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Are beans in the teens justified?

Old-crop soybean prices have shot up by more than $2.50 per bushel since early March (Chart 1). There have been ample bullish developments to justify the rally. The broad recovery in many commodity markets hasn't hurt.

The USDA released its first estimates for the 2009-10 marketing year on May 12. The report was deemed bullish, and prices have been firming since. Actually, there were virtually no surprises in the report for either old-crop revisions or new-crop forecasts.

The estimate for US 2008-09 ending stocks was revised downwards by 35 million bushels, to 130 million bushels (3.53 million tonnes), or 4.3% of consumption, compared with the April estimate of 5.5%. This would be the lowest carryout for US stocks in modern history. The figure was actually a touch above the average guesstimate of 126 million bushels.

The entire revision for ending stocks was the result of further strength in exports. Foreign sales of US soybean exports are forecast to reach a record 33.75 million tonnes this season. Not bad for a worldwide recession. We know, however, that the record sales were not the result of widespread demand. Rather, China did most of the buying in an effort to rebuild inventories, with purchases of 18.3 million tonnes thus far, 5 million tonnes more than last year at this time. Once the target is achieved, the huge purchases should come to an abrupt halt.

Circulating rumors that Chinese cancellations were about to surface spooked the market briefly. With three and a half months remaining in the marketing year, we've all but reached the commitments required to meet the USDA estimate for 2008-09, and US exporters have shipped 83% of those sales, compared with 80.6% shipment of final sales last year at this time. Cancellations would therefore have to be quite significant to have a material bearish effect on the market.

On the international side of the balance sheet the big revision was a 5-million-tonne drop in the estimate for the 2008-09 Argentinean crop, to 34 million tonnes. Here too, there was little, if any, surprise. The average of analysts' guesstimates was 34.5 million tonnes.

Looking ahead to 2009-10, the USDA used the March 31 planting intentions figure for US acreage, with near-record yields of 42.6 bushels per acre, to forecast a near-record crop of 3.195 billion bushels (86.95 million tonnes).

The problem here is that it has been a wet spring. A significant amount of spring wheat and corn acres will not get planted in time and will surely go to soybeans. Some analysts have their soybean acreage estimates more than 2 million acres above the USDA intentions estimate. The May 12 report did not necessarily prove them wrong, because in all likelihood the report made no provisions for the wet weather in April and early May.

The current estimate for US 2009-10 ending stocks is for a jump to 7.4% of usage. With an additional 2 million acres at the anticipated yield, ending stocks jump to over 10% of consumption. While still shy of the more comfortable inventory levels of the mid-2000s, we find it difficult to justify $11-per-bushel soybeans.

While old-crop prices have continued to trade higher since the release of the "fresh" data, new-crop prices (Chart 2) have been contained in their previous range – thus far. The export pace is unsustainable, crop estimates will surely be revised higher, but the risk of adverse growing conditions this early in the year is formidable. We recommend selling a failure of the uptrend in new-crop months. *[May 19, 2009]*

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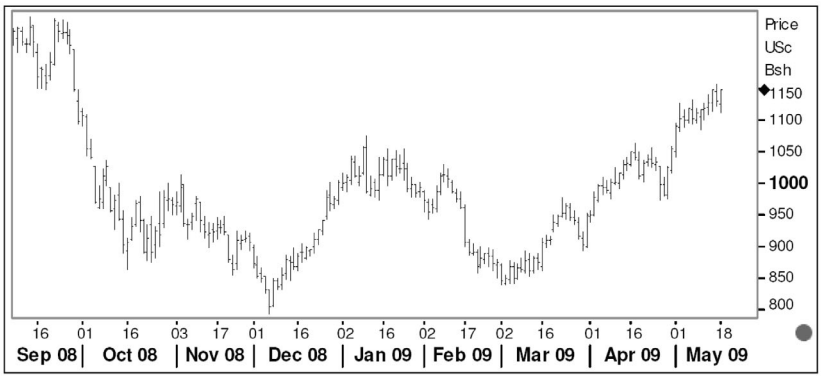
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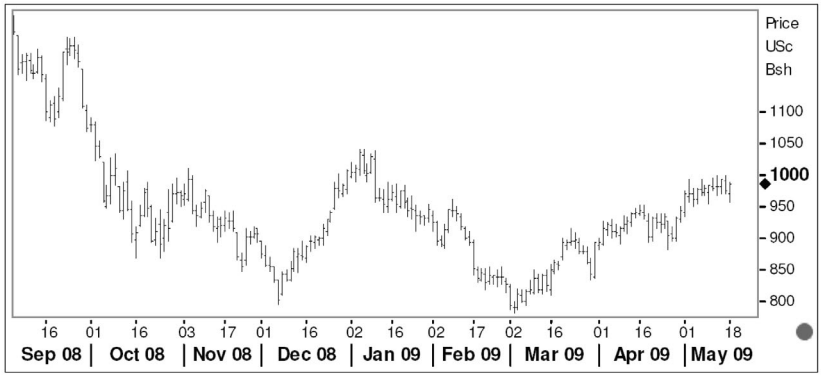
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Chart 1 – July soybeans



Courtesy Reuters

Chart 2 – November soybeans



Courtesy Reuters

CORN

Improved demand and a struggling US crop

Last fall, when VeraSun Energy Corporation was imploding, ethanol plant closures were making headlines, and fears of a sharp drop in demand ran rampant, it was assumed that ethanol usage had been overstated. In response, back in December, the USDA slashed its estimate for 2008-09 US ethanol consumption by the corn-equivalent of a hefty 300 million bushels, to 3.7 billion bushels. Then again in January, it dropped its estimate down to 3.6 billion bushels.

While the recession definitely had an effect on demand, those revisions went a bit far. The estimate has been climbing back. With the May supply/demand situation report, the estimate for ethanol usage had bounced back to 3.75 billion bushels. The USDA's first estimate for 2009-10 is a record-high 4.1 billion bushels.

The balance sheet shows that the other areas of demand – such as domestic feed consumption and exports – have remained lackluster. Actually, exports have picked up some steam. Slumping early-season export levels were clearly a reflection of the world-wide recession, with weekly commitments averaging about 400,000 tonnes. At the beginning of February, commitments were running at only 52% of 2007-08 levels. Since then, however, commitments have been averaging about 1 million tonnes per week and now stand at 68% of last year at this time. On March 5, the title of *Focus on Futures* asked: "A blip up in corn exports. Can it last?" Well, it seems that the answer is in the affirmative.

We'll probably start to see a shift to new-crop sales, but even with a moderate pace of old-crop sales from here through the end of the marketing year, there is an excellent chance that we'll exceed the US estimate of 44.45 million tonnes for 2008-09 exports. Since the start of the marketing year in September, the estimate has been revised downwards in every monthly report, through March. In the May report exports were revised upwards to reflect strong commitments that we've seen over the past several months. With over three months remaining, we would need to average just over 300,000 tonnes of old-crop commitments per week to meet the target.

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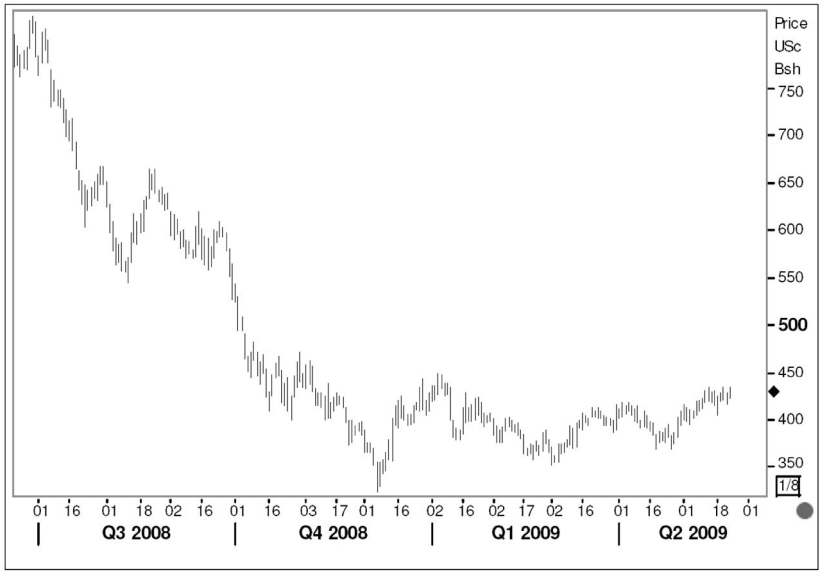
The March 31 planting intentions report estimated that US farmers would plant 84.9 million acres of corn for the 2009-10 crop, 1 million acres less than in 2008-09. While the air was rife with dire economic forecasts, which had clearly manifested in the corn market with a sharp drop in demand, smaller acreage seemed to be a pretty good idea. As illustrated above, however, consumption is creeping back, and now the smaller acreage issue has been complicated by weather. A very wet spring has slowed down planting. As of the most recent weekly crop progress report, only 62% of the crop has been planted, compared with the five-year average of 85%.

The USDA has been rather optimistic with its first estimate for yield of a near-record 155.4 bushels per acre for a crop that is being planted so late. Furthermore, a significant number of acres will probably not get planted and will be shifted to soybeans.

Only Brazil and Argentina can be counted on to pick up some of the slack for the export trade, but neither country produces nearly enough corn to compensate for a poor US crop. As it is, the USDA forecast for 2009-10 global ending stocks is 128 million tonnes, or 16.1% of usage, which is actually below inventory levels of the past two seasons.

We've followed the pack in this market and have done an excellent job of selling the lows on breakdowns. Now that we're bullish and the market is at the top side of the range, we stand perfectly positioned to complete the cycle of poor trading. With underestimated demand and the US crop in a vulnerable spot, though, we should be long. We therefore recommend using the inevitable pullback – of any size or duration – to establish a long position. *[May 22, 2009]*

Chart 3 – July corn



Courtesy Reuters

WHEAT

Is another shortage possible?

Wheat prices have rallied up towards the top of the market's six-month range (Chart 4). The story is very similar to that of many other commodities. The strong assumption that demand would fall sharply as the worldwide recession progressed kept farmers conservative with their planting decisions. Now that it seems that the recession may not last as long as originally forecast *and* unfavorable planting weather has emerged, purportedly burdensome inventory levels do not appear nearly as burdensome as they did three or four months ago.

Regarding consumption, unlike corn and soybeans, there has not been any evidence of demand surprises – for the moment, anyway. For beans, the Chinese went on a soybean shopping spree. Corn exports and US domestic ethanol usage have been better than expected (see *Focus on Futures* May 19 and 24.)

In wheat, the 27-million-tonne estimate for US exports has not changed since the initial estimate early in the marketing year. With only two reporting weeks remaining, shipments stand at 24.9 million tonnes. After the usual adjustments for donations and the like, exports should be at the target or just shy of it.

Global demand estimates were revised down throughout the 2008-09 season, but the current estimate is still a

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record 636 million tonnes. In its first look at the 2009-10 season the USDA is forecasting a 1% increase in global consumption, to yet another record of 643 million tonnes. This estimate does seem to reflect the belief that consumption patterns are expected to return to normal, but is not overly optimistic.

One forecast in the new-crop outlook that some analysts have called into question and that could have a significant impact on US prices, is the estimate for exports to fall by 11%, to 24.49 million tonnes.

On the supply side, aside from Kazakhstan, every Northern Hemisphere exporter of significance planted smaller wheat crops. Planting intentions show that US farmers will plant only 58.638 million acres of combined winter and spring area, down from 63.147 million acres that were planted for the 2008-09 crop. Yields are expected to drop back to 41.4 bushels per acre, down from 44.9 bpa last year, bringing output down to 55 million tonnes, compared with 68 million tonnes in 2008-09.

Global production is forecast at 657 million tonnes, down from 682 million tonnes in 2008-09. Normally, with the near-50-million-tonne surplus left from 2008-09, inventory levels should be at comfortable levels. Indeed, the initial forecast for the 2009-10 global carryout is 182 million tonnes, or 28.3% of consumption. That would be the highest level since 2001-02 and should represent a complete recovery from the desperate situation wheat markets were in over the past few years. Achieving this estimate, though, is a tall order.

The weather in Europe and FSU has been favorable for both planting spring crops and maturing winter crops. North America, however, is suffering through inclement weather that will leave spring acres unplanted and/or cause yields to be lower than already forecast.

Only 79% of the US spring wheat crop has been planted, compared with the five-year average of 95%, because of extremely wet weather. A similar situation exists in Canada. For winter wheat crops, the excessive precipitation is beneficial for developing crops, but harmful for those closer to harvest.

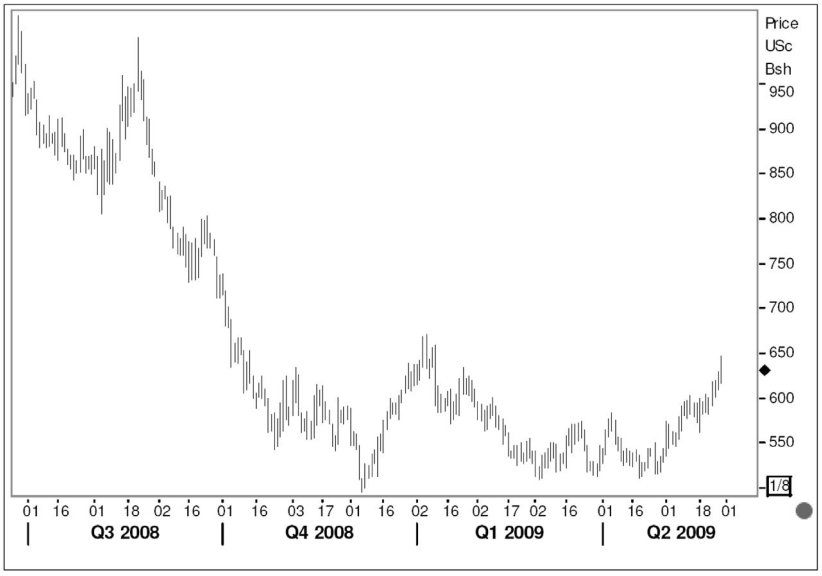
The early forecast for the Canadian crop is 26 million tonnes, down 2 million tonnes from last year. But that estimate is based solely on the planned reduction in acreage. With area and yield loss almost a certainty, we can expect that estimate to be lowered in the coming months.

We keep hearing that traders are overreacting by pushing prices higher. Regardless of the likelihood of downwards revisions to production and the strong possibility that demand growth will return faster than indicated by current estimates, last year's inventory build should prove to be sufficient. Possibly – but the market remains extremely vulnerable to huge production losses, and it is not as if the planting situation can improve from here on in. The planting window for wheat is closed, and we would need perfect weather for the balance of the growing season for winter wheat and for the entire spring wheat season for even partial compensation. If demand snaps back sooner rather than later, the market could tighten in a hurry.

The sharp drop in acreage may turn out to have been a miscalculation, setting the groundwork for the next bull market.

We've been on the sidelines for quite some time, but we believe there is much potential on the upside. Use setbacks to establish long positions. *[May 31, 2009]*

Chart 4 – July wheat



Courtesy Reuters

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COCOA

A strong market despite 'apparently' weak fundamentals

"Long-term investors should maintain conservative long positions that can be held through sharp pullbacks. This one may not be over yet. Traders should place sell stops at $2,350 per tonne, basis July, close only. If this consolidation fails, we could easily see the market slip $300 to $400 per tonne."

We begin our discussion of cocoa by scrutinizing our April 27 recommendation. The long-term investment strategy won hands down. The market has rallied by as much as $400 per tonne since traders were stopped out. Has there been much change in the fundamentals to account for the change in trend?

Certainly on the surface there have not been any stark developments, one way or the other. If anything, most of the bearish fundamentals that inspired our cautious approach are a bit more bearish.

Ivorian arrivals continue to catch up to last year's pace, narrowing the once gaping spread. As of May 29, 2008-09 arrivals of 1.005 million tonnes have grown to 87.7% of 2007-08. This compares with 84.7% when we published our April 27 article and with less than 60% earlier in the season.

We haven't seen much useful information about the progress of the mid-crop. The weather has been mostly favorable, and we can assume from the constant improvement in arrivals that the mid-crop could surprise on the upside.

Like the Ivory Coast, Ghanian output is below last year, but above early-season forecasts. Arrivals stand at 602,000 tonnes, compared with last year's output of 680,000 tonnes. With an expected mid-crop of 50,000 tonnes still to be harvested, output will be much closer to an average crop than previously thought possible.

Estimates of Indonesian output have seesawed. Reports of the invasion of an incurable fungal disease, Vascular-Streak Dieback, surfaced earlier this year, prompting analysts to project Indonesian output to be in permanent decline. Subsequent to that, the International Cocoa Association (ICCO) had a change of heart and raised its Indonesian estimate to 510,000 tonnes, up from the previous season's 495,000 tonnes. The most recent forecast by the ICCO on May 12, citing poor maintenance, has changed direction again, bringing the estimate down to what it called "well below" 500,000 tonnes.

The demand side remains dismal. We reviewed first-quarter Western grind data last month, which showed the proxy for consumption to be down more than 10% across the board. Since then, Malaysia, the largest Asian grinder, reported a 17.9% drop in first-quarter grindings.

Cocoa butter ratios have continued their precipitous decline. Asian ratios have fallen to 1.67 times the London spot price, the lowest level in many years (Chart 6). A recent report suggested that prices are bottoming because offers had moved back up to 1.8, but indicated that there has not yet been any trading at the higher price.

On May 27, to reflect the bearish developments, the ICCO revised its estimate for the 2008-09 global balance sheet to show a much smaller deficit of 84,000 tonnes, down from its March estimate for a deficit of 193,000 tonnes. In classic "market-rising-despite-bearish-news" fashion, July cocoa rallied and settled up $95 per tonne on the session. The market has since gained an additional $100.

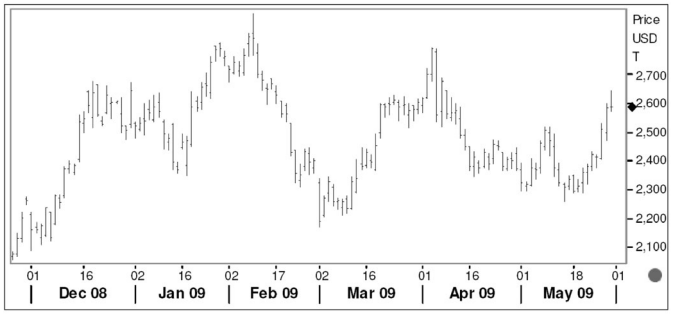
No doubt that – to some extent – the cocoa market has been caught up in the rally of many other commodities with strong underpinnings from a very weak dollar. But we cannot attribute the market's strength to speculative activity.

A study of the open interest's behavior reveals that speculators have not shown any influential presence on the long side. Quite to the contrary. Open interest has moved up a bit, but is very small in historical terms (Chart 7). Commitment of Trader data show that funds and small specs are long, but in small numbers. Consider Chart 8, which shows the net-long position of commodity funds has actually been declining. Although the funds are still net-long, their position is extremely modest compared with where it's been since the bull market began in 2008.

All of which leads us to believe that commercials have been strong buyers and that demand is probably considerably more bullish than indicated by the information that we are privy to. If you managed to remain long, remain steadfastly so, and again, maintain positions that can be held through large dips. If you're stopped out, use those dips to get back on the long side. *[June 1, 2009]*

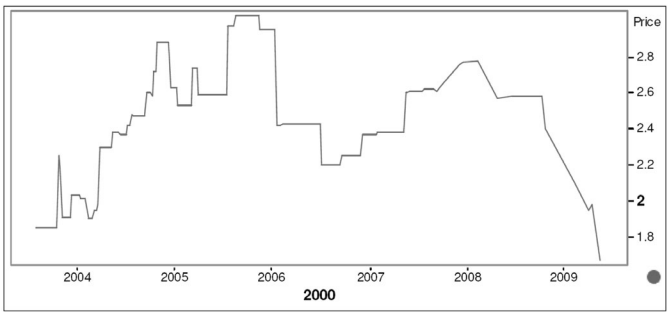
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Chart 5 – July cocoa



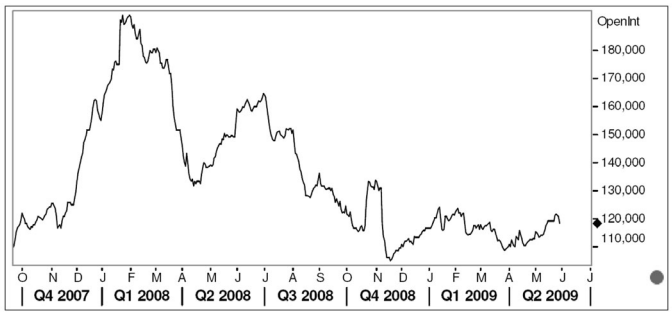
Courtesy Reuters

Chart 6 – Asian cocoa butter ratio



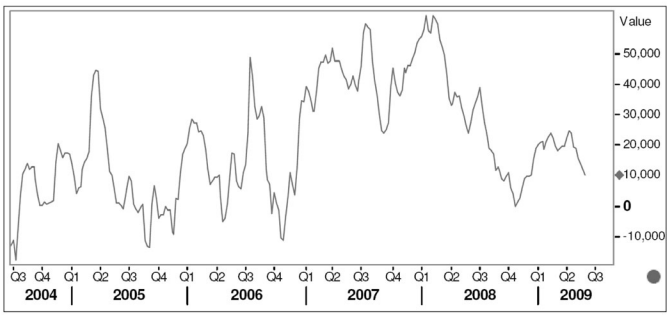
Courtesy Reuters

Chart 7 – Cocoa open interest



Courtesy Reuters

Chart 8 – Commodity fundnet long position



Courtesy Reuters

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