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The impact of a collapse in crude oil prices on the sugar market

After climbing to two-year highs in mid-February, sugar prices have collapsed by a monumental 35%. Where to from here?

Analysts are talking about coronavirus-related demand destruction for goods and services, but it is difficult to say how this will affect basic foodstuffs. People still have to eat. Maybe they'll eat more because there is little else to do. One estimate puts consumption loss at 2 million tonnes, or just under 1% of global demand.

The most pertinent issue that will determine whether sugar prices will continue to tumble or remain supported – and perhaps even resume the bull trend – is going to be the ethanol/sugar output ratio in Brazil.

With what we know now, we would have to say that logic dictates that there will be a strong shift towards sugar output. Low world sugar prices versus soaring ethanol demand and much greater profitability made the tilt to ethanol an easy decision for cane crushers. But the dynamics of the energy market have shifted dramatically.

Crude prices have nosedived. Prices at the pump have fallen by close to 50% in some countries, which has compromised whatever competitive edge ethanol carried. In Brazil, drivers are still limited in their choice of how much petroleum they can use to fill up to the extent that there is a minimum government-mandated level of ethanol blend. Beyond that, however, most cars sold in Brazil are flex-fuel vehicles and after satisfying government regulations, consumers will certainly use as much of the cheaper petroleum as they can. So lower demand for ethanol is inevitable.

In 2019-20 Brazil crushed a record low of only 34% of the cane crop for sugar. One large Brazilian producer estimates that for the 2020-21 Brazilian marketing year, which actually got off to an early start, about 45% of the cane crop will make its way to sugar. If that's anywhere near accurate, the implications are enormous: Every one-percentage point increase in sugar output translates to the equivalent of 800,000 tonnes of sugar, an increase of 8.8 million tonnes.

But don't get too bearish yet. Let's recall that not too long ago, 11¢ per pound for world sugar ushered in a bull run because producers were losing money manufacturing sugar at that level and cut back output. We're not completely convinced that crushers will be too eager to crank up output by quite as much as is being forecast. To be sure, the situation presents a quagmire for Brazilian crushers.

In addition, the tail end of the 2019-20 marketing year saw a huge disappointment for Thai sugar output. After producing 14 million tonnes in 2018-19, weather conditions hammered production, with the most recent estimates seeing figures as low as 8 million tonnes. Thailand is a key supplier to the Asian market. Indian exporters have yet to come through with using the 6-million-tonne subsidized export quota, and there is no other supplier of means that can compensate. Increased supplies from Brazil may simply balance the market.

In summarizing the new developments, we must say that we are no longer as bullish as we've been. Mainly, there is demand destruction to consider and the possibility that gasoline prices remain low enough for long enough to alter the ethanol dynamics in Brazil.

We do not recommend buying "on the cheap," but we would suggest hanging on to July 13¢ calls.

[By Sholom Sanik, March 31, 2020]

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Chart 1 – Weekly ICE sugar contract



Chart courtesy Reuters

CORN

Do we really need all those corn acres?

The March USDA corn crop report contained virtually no changes for the US. Similarly, save for a small uptick in output, the global picture was featureless as well.

Actually, it was a bit puzzling that there were no revisions to the US export estimate. At present, the USDA forecast for 2019-20 foreign sales is 43.82 million tonnes, which, if met, would be 16% below last year’s final tally. Weekly export-commitment progress shows, however, that even that is an optimistic estimate. As of the most recent report, commitments stand at 30.83 million tonnes, down 27% from last year at this time.

The weak sales figure has nothing at all to do with China or trade agreements. China does not import corn from the US, or from any other country, for that matter. It’s just poor demand.

Over the past three weeks, sales picked up a bit of steam. Weekly sales averaged 1.4 million tonnes, compared with 710,000 tonnes in the comparable period last year. Typically, export sales of corn begin to taper off sharply towards the end of the marketing year as South American supplies come on stream. This year will be no different. With large Brazilian and Argentinean crops this year, we’d be hard pressed to see a continuation of this trend. Combined output of 155.8 million tonnes for Brazil and Argentina is expected to top last year’s record 151 million tonnes.

US domestic feed consumption has been the bright spot for the demand side, estimated to be 1.7% higher than last year. The March 31 quarterly stocks report confirmed that feed sector usage has been strong. The USDA estimated that as of March 1, stocks stood at 7.952 billion bushels (202 million tonnes), 173 million bushels (4.4 million tonnes) below the average of trade guesstimates. All else being equal, plugging this into the 2019-20 balance sheet would result in a drop of US ending stocks from the 13.4% stocks-to-consumption ratio March estimate, to just above 12%.

Accompanying the stocks report was planting intentions for the soon-to-get-underway 2020-21 crop. And it was decidedly bearish. The USDA’s Outlook Forum in February provided some broad guidance in terms of the general direction acreage would take – much higher than last year. The final 2019-20 planted figure was 89.70 million acres, and the Forum’s early forecast for 2020-21 was 94 million acres.

Trade estimates in the days prior to the report averaged 94.38 million acres. The USDA came in above the high end of the range of analysts’ estimates at 96.99 million acres. That would be the largest area devoted to US corn in eight years.

As we pointed out in February (see *Focus on Futures*, February 20), “We would tend to lean towards a scenario in which farmers will feel more comfortable taking a risk

with corn *vis-à-vis* soybeans.” This is even more true now because corn is fertilizer-intensive, and the price of fertilizer has nosedived along with energy prices. Not to mention the cost of fuel to power machinery.

The window is still open for change. Soybean prices have outperformed corn by a wide margin (Chart 2), and if that ratio persists, there is certain to be switching to soybeans where possible.

Nevertheless, it is a huge number. Aside from anemic export demand, there is another issue to contend with. For

many years now, ethanol accounted for close to 40% of US corn demand. As people stay at home in the wake of the coronavirus, demand for gasoline, and with it ethanol, is plunging. Producers have already slashed ethanol production.

There is little to justify the planting of near-record corn acres.

Maintain short positions in July corn recommended on February 20 (Chart 3). Lower stops from \$4.10 to \$3.70, close only.

[By Sholom Sanik, April 1, 2020]

Chart 2 – New-crop soybean/corn ratio

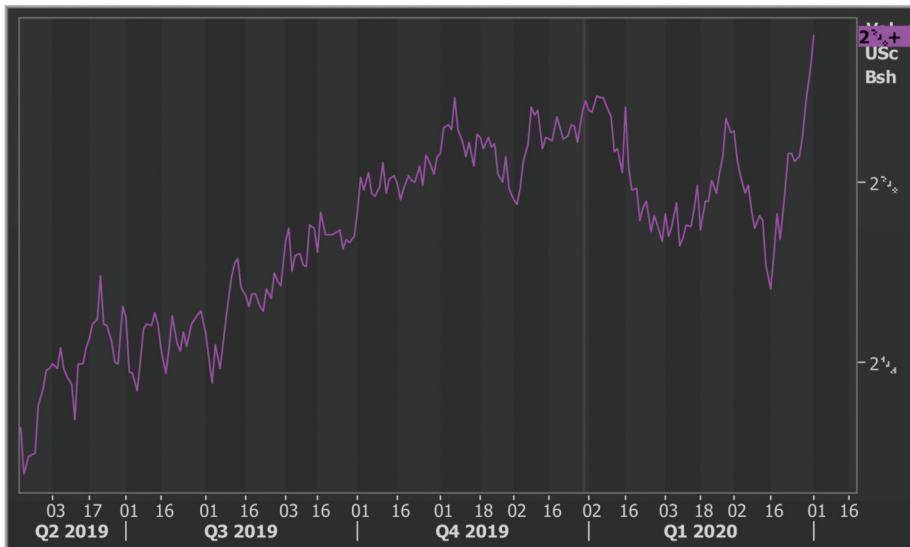


Chart courtesy Reuters

Chart 3 – CBOT July corn

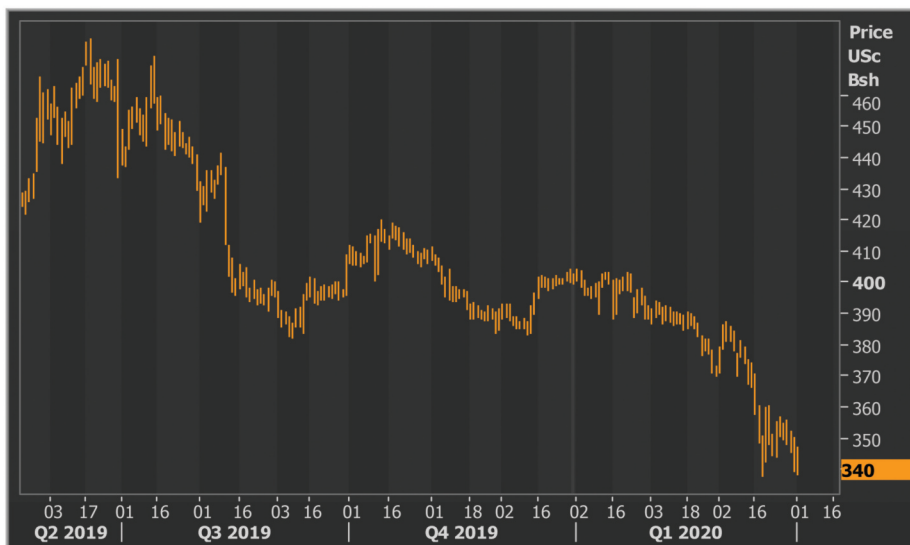


Chart courtesy Reuters

SOYBEANS**Waiting for China...in vain?**

Even as the trade war between the US and China raged, soybean prices maintained some respectability, trading in a \$9- to \$10-per-bushel range (Chart 4). A constant flow of optimism that deals would be struck centered on the reality that China grows but a fraction of the beans it needs to make protein meal to feed its pork and poultry population. Well, the deals came. On January 15 China agreed to buy \$32 billion worth of US agricultural products – which means mostly soybeans – over the following two years. But then Covid-19 showed up and altered the demand landscape.

While government spokespeople in the US and China take to the airways to assure the public that there will not be any food shortages, the reality is that pork production is down in both countries. For example: Smithfield Foods closed a processing facility that accounts for 4% to 5% of US pork production because of a widespread infection rate among employees.

Chinese hog herds fell sharply before the Covid-19 pandemic because of African Swine Flu. Recent data show the pig herd was down 14.4% in the first quarter, year-over-year. Actual pork production is 29% lower because plants are forced to close in adherence to virus protection protocol. So while the pigs still need to eat, there is no incentive to expand the population. Before Covid-19 there was a short-lived surge in meal processing in both countries, but clearly, demand will contract in the foreseeable future.

Total marketing year-to-date Chinese commitments for US soybean imports in 2019-20 are about the same as in 2018-19, but shipments of 12.2 million tonnes are more than double than at this time last year. So there has definitely been progress. In the current environment, however, it is difficult to see huge purchases in the near future.

In fact, the USDA's balance sheet presents an overly optimistic view for ending stocks. A cursory glance

leaves the impression that we have returned to a close-to-normal situation. The April estimate for the 2019-20 carryout was 480 million bushels, or 11.9% of consumption, down from 22.8% in 2018-19 during the peak of the trade tension. Pre-trade-war ending stocks were 10.1% of usage.

The problem is that even after the USDA trimmed its export estimate in April, the estimate for annual final sales is 1.4% above last year's final levels, but the weekly commitments report shows that exports to all US customers is down 14.9% from last year. Historically, sales slow down from now until the end of the marketing year in August, and it could be a formidable challenge to reach the sales target. Of course, this is anything but a normal year, and if the Chinese do come through with several weeks of mega purchases, then maybe we can make it. But as we enter the period of availability of South American origins and the likelihood that Chinese demand is smaller than it has been in previous seasons, we do not hold out much hope. As such, the carryout is probably going to be revised upwards for the remaining months of the marketing year.

Looking ahead, there is no bullish relief in sight. March 31 planting intentions actually presented a bullish surprise. The very preliminary February USDA Forum forecast 85 million acres, up from 2018-19 area of 76.1 million acres. Traders' guesstimates revolved around this estimate with the average at 84.86 million acres, but the actual figure came in at 83.51 million acres. However, this is still much too high. A 10% increase in planted area in an environment of bursting silos will only serve to exacerbate an already burdensome supply situation.

Establish short positions in November soybeans, currently trading at \$8.50 per bushel. Place initial stops at \$8.90, close only.

[By Sholom Sanik, April 22, 2020]

Chart 4 – CBOT November soybeans

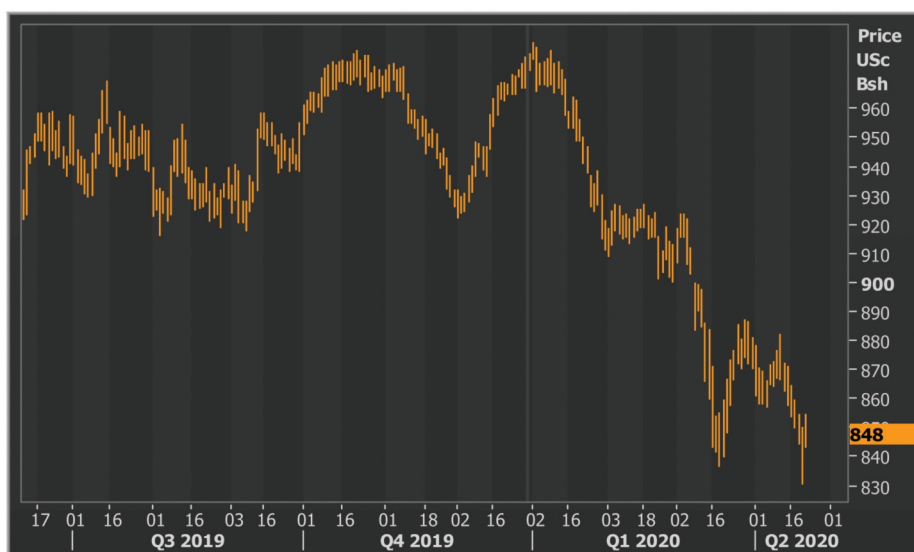


Chart courtesy Reuters

COTTON

A knockout blow for demand

Cotton prices have been in a precipitous decline since February. Supply/demand fundamentals were not especially bullish heading into Covid-19, and the pandemic certainly did not help. With the closure of bricks-and-mortar stores around the globe, clothing sales have nosedived. True, online sales have picked up some of the slack, but clothing purchases have been one of the hardest-hit retail categories. According to both the Census Bureau and the National Retail Federation, total US clothing sales in March were down 50.5%, month-over-month from February. In addition, mill activity in all major production regions fell sharply.

The USDA slashed its estimate for 2019-20 US exports in the April crop report by 1.5 million bales, to 15 million bales. As a result, the ending-stock estimate jumped to 37.4% of usage, up from the 26.2% March estimate. This compares with 21.5% and 27.3% in 2017-18 and 2018-19, respectively. A study of US exports would seem to indicate that stocks will keep piling up and the ending stock figure will be revised higher before the marketing year ends on July 31.

Total marketing-year-to-date sales, shipped and unshipped, stand at 15.1 million bales, just about exactly at the USDA target. Indeed, shipments of 9.7 million bales is respectable for this time of year. Last year at this juncture, shipments were 8.2 million bales. New sales have ground to a halt, which in itself is fine, because we have enough commitments *if* importers do not start cancelling orders. However, two of the past three weekly export reports showed net cancellations. While it's normal to see some net cancella-

tions late in the season, they typically do not appear until June or July. If this becomes a trend, the USDA will need to rewrite the balance sheet. Given the drop in milling, this could very well become a realistic scenario.

There is talk that the Chinese are going to bolster their reserves with a large cotton purchase. That would be bullish for US prices if the US exporters land a large part of that purchase *and* if it comes soon.

Spring planting for the 2020-21 crop has begun. March 31 planting intentions showed that farmers intend to plant 13.7 million acres. It was a bearish surprise. The average trade guesstimate was 12.7 million acres. Simply put, if China does not come through with a large buy order, it would spell disaster for prices. It would mean that we will produce roughly the same amount as the past two seasons into a market that has lost a chunk of demand. We have not seen any forecasts for China and India as of yet, but if the top three producing countries are going to produce cotton recklessly, the bear market will continue.

The USDA took the axe to 2019-20 global consumption in the April crop report to account for the demand destruction discussed above. Global usage was revised lower by 6.4%, to 110.58 million bales. Over the past several years the burdensome global stockpile of cotton – consisting mainly of Chinese stocks – was whittled down from a level that reached close to 100% of usage. In the previous two seasons, that figure fell below 70%. With this revision to world demand we are back at 82%.

As long as the global economy is at a standstill, that revision to demand is modest. And if plantings in 2020-21 proceed as planned, we will be saddled with much more cotton than the world needs.

The recent rally was precipitated on hopes of a large Chinese purchase. Indeed, such a purchase would spark further buying. However, that cotton will not “disappear” until retail and mill demand return. So, it will pile up in either the

US or in China. Under current conditions, it will not change the global balance sheet.

We advise using this rally to establish short positions in anticipation of lower prices. Sell December cotton, currently trading at about 58¢ per pound. Place initial stops at 63¢, close only.

[By Sholom Sanik, April 24, 2020]

Chart 5 – ICE December cotton



Chart courtesy Reuters

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