing the damage caused by two years of anemic sales. We see the market range-bound. Stand aside.

[By Sholom Sanik, January 17, 2020]

Chart 1 – March soybeans

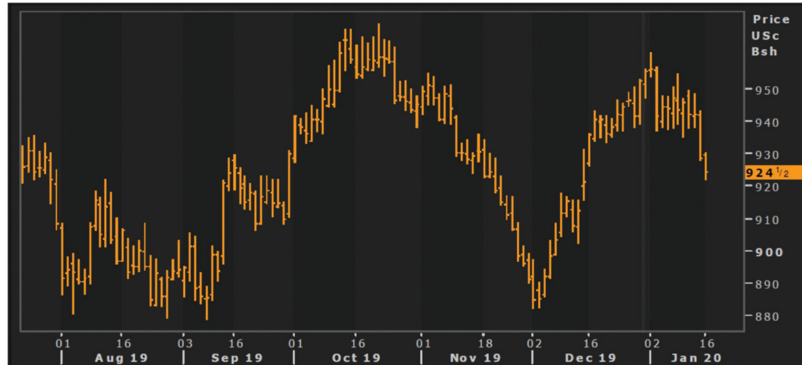

Chart courtesy Reuters

Chart 2 – Chinese pork imports

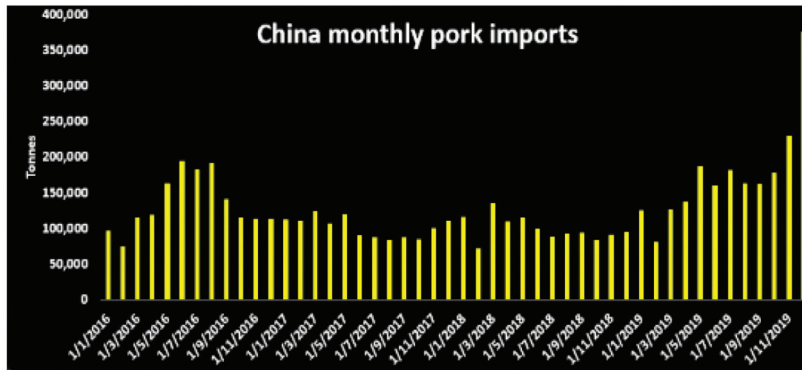

Chart courtesy Reuters

SUGAR

Can the market actually be tight?

Sugar prices have rallied to one-year highs (Chart 3). Production for the 2019-20 marketing year in all major producing/exporting nations has fallen - in Brazil because of competition from ethanol and in Asia because of weather issues.

In Thailand, for example, the world's second-largest exporter, pre-crushing-season output forecasts were looking for a drop in production to 13.2 million tonnes from 14.6 million tonnes in 2018-19. Now that the crushing season is well underway, that estimate has fallen to 12 million tonnes.

The Indian crush got off to a late start because of flooding in some key regions, which will render some cane unusable and result in lower yields.

Output is down 26% year-to-date. Maharashtra State, which normally accounts for about one third of Indian sugar output, was particularly hard-hit. Roughly half the mills in the state began crushing very late. Early estimates put output at 5.5 million tonnes, down from 9.3 million tonnes in 2018-19.

Even if Indian output were to stabilize at the current rate of output, production and domestic consumption would be balanced, which means that exports would be eating into ending stocks – if exports are meaningful, that is. At the moment, the government's scheme to subsidize 6 million tonnes of exports is not – like last season – catching on. To date, only 2 million tonnes have been sold, reportedly because exporters are holding out for higher prices.

Going forward, the big variable will be Brazil. The 2019-20 crushing season has ended. Despite a larger cane crop, sugar output in the Center-South was 27 million tonnes, down about 1 million tonnes from 2018-19 because of a greater percentage of cane diverted to ethanol. Only 34% of the cane crop was crushed for sugar, a record low.

With sugar prices on the rise, though, what can we expect in terms of overhead resistance?

Trade sources indicate that if the market reaches 15¢ per pound, Brazilian producers will hedge the equivalent of 200,000 contracts.

Furthermore, one analyst estimates that the breakeven

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price for producing sugar versus ethanol is around 15.5¢ per pound. It should be noted, however, that mills generally prefer to produce ethanol, unless there is a distinct price advantage. That's because the way the industry operates, ethanol buyers make their payment to mills almost on demand, whereas the lag time for sugar payment is about 45 days. A significant shift away from ethanol output may come only when sugar prices are materially higher.

So while there are definitely grounds for sugar bulls to be concerned regarding a shift towards increased sugar production, we are not there yet. Besides, the market is tight, and the Brazilian 2020-21 crush season does not begin until April.

The dynamics of the commodity-fund position have changed. The record short position has been covered, and the funds are now net-long (Chart 4). That's a bit worrisome because open interest has soared even while the market consolidates (Chart 5), which is often a recipe for an overbought market. Nevertheless, we believe strongly in the long-term bullish fundamentals and continue to advise holding on to long July 13¢ calls.

[By Sholom Sanik, January 29, 2020]

Chart 3 – Weekly ICE sugar nearest contract

Chart courtesy Reuters

Chart 4 – CFTC ICE sugar net fund position

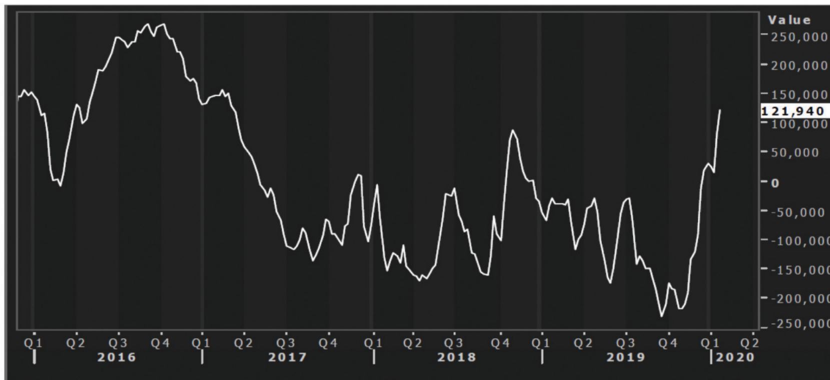

Chart courtesy Reuters

Chart 5 – Daily ICE March sugar (bar), open interest (line)

Chart courtesy Reuters

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COCOA

Is this bull for real?

Cocoa prices are trading at multi-year highs (Chart 6). Why? After a brief respite and a sharp setback in January, the bull resumed its powerful upward thrust to set yet another high for the move (Chart 7).

At best, we know about the $400-per-tonne premium – the Living Income Differential (LID) – that importers have agreed to pay to Ivorian and Ghanaian exporters to ensure a proper living wage for farmers. The LID program kicks in for 2020-21 deliveries, in September 2020. One theory being talked about is that trade houses are building a long position so that they could take delivery of exchange stocks for which the $400 payment does not apply.

While exporters have agreed to pay the premium, nobody has paid a penny yet, as illustrated, and we do not believe that it is too far-fetched to be a bit skeptical about whether this is ever going to work.

Part of the initiative is to curtail output by forming something of a cartel. On the surface, this seems feasible because the Ivory Coast, Ghana, and the other participating countries grow over 70% of world supply. If OPEC is being used as a model, however, the plan would fail. Crude oil production in participating countries is centrally controlled. Cocoa farming consists of thousands of small, privately owned plantations. It would be impossible to control output levels. In particular, at least for the foreseeable future, with cocoa being the best-performing commodity on the board, farmers will not be cutting back output any time soon.

Traditional supply/demand metrics are not providing a screamingly bullish case. The vulnerable Harmattan-wind period in West Africa from November through March has indeed been dry. Regardless, Ivorian port arrivals stand at 1.435 million tonnes, down just a tad from last year at this time. Ghanaian arrivals as of late January are at 596,000 tonnes, up from 591,000 tonnes last season. We're at the tail end of the main-crop season. The mid-crop runs through until September, leaving ample time for output to meet or exceed last year's record production of 2.17 million tonnes.

Perhaps more significant is that consumption data do not seem to support estimates for robust demand growth. Origin grinding countries continued to show positive results in the fourth-quarter, with the Ivory Coast up 4.4% and the Asian grind at 8.6%-plus. North America was down 5.9%, and Europe, which is still the largest processing zone, was 1.1% lower. Collectively, that represents an increase of 1.7%. The International Cocoa Organization's (ICCO) most recent estimate for the 2019-20 marketing year puts grinding growth at 4.6%. Based on previous quarters, the ICCO was not that far off the mark, but this quarter was certainly a setback.

A brief look at product prices may explain why grinding activity has slowed. At 2.59, the butter ratio is at multi-year lows (Chart 8). Although powder prices have been stronger, the combined ratio still languishes at multi-year lows (Chart 9).

Were the LID concept to work, perhaps this explosive move will prove to be warranted. At this time there is no evidence that it will. By the same token, standing in the path of an oncoming freight train has rarely proven to be a winning trading strategy. Still, we believe that it would not be completely reckless to sell key downward reversals, placing stops at the most recent highs, close only.

[By Sholom Sanik, February 11, 2020]

Chart 6 – Weekly ICE cocoa nearest contract

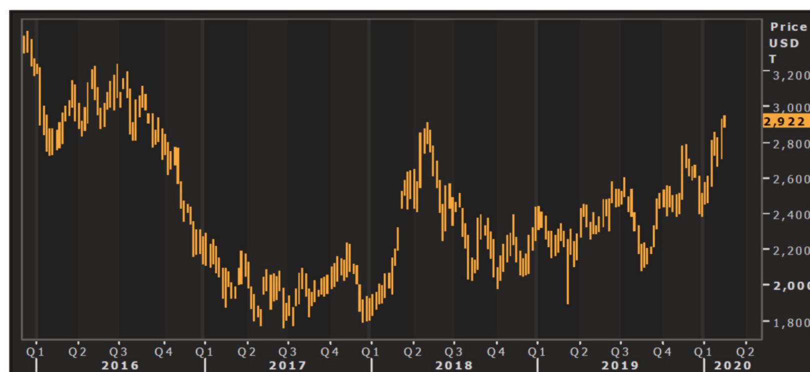

Chart courtesy Reuters

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Chart 7 – May ICE cocoa

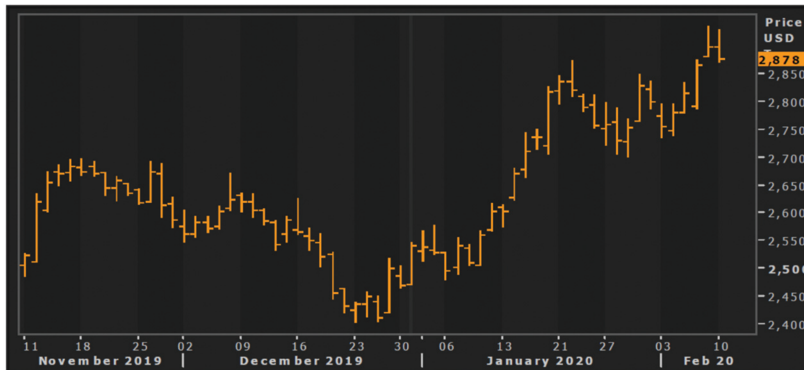

Chart courtesy Reuters

Chart 8 – Cocoa butter ratio

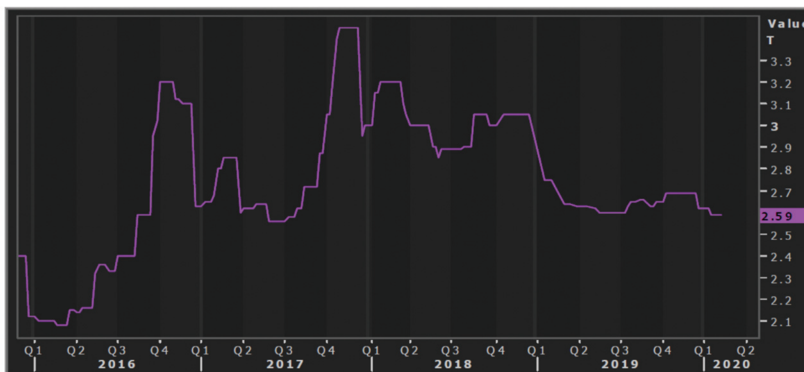

Chart courtesy Reuters

Chart 9 – Combined cocoa butter/powder ratio

Chart source: Reuters

CORN

Can US prices withstand shrinking exports?

The 2019-20 season has arguably been the single most confusing crop year for US corn. Everything that could go wrong with the weather, in fact, did. As a result, throughout most of the planting and growing periods, well-regarded analysts who participate in news wire polls, many of whom have respectable resources at their disposal, were consistently well below the USDA with their crop estimates. Back in August, well into the growing season, the average guesstimate for planted acreage was about 5 million acres below the USDA actual estimate – an epic miss. The guesstimates were also

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about 2 to 3 bushels per acre below the USDA.

The current USDA estimate for the crop is 13.962 million bushels. That's 3.5% below the average record crops of the previous two seasons. Although the harvest is long over, there is still a lack of clarity. The USDA said in January that it could revise final production in the spring to address the possibility of a large number of unharvested acres in key northern states. Perhaps this will make some sense of the far more conservative estimates by private forecasters.

The point of this discussion is that a bullish revision should not matter very much. Domestic corn demand has been strong in 2019-20. Combined, feed and ethanol usage is estimated at 142 million bushels higher than in 2018-19. Export demand, however, is anemic. Marketing-year-to-date commitments stand at 600 million bushels, down 220 million bushels, or 27%, from last year at this time. The USDA forecast for the 2019-20 marketing year, which runs through the end of August, estimates exports for the season at 1.725 billion bushels, only 16% below last year's level, so there's a lot of catching up to do if we're to hit the USDA target.

And don't blame the trade war for this one. China has run a production/consumption deficit over the past few seasons, but it imports less than 3% of total usage because it has carryover stocks equivalent to roughly 70% of consumption. Historically, Chinese imports of US corn have been statistically insignificant.

As we head into the 2020-21 spring planting season, the average of the acreage guesstimates we've seen is 94 million acres, which compares with 89.7 million acres for 2019-20. That would be a lot of new-crop corn in an environment of poor export demand. Of note, analysts seem to believe that we've seen the worst of the trade spat and are forecasting a 10% to 15% increase in soybean area. We would tend to lean towards a scenario in which farmers will feel more comfortable taking a risk with corn *vis-à-vis* soybeans. Were that to be an accurate assessment, we could see even more acres allocated to corn as the planting season wears on.

The February USDA crop report estimated US ending stocks for the current marketing year at 1.829 billion bushels, or 13.4% of consumption. On the surface, that does not represent a particularly overburdened balance sheet. The average carryout for the previous two seasons was 15% of usage. However, if exports continue at the current pace, a rough calculation would pile as much as an additional 200 million bushels onto the ending stock tally, pushing the stocks-to-consumption ratio up to about 17%.

Brazil and Argentina are expected to equal record crops produced in 2018-19, at 101 million tonnes and 51 million tonnes, respectively. With those supplies soon to become available, US prices will need to drift lower to attract demand. We advise establishing short positions in July corn, currently trading at about $3.88 per bushel. Place initial sell stops at $4.10, close only.

[By Sholom Sanik, February 19, 2020]

Chart 10 – July CBOT corn

Chart source: Reuters

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