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Corn: not just for cows anymore

After a steep plunge in mid-2019, corn prices consolidated during the harvest of the 2019-20 crop. Prices remained steady, even as the results of early surveys seemed to indicate that US farmers were going to plant a huge crop come spring (Chart 1). At the time, the only global crisis traders had to grapple with was the US/China trade war, from which the US corn market was largely insulated because China does not import very much corn. It was a soybean problem, and there were solid grounds to assume that corn demand was a safer bet. The onset of Covid-19 towards the end of the winter, however, made it clear that few commodities would command the kind of demand that would be required to consume record output. In the space of a few weeks corn plunged to four-year lows (Chart 2).

The fact that corn is no longer just an animal feed market, but an energy market as well, only served to exacerbate the problem. In 2018-19, the most recent marketing year untouched by the pandemic, ethanol consumption was the corn equivalent of 5.4 billion bushels and comprised 37.6% of US corn usage.

Before anybody had heard of Covid-19, the estimate for 2019-20 was 5.5 billion bushels. In response to lower energy consumption, the USDA cut its estimate to 4.9 billion bushels. That estimate is roughly in line with analysts' estimates that US gasoline usage will decline about 8% in 2020. Weekly statistics, however, show that the USDA estimate is optimistic.

Of course, much remains unknown at this moment. Assumptions are based on a reopening of the economy. However, driving trends in a post-pandemic world could change dramatically. Working at home for many may be a new paradigm and will reduce commuting needs. Cautious behavior could reduce leisure travel. All these factors will be significant determinants for gasoline and ethanol demand. In any case, it is hardly the environment for the absorption of a record crop.

The USDA initiated coverage of the 2020-21 US corn crop forecasting a record yield of 178.50 bushels per acre. Unlike recent seasons, planting went off without a hitch. The last weekly planting-progress report of the season showed that 97% of the crop had been planted, compared with only 78% last year and a five-year average of 94%.

Most recently, though, prices have rallied. Commodity funds are heavily short this market (Chart 3), and inclement weather sparked some short-covering as fears that the fantastic yields could be in jeopardy. The progress report following the final planting report showed that the good-to-excellent portion crop fell by four percentage points, to 71%. It may not sound like much, but the last time the top portion of the crop dropped by that much from one week to the next was in 2012, which ushered in a disastrous drought-plagued crop.

The problems actually began in May when the tail-end of the seeding season slowed a bit due to extremely wet weather. Then the weather turned hot and dry. Both situations affected the early development of the crop. Key corn states such as North and South Dakota, Nebraska, Kansas, and Colorado have been impacted.

The crucial period for corn development is July and August. Some forecasts are calling for a return to favorable weather, so as weather scares go, this one could fade as quickly as it arrived.

The June USDA crop report forecast 2020-21 US ending stocks at 3.323 billion bushels, or 22.5% of consumption. Consider: This compares with 15.5% and 15.2% in 2018-19 and 2019-20, respectively. Given the potential demand loss from the ethanol sector alone, crop damage would need to be severe to make a dent in what we believe will be overwhelming supplies.

Remain short. On May 13 we suggested lowering stops to $3.45 per bushel. Roll July corn into December, using an equidistant of $3.57, basis December, close only.

[By Sholom Sanik, June 18, 2020]

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Chart 1 – CBOT July corn

Chart courtesy Reuters

Chart 2 – CBOT corn weekly nearest contract

Chart courtesy Reuters

Chart 3 – CFTC commodity fund net-short position

Chart courtesy Reuters

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SUGAR

Energizing cane

Since mid-April, sugar prices have traded in lockstep with crude oil prices (Chart 4). In the early stages of the pandemic, it was believed that the shutdown of economies around the globe would cause severe demand destruction for ethanol in Brazil and processors would dramatically shift cane crushing to sugar for the 2020-21 marketing year. Which actually did happen.

Very early in the Brazilian crushing season, which begins in April, the percentage of sugar production *vis-à-vis* ethanol jumped to 47%, compared with only 36% for the comparable period in 2019-20. Projections for the whole season called for 45% of cane to be devoted to sugar output, compared with 32% for 2019-20. If achieved, the implications would be staggering.

Some estimates put 2020-21 Brazilian sugar production at 40 million tonnes, up from close to 30 million tonnes in 2019-20. Combined with an inevitable drop in sugar consumption tied to a drop in global GDP, inventories would balloon. That explains the steep dive in sugar prices. Then came a mighty rally in crude prices and a perceived return to normal ethanol production/usage patterns, followed by a spike in sugar prices.

Any evidence that does exist, however, suggests that sugar production remains strong. The second half of May saw crude oil prices rally to $40 per barrel from $30. The most recent data from Brazil show that during this period, ethanol production was 1.8 billion liters, or 16% below last year. Sugar output was 2.55 million tonnes, 36% higher than last year. The sugar/ethanol ratio was maintained at 47%, compared with 35% for the comparable period. Domestic ethanol sales were down 30%, while sugar exports were up 65%.

One final point regarding Brazil. Generally the ratio slants towards sugar over ethanol later in the crush season because the sucrose levels are higher in more mature crops. Ethanol prices would have to rise materially, and demand would have to improve for processors to shift significantly towards ethanol. So for now, we expect the 40-million-tonne production estimate to hold.

Asian crops were poor in 2019-20 because of drought. Nevertheless, as the season draws to a close, estimates for Indian output have been revised upwards by 500,000 tonnes, to 27 million tonnes. The Thai season remains a disaster, with output down about 35% from 2018-19. That's history. The monsoon this year has been excellent thus far, leaving both countries with subsoil moisture that should see output return to normal levels in 2020-21. Since June 1, the monsoon rains have been 29% above average.

It is far too early for specific estimates for the 2020-21 output. Crushing does not begin until November. While India has been developing a biofuel industry, sugar-based ethanol production is tiny when compared with Brazil. Large cane crops in these two producing nations means a lot of sugar will be produced over the next 12 months.

As the pandemic took hold, commodity funds subscribed to what we consider the correct analysis of this market: A drop in energy consumption will mean weak demand for ethanol and the inevitable sharp swing to sugar production in Brazil. But then the surge in crude oil prices sparked massive short covering. Chart 5 shows that the net fund position has now crept on to the long side. However, the recovery in crude prices was caused at least in part by output cuts by OPEC and Russia and not a surge in demand. The fact that Brazilian cane crushers continue to favor sugar output over ethanol perhaps provides the best evidence of this.

Unfortunately, our 12¢ buy stop in October sugar suggested on May 12 was triggered. We are undeterred. We are entering an environment in which large new supply becomes available against a backdrop of uncertain demand levels. To avoid the whipsaw factor, we recommend the purchase of March 2021 12¢ sugar puts, currently trading at around 80 ticks. *[By Sholom Sanik, June 19, 2020]*

Chart 4 – ICE October sugar (bar), August crude (line)

Chart courtesy Reuters

Chart 5 – CFTC commodity fund net position

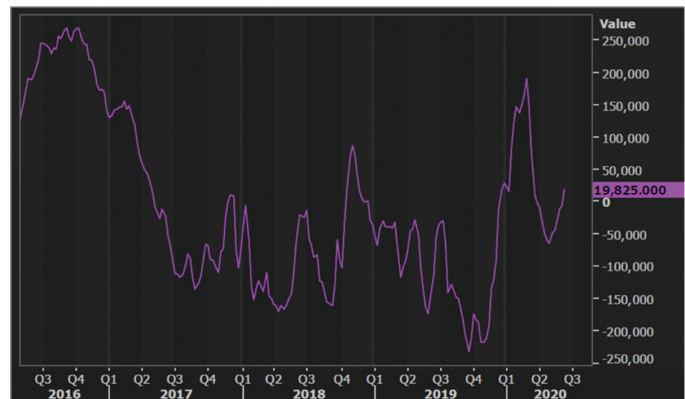

Chart courtesy Reuters

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SOYBEANS

Will Chinese purchases be enough to chase the bear?

Soybean market traders are focusing their attention on whether China will live up to its commitment to buy US beans. The market was in rally mode from late April through mid-June, consolidated, and most recently, has slumped (Chart 6).

Although old-crop purchases by China have picked up, the overall US export market for 2019-20 is a writeoff. Total sales to China (shipped and unshipped) stand at 15.8 million tonnes, a small increase from 14.3 million tonnes at this time last year, but light years from 28.5 million tonnes in 2018-19.

The USDA target for 2019-20 to all destinations is 44.90 million tonnes. As of the most recent weekly export sales report, only 36.9 million tonnes have been shipped. There are 10 reporting weeks remaining in the marketing year, and with weekly shipment tallies waning, there is simply no way that we'll even come close to hitting the USDA target.

To put this in ending-stock perspective, the current USDA estimate for US 2019-20 is 15.92 million tonnes (585 million bushels), or 15% of consumption. That compares with 22% in the worst of the trade-war period in 2018-19, but still far above the average of the pre-trade-war years when the carryover averaged 7%. After adjusting for the export-target shortfall (using an optimistic assumption that shipments will continue at their recent pace), 2019-20 ending stocks will be back to 20% of usage, and probably higher.

Looking ahead, China has already booked 3.44 million tonnes for 2020-21. That compares with, well, just about zero last year, but 1.5 million tonnes and 1.1 million tonnes in 2018-19 and 2017-18, respectively. Forward commitments to all destinations are 6.095 million tonnes, which is roughly in line with the pre-trade-war era. So, we're in the process of returning to normal on the export front.

This does not mean that we are necessarily looking at higher US prices down the road. First, the South American crops keep getting larger. Combined 2020-21 Brazilian and Argentinean output is expected at 184.5 million tonnes, up from 174 million tonnes in 2019-20. Brazilian exports jumped by close to 15% in 2019-20 as they filled the gap left by the US-China trade war.

There has been some discussion regarding whether Brazil will be sold out of beans because of its "new" customer. While Brazilian ending stocks dropped sharply from 2018-19 to 2019-20 – 27% of usage to 18.18% – there is no shortage of beans if something goes wrong with the US-China trade agreements.

Even if China honors its pact with the US, the real bearish factor is the size of the US crop. It's been years since we sailed through the planting season without weather problems. The most recent weekly planting progress report shows that 96% of the crop has been planted, compared with 83% last year at this time and a five-year average of 93%. Timely planting in the spring means reduced risk of frost damage in the fall.

Early growing weather was touch and go for a while, but it has been raining, and barring any further issues, we have every reason to assume that the USDA has underestimated the crop size. The yield is forecast at 49.8 bushels per acre (bpa). That's up from last year's 47.4 bpa, but with the crop in early and cooperative weather, there is no reason to doubt that we cannot achieve the best yields of the past few seasons, or even higher.

In 2016-17 the yield reached a record 52 bpa. Were that to happen again, a rough estimate puts output 3 million tonnes (110 million bushels) above the USDA's crop estimate. If we add that to the upward revision we anticipate for the 2019-20 carryover, we expect US inventories to remain stubbornly high – between 15% and 18% of consumption – through the end of the 2020-21 marketing year.

We were stopped out of our short position in November soybeans at $8.70 per bushel. Prices subsequently continued to rise but have slipped and are now back to our exit point. We recommend reestablishing a short position. Place protective buy stops at $9.00, close only.

[By Sholom Sanik, June 26, 2020]

Chart 6 – CBOT November soybeans

Chart courtesy Reuters

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CORN

How do you lose 5 million acres?

On June 26, two trading sessions before the USDA was scheduled to release its updated US planted acreage report for the 2020-21 crop, corn prices were trading at four-year lows (Chart 7). The street was aware that corn area of 97 million acres was overestimated in the March planting intentions, but the magnitude of the revision caught everybody off guard. The average of analysts' guesstimates was 95.3 million acres, with the low end of the range at 93 million acres, but the actual figure came in at 92 million acres. It was the largest June-to-July acreage revision since 1983, so it was quite the surprise.

The quarterly stocks report released concurrently showed June 1 stocks at 5.224 billion bushels (132.7 million tonnes (MT)), 270 million bushels (6.85 MT) higher than expected, but that was no match for the close-to-1-billion-bushel (25 MT) drop in supply implied by the downward acreage revision. The market responded with a two-day 25¢-per-bushel rally (Chart 8).

Early in the growing season, we were looking at optimum yields because smooth planting saw the crop get into the ground at near-record speed. But weather in the key Midwest growing regions has been on and off, and as a result, the crop ratings were slipping. In early June, the good-to-excellent portion of the crop was estimated at 74%, but then dipped to 69%. The most recent rating has jumped backed to 72%, so for the moment, the weather scare is on hold.

Headlines indicating that Chinese corn supplies are tight have attracted some bullish sentiment as well and have been underpinned by well-publicized purchases of US corn. According to Chinese customs data, year-to-date imports from all sources are 3.66 million tonnes, compared with the USDA estimate of 7 million tonnes for the 2019-20 marketing year. Forward new-crop Chinese purchases from the US, however, make the situation look a bit more interesting with bookings of 3.78 million tonnes – very high for this time of year, if it turns into a trend, that is.

China has run a production/consumption deficit for several years now. Nevertheless, although Chinese ending stocks have been ratcheted down over the past several years, they remain at an estimated 194 million tonnes, yielding an off-the-charts stocks-to-consumption ratio of 70%. So, it's hard to make a strong case for *bona fide* tightness that would lead to a meaningful continuous flow of overseas purchases. Rather, it is not a stretch to make the assumption that China is merely fulfilling its commitment under the trade agreements made with the US on a basket of agricultural products.

Whatever bullish case you choose – smaller acreage, weather, or Chinese imports – the rally has petered out. December corn is now trading back to pre-acreage-report levels (Chart 8).

The July 10 monthly USDA crop report seemed to take the wind out of the rally's sails. The report incorporated the 5-million-acre downward revision for the 2020-21 crop, so the 1-billion-bushel (25 MT) slash in output was not news. Ending stocks fell sharply as a result, but were in line with expectations. At 18% of usage, ending stocks will still be the highest in 15 years (Chart 9). There were few other changes from June, save for a 200-million-bushel (5.08 MT) increase in the estimate for feed demand.

Annual ethanol consumption peaked at the corn equivalent of 5.378 million bushels (136 MT) in the pre-pandemic era. The USDA maintained its June estimate of 5.2 billion bushels (132 MT), down only 3.3% from 2018-19. We're a bit skeptical of this optimism. The Energy Information Administration's (EIA) most recent weekly report shows that gasoline consumption has improved dramatically from the worst levels of the pandemic shutdowns (Chart 10), but is still about 8% below normal. True, if the economy can continue to reopen at a steady clip, the forecast for ethanol usage may be correct. The flareup in infections in some key regions in the US, however, leaves the timing of a recovery in doubt. In addition, the shift to a work-at-home economy in key sectors also means that a certain amount of driving may be lost permanently. As such, it is too early to assume that there will not be greater losses in ethanol consumption – and therefore production – down the road.

Unfortunately, our June 18 buy stop was triggered right near the highs of the move. We still believe that corn supplies are abundant. That may be especially true with the unknown future of ethanol usage, which has accounted for 35% of the US corn crop in recent years. It's a long summer, and any hint of drought conditions will spark rallies as we enter the pollination period. We suggest establishing a short position in December corn on a rally to $4.45 per bushel.

[By Sholom Sanik, July 28, 2020]

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Chart 7 – CBOT weekly nearest corn contract

Chart courtesy Reuters

Chart 8 – December corn

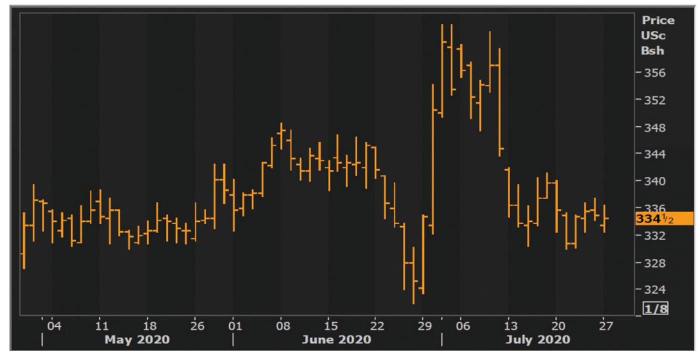

Chart courtesy Reuters

Chart 9 – US corn ending stocks

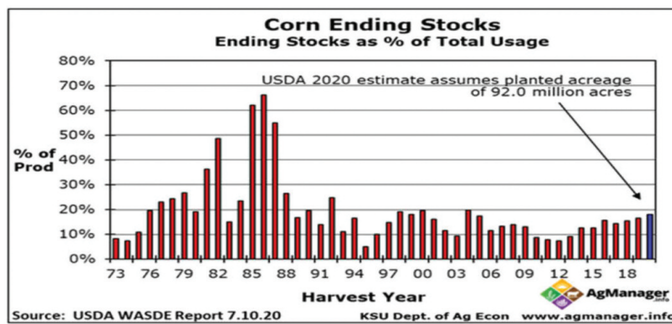

Chart courtesy Kansas State University

Chart 10 – US gasoline consumption

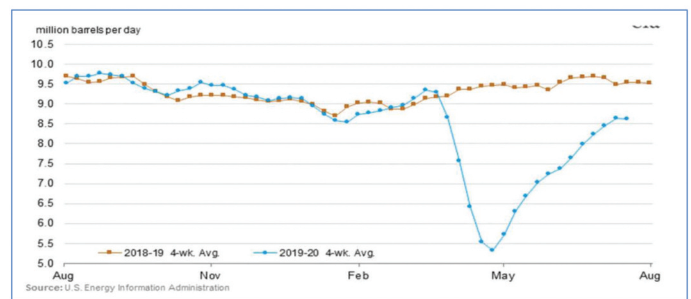

Chart courtesy EIA

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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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