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Sugar: A bear in hibernation

After a sharp drop in the early days of the pandemic, sugar prices have been rising and are now trading at five-month highs (Chart 1). Warranted? Sustainable?

For starters, commodity funds seem to be very bullish. Chart 2 shows that the net-long position has reversed from a net-short position of 64,000 contracts in May to a current net-long position of 122,000 contracts. We're not quite certain what motivated such a turnaround in sentiment.

There are two bullish factors that have been floating around. First, Chinese imports have been making headlines. Year-to-date imports are reportedly up 16%, but at 1.3 million tonnes, the volume is not overwhelming. China is not by any means a new story. For many years now, there has been an annual 5-million-tonne production/consumption deficit, which has been met with imports. Chinese buying could become a more significant factor if there was a buying spree targeting an inventory build. The numbers, however, do not support this.

The other bullish factor is Thailand, a major supplier to the Asian arena. Output spiked to a record 14 million tonnes in 2018-19, but drought wreaked havoc with the 2019-20 crop, which saw production fall to 7.5 million tonnes. The effects of the drought have lingered, and most analysts see only a slight improvement for the 2020-21 crop. Weather will play a crucial factor going forward into the new-crop harvest.

Interestingly, while private forecasters remain negative on the prospects for a Thai recovery this year, the USDA publishes a biannual comprehensive global sugar overview, *Sugar: World Markets and Trade* (April 2020) in which it is far more optimistic for Thai prospects. The USDA estimates 2020-21 Thai output at 12.9 million tonnes. We're not quite sure about what to make of the very wide disparity in Thai estimates, but at the very least it is an indication that there is no conclusive evidence to assume that another Thai crop failure is a given.

India, on the other hand, is expected to see a full recovery from this season's sub-par crop that reached only 26.5 million tonnes. Estimates for 2020-21 (November through October) have been inching up with the latest round of forecasts hovering around 30.5 million tonnes.

We were admittedly skeptical regarding the motivation for Indian exporters to accept the government export subsidies, but at this point it appears that almost all the sugar under the 6-million-tonne government program will be sold abroad in the 2019-20 marketing year. At last count, the export tally was a record 5.2 million tonnes. Estimates for 2020-21 call for exports of 6 to 7 million tonnes. The point being that even if Thai output remains anemic, India can pick up the slack. With a healthy crop, India will have a production/domestic-consumption surplus of 3 to 4 million tonnes.

Finally, the ethanol/sugar ratio in Brazil continues to favor sugar production. Sugar traders have one eye on crude oil prices at all times. Chart 3 shows that sugar prices continue to move in lockstep with crude. However, the connection between rising crude prices and an increase in ethanol production at the expense of sugar output in Brazil is weak. We are now in the fifth month of the Brazilian crush, and the data show that Brazilian processors are still wary of producing too much ethanol. Year-to-date sugar output stands at 16.3 million tonnes, almost 50% higher than the same period last season. Ethanol output on the other hand is 12.1 billion liters, down 6% from last year.

At this point of the season last year, only 35% of the cane crop was crushed into sugar, compared with 46% this year. Total Brazilian output for the season is estimated at 41 million tonnes, up from 29 million tonnes last year.

In conclusion, whatever happens to Thai output, and even if China increases imports from previous years, Brazil

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and India can meet the demand.

We do not believe that a solid bullish case exists. Battling commodity funds is a challenge, but supply/demand fundamentals win in the end.

On June 19, we recommended the purchase of March 12¢ sugar puts, trading at 80 ticks at the time. To date, they have lost half their value, but we advise sticking with them. For new positions, we recommend the purchase of March 13¢ puts, trading at 73 ticks.

[By Sholom Sanik, August 13, 2020]

Chart 1 – CFTC net-long ICE sugar position

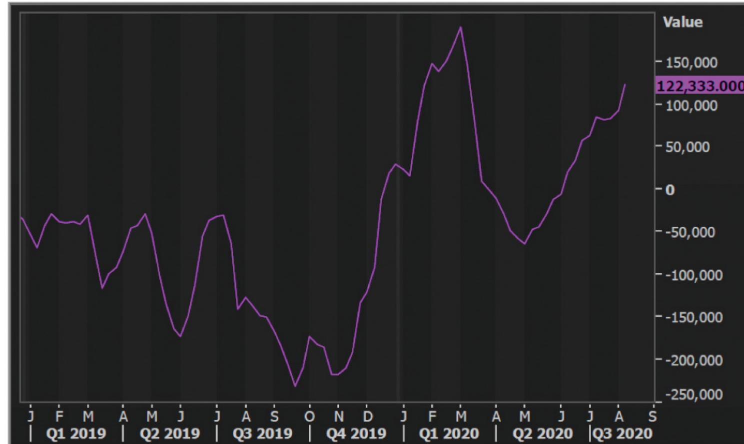

Chart courtesy Reuters

Chart 2 – March sugar

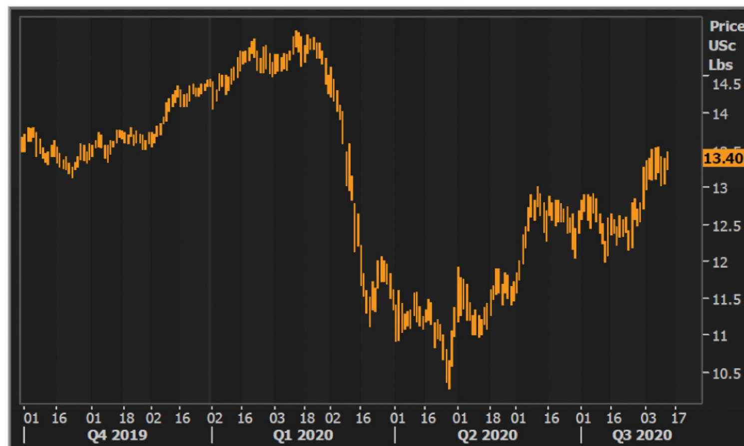

Chart courtesy Reuters

Chart 3 – March sugar (bar), October crude oil (line)

Chart courtesy Reuters

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COTTON

Weighed down with inventory

Cotton prices have been strong, now trading close to six-month, early-pandemic-era highs (Chart 4). There have been some bullish supply/demand factors that have supported the rally, none of which – as we will attempt to illustrate – can necessarily be the underpinnings of sustained strength for this market.

The most recent entry has been the threat of hurricane damage. Although not common, hurricanes have at times in the past resulted in material crop losses. Thus far, the storms have caused some damage to cotton fields in Louisiana, one of the smallest-producing states. With any luck, if the worst of the storms miss vulnerable areas in top-producer Texas, the spillover rains will be welcome in some regions that are experiencing dry conditions.

US exports for 2019-20 finished at a near-record 15.4 million bales – quite the feat considering the impediment of the US-China trade war, which saw the Chinese slap a 25% tariff on US imports. Looking ahead to the 2020-21 marketing year, most Chinese forward sales are unshipped carry-overs from the 2019-20 marketing year.

On the surface, total export commitments of 6.85 million bales to date for all destinations for 2020-21 sounds like a lot for the marketing year, which began just a few weeks ago. However, that tally lags the 8.08 million bales we saw last year at this time. As such, the USDA's estimate for exports of 15 million bales for 2020-21, down just 400,000 bales from last year's 15.4 million bales, is on the optimistic side.

The August monthly USDA crop report lowered the US harvested-to-planted ratio to 75% from 85% estimated in July because of poor conditions in dry areas. However, the healthy areas more than fully compensated. The pound-per-acre yield was increased to a record 925 pounds from 812 pounds in July. Assuming no huge hurricane-related surprise, the resulting crop would reach 18.08 million bales, up from the July estimate of 17.5 million bales. That will be lower than last year's bumper crop of 19.9 million bales. But inventories will continue to pile up. Ending stocks are estimated at 7.6 million bales, or 43% of usage. The pre-pandemic carry-over was 27% of usage.

The problem with burdensome supplies is global. Indian production is estimated at an upwardly revised 29.7 million bales, below last year's 30.5 million bales, but still large for a well-supplied market. Similarly, Chinese output is expected at 26.5 million bales, down from 27.25 million bales in 2019-20.

Global ending stocks for 2020-21 are estimated at 104.91 million bales, or 96.5% of usage. That's a bit lower than 98% in 2019-20. During the 2018-19 season, the Chinese sold a huge chunk of cotton from state reserves and succeeded in whittling down global stocks to 66.7% of usage. But consumption fell to 102 million bales in 2019-20, down from 120 million bales in 2018-19, and as illustrated, farmers in the major producing nations did not cut back much on production.

The USDA's estimate for 2020-21 global usage was revised downwards to 113.05 million bales in its August report. So, while that may be in line with what we can expect from a tepid recovery in clothing demand, inventories will remain stubbornly high regardless.

Retail demand for clothing in the US improved dramatically from the pandemic lows. However, we are still not close to normal levels, as depicted in Chart 5. The chart from the St. Louis Fed shows that the enormous surge in spending on clothing plateaued during June and July. These data include brick-and-mortar stores that offer online shopping. While the data do not include strictly e-commerce companies (mainly Amazon.com) we are still far from a complete recovery.

Commodity funds have flipped from short to long over the past few months (Chart 6). We believe that soon, when the bearish fundamentals on both the supply and demand sides manifest themselves, they will be forced to liquidate, adding downside pressure.

Establish short positions in December cotton, placing initial stops at 71¢ per pound, close only.

[By Sholom Sanik, August 31, 2020]

Chart 4 – December ICE cotton

Chart courtesy Reuters

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Chart 5 – US advance retail sales: clothing and clothing accessory stores

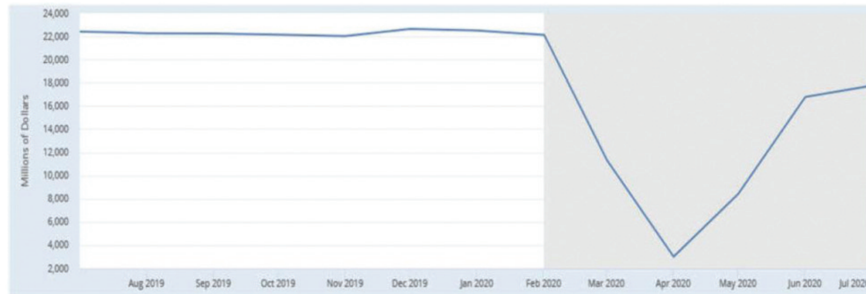

Chart courtesy St. Louis Fed

Chart 6 – CFTC net-long commodity fund positions

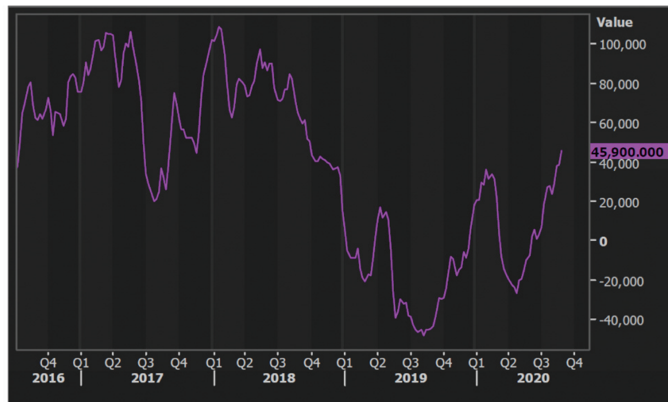

Chart courtesy Reuters

COCOA

A faux bull

Cocoa prices are on a tear. December cocoa has rallied $600 per tonne since mid-July, just shy of $2,700 per tonne (Chart 7). That's not far from pre-Covid levels. Is this move supported by developments in supply/demand fundamentals? We think not.

Commodity prices, for the most part, have a strong bid under them. With most markets priced in US dollars, the weak dollar certainly has some influence. There's also discussion in news reports about the fear that labor will be hard to come by because workers are fearful of exposure to the dreaded virus. As we will illustrate, none of the principal producing nations have shown a significant decline in output that would justify attributing this reason to the rise in cocoa prices. In fact, it's been a challenge for us to identify any solid bullish case in cocoa's supply/demand fundamentals.

True, the Ivory Coast had an off season in the soon-to-be-completed 2019-20 crop year, at least when compared with the previous season's record output of close to 2.2 million tonnes. Port arrivals to date stand at 2.043 million tonnes, 6.5% lower than in 2018-19. Weather was not perfect throughout the season, but it will still register as the second-highest production on record.

Production in number-two producer Ghana reached 850,000 tonnes, its average output over recent years and in line with early-season expectations.

Nigerian output has been sliding for years now and is expected to reach no more than 250,000 tonnes, down from 305,000 tonnes last year. Similarly, Indonesia has seen output fall steadily over the years with production at no more than 200,000 tonnes, about half of what it used to produce. But the faltering of these two countries' crops is not news and was well known to the market when prices were $500 per tonne lower.

Up-and-coming West African producer Cameroon has seen output rise from the 200,000-tonne level five years ago to about 300,000 tonnes currently, compensating at least for Nigeria.

All told, global production muddled through output issues in the 2019-20 marketing year associated with the pandemic. The most recent demand data, however, show that consumption did not do so well.

Second-quarter grinding was weak in all regions. The Ivory Coast has seen the largest growth in cocoa processing over the past few years as the country's expanding capacity is being increasingly utilized. Year-to-date grinding activity

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rose by 2.6%, the smallest increase in quite some time.

The traditional grinding regions all registered dismal results for the second quarter, year-over-year: Asia was down 5.9%, Europe was 8.6% lower, and North America fell by 10.7%.

It is not surprising that processors are not motivated. Prices of cocoa butter, the main ingredient used in the manufacture of chocolate, have plunged since the beginning of the pandemic. Powder prices have soared during this period, which has left the butter/powder ratio steady, but would not have been enough of an incentive for grinders to have increased bean purchases (Chart 8).

In an August 31 report, the International Cocoa Organization estimates that the outgoing 2019-20 marketing year will leave a production/consumption surplus of 42,000 tonnes – not huge, but that estimate is up from its previous forecast for a *deficit* of 80,000 tonnes. Looking ahead, a recent poll of analysts puts the 2020-21 global balance at a 220,000-tonne surplus.

As we enter the start of the West African main-crop harvest season, weather has been favorable, and as a result we have no reason to suspect that there will be any supply-side issues going forward.

We'd like to establish a short position. The funds have flipped from short to long (Chart 9), and doing battle with the trend they help create is often a recipe for disaster. We therefore advise taking a short position with a conservative stop of $150 per pound, which would take us above recent highs. The trade may not work on the first attempt, and having foresight to save ammunition for another attempt would seem prudent.

Sell March cocoa, currently trading at $2,550 per tonne, and place initial stops at $2,700, close only.

[By Sholom Sanik, September 8, 2020]

Chart 7 – March ICE cocoa

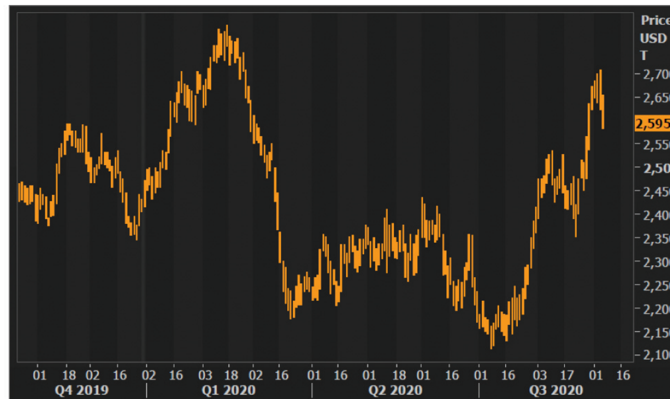

Chart courtesy Reuters

Chart 8 – European and US cocoa butter and powder prices

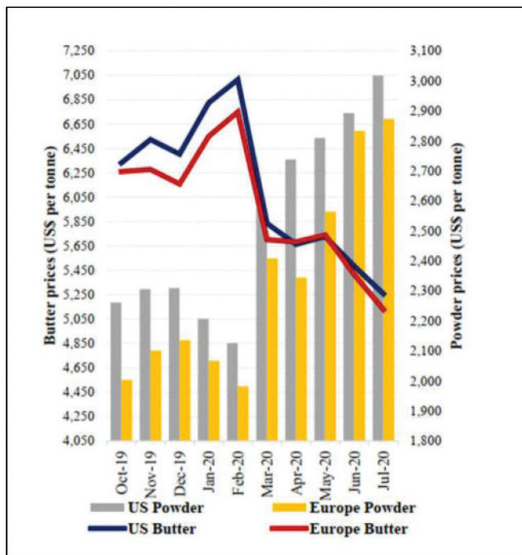

Chart courtesy International Cocoa Organization

Chart 9 – CFTC net-long commodity fund position

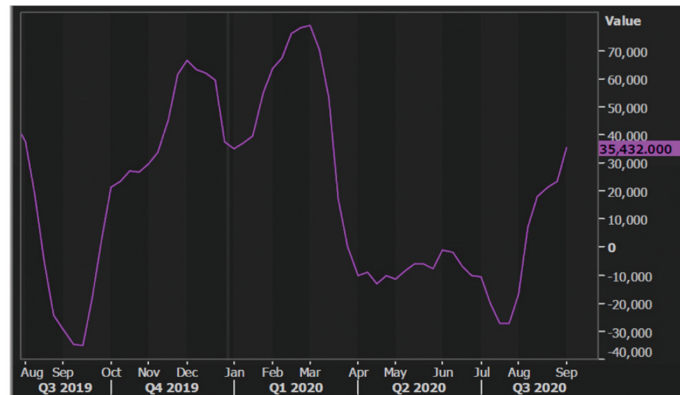

Chart courtesy Reuters

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SOYBEANS

China goes on a shopping spree

Soybean prices are peeking above the $10-per-bushel level in the aftermath of the September USDA crop report for the first time since the US-China trade war began in mid-2018 (Chart 10).

Two important developments fueled the rally that began in mid-August.

1. Exports

China has been buying US soybeans at breakneck speed. Export commitments for the 2020-21 marketing year, which began on September 1, stand at 15.473 million tonnes. That compares with next to nothing last year and an average of about 7 million tonnes in normal, pre trade-war years. The Chinese are working towards fulfilling their part of the trade agreement signed between the two countries in January for China to purchase over $30 billion worth of agricultural products from the US. As such, it could remain a bullish factor because there is a long way to go to meet that target.

Total US export commitments to all destinations stand at 29.9 million tonnes, more than three times last year at this time. The USDA is forecasting sales abroad at a record 57.83 million tonnes for 2020-21, and certainly, if exports continue at this pace, that would be achievable.

2. US crop

US farmers increased acreage for the 2020-21 crop by 10% this spring, anticipating a return to normal import levels from China. As illustrated above, it was a good call. Planting weather was excellent, and it seemed that supplies would be ample to meet the demand. But growing weather was not as cooperative, with hot and dry conditions plaguing crops in key Midwest growing states.

Before the weather turned inclement, the USDA was forecasting record yields of 53.3 bushel-per-acre (bpa), significantly above the previous record of 50.6 bpa set in 2018-19. Responding to the poor weather in the September crop report, the USDA revised the yield downwards to 51.9 bpa.

Although hardly a surprise – the average of analysts' guesstimates was 51.8 bpa – the market rallied sharply and maintained the strength in the sessions following the release of the report on September 11.

The drop in output on account of weather combined with a downward revision to last year's inventories resulted in a material drop in 2020-21 ending stocks. Stocks as a percentage of usage are estimated at 10.4%, down from the July estimate of 13.7%. More importantly, the new level represents a complete recovery from the depths of the trade war days when US ending stocks rose to 22.9% of consumption.

By the same token, we do not believe that soybean prices have embarked on an extended bull run. There are two factors to consider: It's early in the marketing year, and the Chinese have not taken delivery of the massive amount of beans they have contracted to buy. The two countries need to remain friendly. Cancellations are not unheard of.

In addition, the USDA raised its estimate for the 2020-21 Brazilian crop, by 2 million tonnes, to yet another record of 133 million tonnes. It would therefore be misguided to assume that the return of the US balance sheet to historically normal levels signals tightness when considering the global picture.

For the moment, we stand aside.

[By Sholom Sanik, September 17, 2020]

Chart 10 – CBOT November soybeans

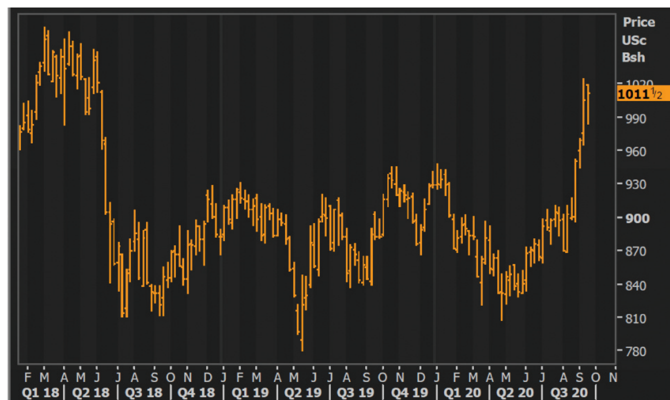

Chart courtesy Reuters

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