FRIEDBERG'S
FOCUS ON FUTURES
Friedberg Mercantile Group Ltd.
Volume 12, No. 2 April 6, 2009

Cocoa: Ivorian arrivals improve, demand slackens, but still a bull market

During February, cocoa gave back a fair chunk of the rather exciting 50% gain it posted from November to January (Chart 1). We maintain our bullish long-term views for this market, but the February correction was justified. In light of some bearish developments, the rally was overdone.

The unusually weak start to the main-crop harvest in the Ivory Coast was the main factor that drove prices higher. Virtually every other commodity on the board was still collapsing or groping for a bottom as recession spread around the globe and traders worried about a sharp drop in demand for all goods and services.

Cocoa, of course, was not immune, but the sudden and unexpected potential drop in supplies meant huge deficits, even after accounting for falling consumption. As the season progressed, however, port-arrival levels improved. At the beginning of January – when about 75% of the main crop has typically been harvested – port arrivals stood at just under 500,000 tonnes, only 61% of the previous year. Maintenance of that pace would have meant a devastatingly small crop. The pace has increased significantly, though. As of March 16, arrivals have moved up to 885,000 tonnes, 85% of last year at this time.

Demand has been dismal, at least in terms of what we can tell from butter ratios. The price of the principal by-product of the cocoa bean has nosedived, which means it is not profitable for processors to buy beans. Charts 2 and 3 show that butter ratios in both Europe and Asia have tumbled back to levels not seen since 2003.

In April we will see first-quarter grind results. The International Cocoa Organization (ICCO) has forecast a decline of 2% in the first half of 2009 for the US and Europe. Western grindings still comprise about half of the nearly 4 million tonnes of world grindings. Their significance is diminishing, however, because origin-country grindings are growing rapidly. West African grindings are expected to grow at a rate of 25% per annum during the 2008-09 marketing year. A slightly negative number for the US and Europe would therefore be inconsequential.

Over the past few days, the market sprinted sharply off recent lows. Much of it can be tied to the general euphoria over the Fed's announcement of a bond buy-back program that is intended to drive down long-term interest rates and stimulate economic activity. The move sparked a rally in commodities across the board.

But the rally had its own cocoa-related fundamentals to lean on. Pessimism regarding the Ivorian crop had eased because of the uptick in main-crop arrivals and on hope for a good performance by the mid-crop, which some analysts were saying could top last year's robust 315,000 tonnes. That is not the way it's playing out, however. Recent estimates put mid-crop estimates as low as 200,000 tonnes.

Some analysts have maintained their forecasts for a 2008-09 global deficit in the area of 50,000 tonnes. The ICCO's March 3 estimate pegged the deficit at just under 200,000 tonnes. These are conservative estimates that forecast continued weakened demand. If consumption returns to normal levels, we'll be looking at a much larger deficit, even before the 2008-09 crop is over in September.

In addition, looking ahead to the Ivorian 2009-10 crop, we find the prospects for a return to normal output levels rather dim. The root of the problem is that the Ivorian government imposes a 46% export tax on cocoa, which is passed on to farmers and keeps profitability low. This has manifested itself in insufficient capital for investment in the pesticides

Inside

Cotton: Production cut too much? 3
Wheat: No inspiration.....4
Soybeans: Price supports 5

Unless otherwise indicated, all articles have been written by Sholom Sanik (E-mail: *ssanik@friedberg.ca*).

Futures and options trading is speculative and involves risk of loss. Past trading results are not indicative of future profits.

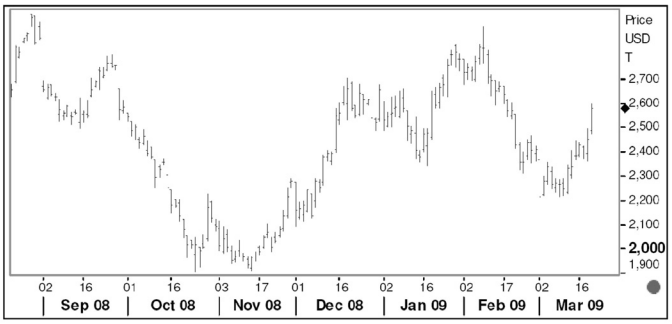
Get Focus by e-mail
Focus on Futures is available by e-mail as an Adobe PDF file. If you prefer to receive your copy of *Focus on Futures* by e-mail, please send us a message at *focus@friedberg.ca* with your full name, e-mail address, and street address.

©2009 by Friedberg Mercantile Group Ltd. Reproduction in whole or in part prohibited.

that are necessary to combat ever-spreading cocoa diseases. The World Bank has been trying to persuade the government to cut these taxes. In the meantime, farmers have been turning to alternative crops, such as rubber, whose prices are low (Chart 4), but are not subject to the burdensome tax.

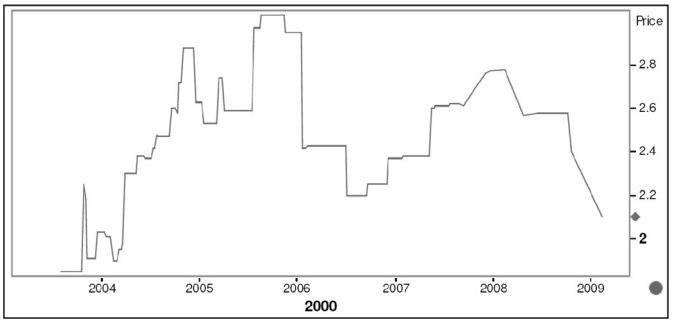
Remain long cocoa. *[March 20, 2009]*

Chart 1 – May cocoa



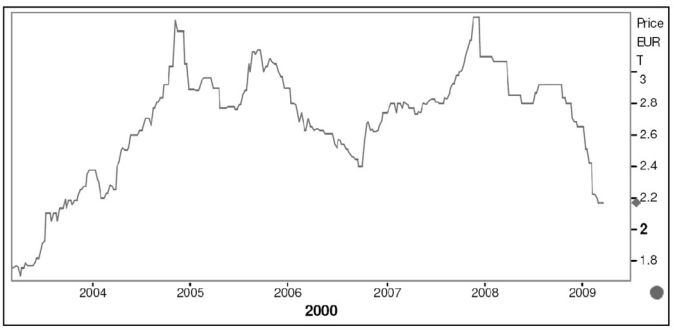
Courtesy Reuters

Chart 2 – Asian cocoa butter ratio



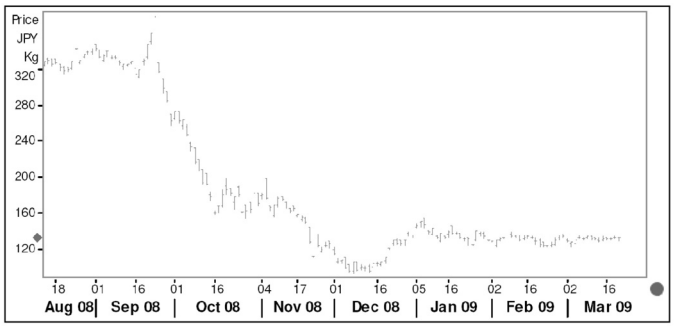
Courtesy Reuters

Chart 3 – European cocoa butter ratio



Courtesy Reuters

Chart 4 – Tokyo rubber – nearest contract



Courtesy Reuters

©2009 by Friedberg Mercantile Group Ltd. Reproduction in whole or in part prohibited.

COTTON

Usage remains weak, but have production cuts gone too far?

Viewed in isolation, the global cotton balance sheet depicts a painfully burdensome inventory situation, which should keep prices sliding. In its March supply/demand report, the USDA slashed its estimate for usage by yet another 1.5 million bales, to 111 million bales. That's down from a forecast of 125 million bales this past summer, at the start of the marketing year. Ending stocks as a percentage of consumption will rise to 56.3%. In the late 1990s similar inventory levels eventually brought prices down to below 30¢ per pound. Are we headed in that direction?

We are now heading into a third season of declining crops. In 2007-08, US acreage fell by a whopping 29% from the previous season. The drop was cushioned by record yields as well as by larger crops in other countries, mainly India. At 120.55 million bales, global output was still close to record levels.

In 2008-09 US yields were back to average levels, and other countries were planting more profitable crops. Global output fell to 108.65 million bales, or 10% from 2007-08. Supplies remained ample, because consumption was down by a similar amount.

For 2009-10, we find yet another round of acreage cuts. The USDA Outlook Forum for US cotton area was 8.5 million acres, down from 9.47 million acres in 2008-09. The range of private forecasts is between 8.1 million and 9 million acres. The USDA will release its planting intentions report on March 31, which will provide a more current estimate.

China is the world's largest grower and user of cotton. A recent estimate put Chinese acreage down 14% from 2007-08. At last year's yields, this would mean a roughly 5-million-bale loss to global output.

But demand is getting hammered.

The USDA has been lowering its forecast for US 2008-09 mill usage every month since December, but its estimate has been lagging apparent consumption rates. With the March estimate of 3.75 million bales – down from 3.9 million bales in February and from 4.61 million bales in 2007-08 – the USDA has finally caught up. The most recent reading on monthly mill consumption of 259,000 bales was a bit higher than the previous month's result, but still dramatically below year-ago levels. Year-to-date census data show that mill consumption is 19.7% lower than last year, and is now about the same as the USDA estimate if this pace continues through the end of the season.

That is definitely bearish, but at least we know that if monthly mill consumption moves back towards the 300,000-bale level, we're past the worst. If we spend a few more months below 250,000 bales, the USDA is still being liberal with its 3.75-million-bale estimate.

Export data for Chinese textile products and Indian cotton are dismal, with sharp, double-digit percentage declines over the past few months.

US exports have become the one bright spot for cotton demand. Over the past few weeks, new sales have been steady, and total commitments for the marketing year have actually pulled ahead of last year's pace by a decent margin. The USDA responded to this relatively surprising turn of events by raising its estimate for annual foreign sales by 500,000 bales in the March supply/demand situation report, to 12 million bales. Shipments are running 200,000 bales behind last year at this time. Considering that we are expecting sales of only 12 million bales, compared with last year's 13.65 million bales, we are actually shipping at a very brisk pace.

If Asia is seeing poor demand for finished goods, then bulls should not be complacent, even regarding robust US exports, because those sales will dry up soon enough.

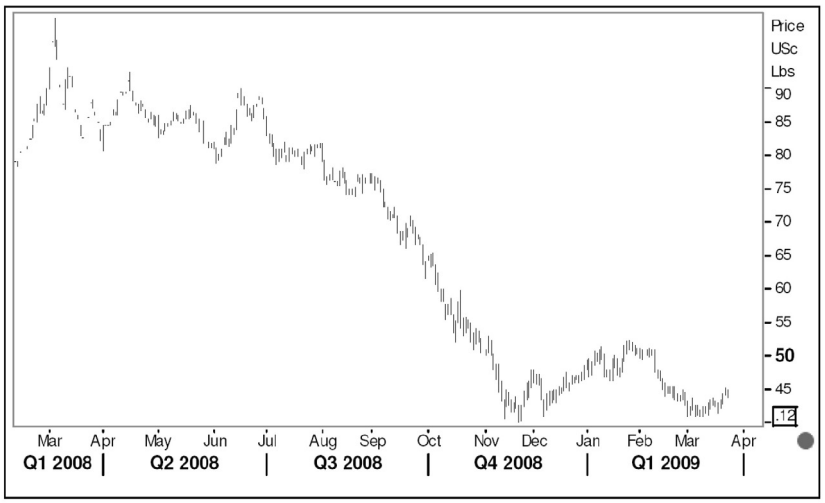
The balance sheet no doubt is ugly. When the USDA introduces the balance sheet for 2009-10 in May, it won't be much better. The drop in global output, however, leaves the market vulnerable to normalization of the demand side. The drop in demand is indeed quite dramatic, but prices may have already discounted this.

We maintain our conservative long recommendation.

[March 25, 2009]

©2009 by Friedberg Mercantile Group Ltd. Reproduction in whole or in part prohibited.

Chart 5 – May cotton



Courtesy Reuters

WHEAT

Poor crop conditions fail to inspire

The 2009-10 winter wheat crop is emerging from dormancy, and the spring wheat crop is ready for planting. In a typical year, current weather conditions, as well as other factors, would have sparked a healthy rally over the past few weeks, but this year is anything but typical.

Key hard-red-winter-wheat regions, from Kansas south through to Texas, experienced significant dryness throughout March. Further north, in the spring wheat planting areas, heavy rains caused flooding that rendered at least 500,000 acres – and perhaps as much as 1 million acres – in North Dakota unfit for planting spring wheat. The market bounced off the $5-per-bushel level as these weather concerns surfaced, but the rally did not hold (Chart 6).

With domestic and foreign consumption compromised by the global economic crisis, the USDA March 31 quarterly stocks report was somewhat of a surprise. US inventories as of March 1 stood at 1.036 billion bushels, 26 million bushels below traders' guesstimates. Released alongside 2009-10 planting intentions, the two reports evoked a bullish response from traders, with a 40¢-per-bushel rally.

The spring planting intentions report, however, is largely a non-event for wheat. The winter wheat crop that was planted last autumn represents 73% of the total US wheat crop, and although the acreage estimates are always subject to revisions, they are relatively minor. In fact, the winter acreage was bearish if anything, coming in 750,000 acres above the average guesstimate. But the spring wheat estimate was close to 500,000 acres below expectations. The rally was influenced more by the rally in the neighboring soybean pit (which had a bullish 3.5-million acreage surprise) than it was by wheat-related issues.

Chart 7 includes the fantastic blowoff that took wheat prices to over $13 per bushel in February 2008. Current prices look awfully cheap by comparison. The same chart also shows, however, that in historical terms, wheat is also awfully expensive. While we were trading well above the cost of production for most of the trip up to $13 per bushel, we are close to breakeven now. The broad increase in commodity prices resulted in a jump in the cost of energy and other inputs. In 2006 average production cost for US wheat was about $3 per bushel. Even after accounting for the sharp drop in commodity prices over the past six months, the average cost of production is still over $5 per bushel. Without double cropping, which saves much of the costs, a farmer still cannot make much money at these prices.

We could be returning to the type of situation we experienced in the period prior to the bull market in which world production declined for years until it finally slipped into deficit. Prices are certainly not high enough to inspire farmers to favor planting wheat. This indeed is bullish for the longer term.

In the shorter term, however, wheat is still not likely to develop any deficits over the next year or so. Global wheat production in 2008-09 reached a record-by-far 684 million tonnes. Demand grew as well, but at a much slower pace than output growth, which left a surplus of more than 35 million tonnes. Global ending stocks are estimated at 156 million tonnes, or 24% of consumption. Inventories are not as high as they were in the early part of this decade, but much higher than the 19.4% and 20.59% of consumption in 2007-08 and 2006-07, respectively.

Poor weather for emerging crops and some serious losses

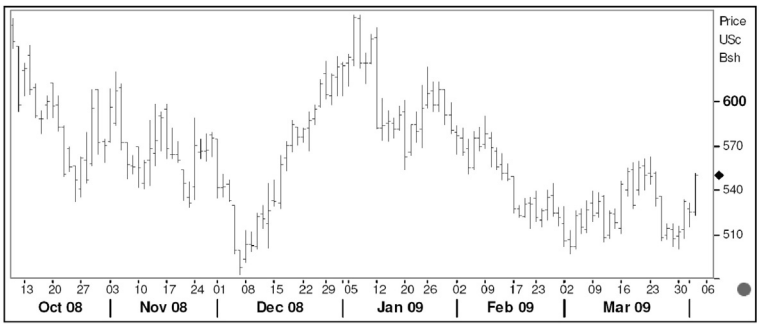
©2009 by Friedberg Mercantile Group Ltd. Reproduction in whole or in part prohibited.

in acreage available for planting have therefore not been able to generate enough interest to generate sustainable rallies.

We're friendly to the short side, but there are two distinct dangers. The market already knows that the US will produce a small crop. Persistent bad weather would give us an even smaller crop and would very likely spark a rally that would test the $6.5-per-bushel resistance level. Second, a pickup in global economic activity would certainly bring demand back to the wheat market. Stay sidelined, but stay tuned.

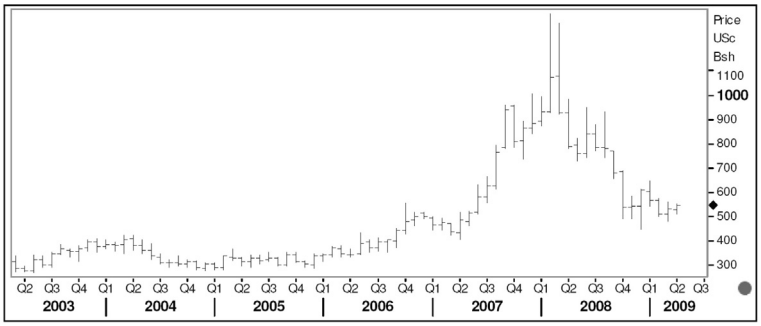
[April 3, 2009]

Chart 6 – May wheat



Courtesy Reuters

Chart 7 – Wheat, nearest contract



Courtesy Reuters

SOYBEANS

A surprising acreage report and strong exports support prices

In early March we developed a bearish case for soybean prices that revolved around two premises. First, even after falling from record levels that reached over $16 per bushel, prices were still high in historical terms and presented the most profitable planting option for US farmers, given relatively lower prices for wheat and corn. Cotton, in particular, presented no challenge at all, because prices retreated all the way back to pre-bull-market levels. This meant that whatever tightness might still have lingered from the 2008-09 marketing year would vanish after the US 2009-10 harvest in the fall. Chart 8 shows that in fact this is precisely the scenario that the market was anticipating. The spread between old crop May and new crop November has widened by close to $1 per bushel since the beginning of the year.

The other issue was that soybeans have been a standout among US agricultural products in that they have not experienced a sharp drop in foreign demand. Most analysts were skeptical, though, and were careful not to draw conclusions about a general economic recovery from this. China was doing all the buying and not because of bona fide market demand. The government has been building reserves. Once its (unknown) target had been reached, the buying would dry up.

The expectations for an acreage increase and a halt to the foreign demand bubble were both wrong, at least as of this moment.

The March 31 planting intentions report proved to be quite a surprise for traders. The range of guesstimates was between 77 and 83 million acres, but the actual figure was

©2009 by Friedberg Mercantile Group Ltd. Reproduction in whole or in part prohibited.

76.024 million acres. We should assume an improvement over last year's yields of 39.6 bushels per acre, which were down by 2 and 3 bushels per acre from 2007-08 and 2006-07, respectively. That works out to well over 100 million fewer bushels of soybeans grown by US farmers for the 2009-10 marketing year than indicated by the street's expectations.

As far as exports are concerned, Chinese purchases were indeed drying up. Consider that average Chinese weekly new commitments in January were 536,000 tonnes, and a bit lower, but still very strong in February at 525,000 tonnes (old and new crop purchases combined). In March that figure dropped to 272,000 tonnes, and indeed, total weekly sales nosedived. This was confirmation that Chinese buying was slowing down, and the one bullish angle to the soybean demand picture would be gone.

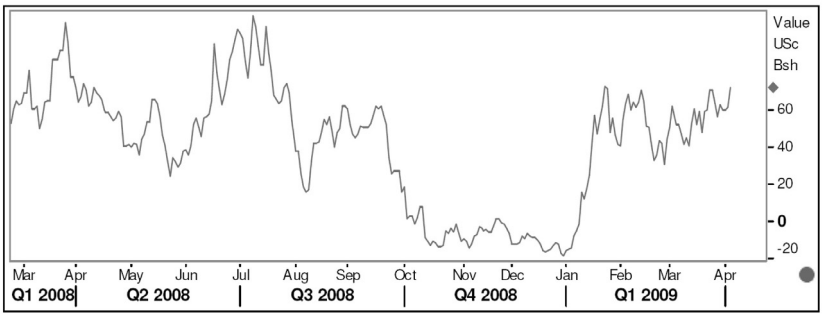
Then, the first weekly export report in April contained some noteworthy highlights. First, at just under 1.2 million tonnes, commitments were significantly above analysts' estimates. In addition, save for an insignificant Chinese purchase of 58,000 tonnes, old-crop buying was attributed to a broad array of countries. On the new-crop side, the Chinese were back with another large purchase of 412,000 tonnes.

In addition, the March 31 quarterly stocks report showed inventories as of March 1 at 1.3022 billion bushels, 200 million bushels below expectations. This added to ideas that perhaps even domestic consumption has been understated.

Data collected for planting intentions have become somewhat stale because, as we pointed out in our notes on wheat (April 3), as much as 1 million spring wheat acres have been lost to flooding in North Dakota, and possibly other regions as well. It will be too late to plant spring wheat, but there is ample time for soybeans.

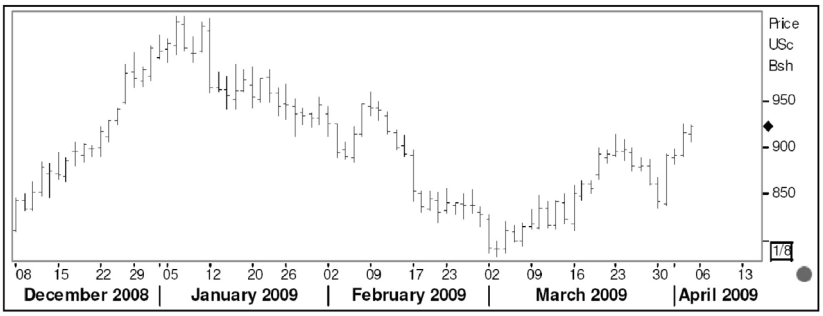
The acreage report was clearly a shock. Nevertheless, we should bear in mind that even at 76 million acres, it will be a record crop in an environment in which livestock herds are shrinking. Prices have broken out of recent ranges, so it is only prudent to cover short positions. We still believe that there is limited upside, so stay tuned. *[April 6, 2009]*

Chart 8 – May soybeans/November soybeans spread



Courtesy Reuters

Chart 9 – November soybeans



Courtesy Reuters

Friedberg's Focus on Futures is published by Friedberg Mercantile Group Ltd., P.O. Box 866, Suite 250, 181 Bay Street, Toronto, Ontario, M5J 2T3. Contents copyright © 2009 by Friedberg Mercantile Group Ltd. All rights reserved. Reproduction in whole or in part without permission is prohibited. Brief extracts may be made with due acknowledgement. Friedberg Commodity Management Inc., an NFA registered CTA, takes full responsibility for the contents of this publication.

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:
In Canada
Friedberg Mercantile Group Ltd.
Suite 250
181 Bay Street
Toronto, Ontario M5J 2T3
416-350-2903
Attn: Sholom Sanik

For U.S. Persons
Friedberg Mercantile Group, Inc.
Suite 250
181 Bay Street
Toronto, Ontario, Canada M5J 2T3
1-800-461-2700

All statements made herein, while not guaranteed, are based on information considered reliable and are believed by us to be accurate.
Futures and options trading is speculative and involves risk of loss. Past trading results are not indicative of future profits.