FRIEDBERG'S
FOCUS ON FUTURES
Friedberg Mercantile Group Ltd. Volume 12, No. 7 September 8, 2009

Sweet stuff

Sugar prices sailed right past the February 2006 peak without a hint of resistance (Chart 1). The drought in India is severe. Monsoon rains across India are estimated to be only 75% of normal, but even smaller in the sugar growing regions.

The tone of sugar-related legislative reform in India has shifted. Until recently we heard about easing import rules, but with the potential for shortages, relaxation of protectionist tariffs is a foregone conclusion. Rather, the government is working on establishing hoarding guidelines. For example, there have been reports that the government has requested Western food companies that have large operations, such as Coca-Cola, Nestlé, and Pepsico to provide authorities with the particulars of their sugar inventories. There is a proposal that would restrict commercial sugar users to hold no more than 15 days' worth of supply.

The estimate for the 2009-10 crop peaked at 20 million tonnes several months ago, which would not have been enough to meet even domestic demand, let alone for inventory rebuilding. Recent estimates have fallen to 17 million tonnes, but given the relentlessly disappointing monsoon, the next series of estimates is likely to be even lower.

Ending stock estimates have fallen accordingly. Heading into the new Indian marketing year on October 1, estimates for carryover stocks are at 2.5 million tonnes, down from a norm of about 10 million tonnes in recent years.

The street estimates that India has already imported 4 million tonnes. This amount will barely suffice to meet domestic demand, and is certainly not enough to replenish inventories back to comfortable levels. More imports should be the temporary solution. However, we don't see where those imports will come from, and this is why we believe prices have risen so sharply and will continue to do so. The Brazilians did not plan for an Indian drought disaster. Between exports and domestic consumption Brazil is fairly well cleaned out of its entire crop every year, leaving almost no carryover. So if it has already sold several million tonnes to India, there isn't much wiggle room. And, of course, no other producing country has the volumes that would be needed by India.

In addition, weather in Brazil at the tail end of the crop has not been optimum and has hampered harvesting, which will lower yields to some degree. Recent estimates for the total sugar crop have been lowered by 1 million tonnes, to about 31.5 million tonnes. Aside from a lower-than-expected harvest, at this point, the crush ratio of sugar/ethanol has very little flexibility, if any. Forecasts for 57.5% of the cane crop to be turned into ethanol have not changed much over the course of the harvesting season. Even if there were an interest to produce more sugar, it probably could not be done, because sugar mills are running at capacity. New investment in recent years has all been in ethanol mills, and despite the fact that sugar processing is obviously far more profitable, any tweaking of the ratio in favor of greater sugar production will be insignificant.

Czarnikow estimates 2008-09 global ending stocks at 20 million tonnes, about 12% of consumption, which is a joke when compared with 40% to 50% of consumption that we've been working with in recent years.

We often speak about commodity markets being tight. But this is truly a classic.

Open interest has been moving up with the market, but Chart 2 illustrates that the exuberance displayed by the speculative community pales in comparison with the amount of money that poured in 2008 when the market reached only 15¢ per pound. Accept handsome profits only if prices stop making new highs while open interest continues to climb.

[September 2, 2009]

Inside

Cocoa: A bull with falling demand? 2
Corn: Prices falling 3
Cotton: Heading south?.....5

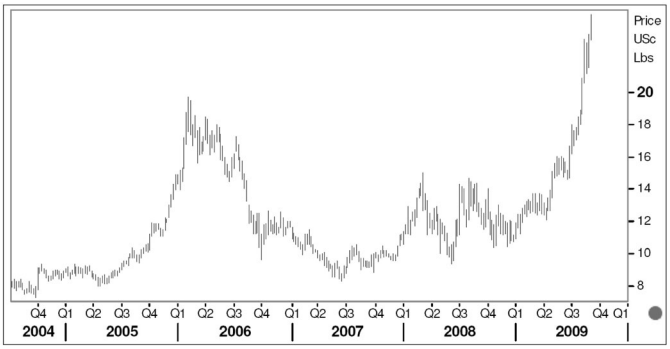
Unless otherwise indicated, all articles have been written by Sholom Sanik (E-mail: *ssanik@friedberg.ca*).

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.

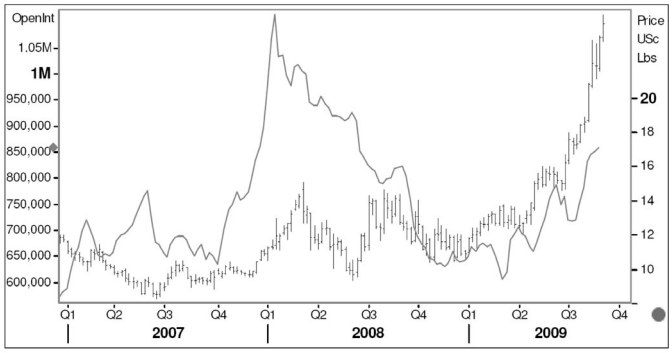
©2009 by Friedberg Mercantile Group Ltd. Reproduction in whole or in part prohibited.

Chart 1 – Weekly nearest contract sugar



Courtesy Reuters

Chart 2 – Sugar: Weekly nearest contract (bar), open interest (line)



Courtesy Reuters

COCOA

A bull market with falling demand?

Cocoa prices have been consolidating near their recent highs. Actually, the consolidation has lasted longer than is typical for cocoa (Chart 3), which we view as constructive for bulls. With a struggle between a bullish supply side and a bearish demand side, it would seem that the market has resolved itself in favor of the bullish case.

The 2008-09 October-September Ivorian season is drawing to a close. Arrivals for the tail end of the mid-crop over the past few weeks have been running behind last year's pace, so we don't expect the total crop to get much past the current tally of 1.114 million tonnes, down from 1.311 million tonnes last year.

The early outlook for the 2009-10 main-crop is positive because there has been ample rainfall. The benefits are reduced to some degree, however, because the rain has been detrimental for proper drying of the beans that have already been harvested. This has been an issue with other West African producers as well, such as Nigeria.

The ICCO revised the Indonesian crop upwards by 5,000 tonnes, but in the grand scheme of things, no other producer has come close to compensating for the 200,000-tonne drop in Ivorian production.

We've already detailed the dismal second quarter Western grind in our last report (see *Focus on Futures* July 21).

There isn't much in the way of data available between the quarterly results, but in following up on the price of cocoa butter, we find that butter ratios have continued to stabilize after a massive free fall that began in 2008 (Charts 4 and 5).

Recently reported Asian grind results are mixed. In Malaysia, activity seems commensurate with the slight uptick in butter ratios and confirm that we may be heading out of the huge drop in consumption. In 2007-08, grindings reached 331,000 tonnes. For 2008-09, the estimate is for a dramatic drop to 270,000 tonnes, but that represents a 10,000-tonne upward revision from the previous forecast.

In Indonesia, 2008-09 grindings are estimated at 115,000 tonnes, a 5,000-tonne slide from the July estimate, and down from 2007-08 grindings of 150,000 tonnes. However, some processing capacity that was shut down temporarily has reportedly been put back into production, and may not yet be reflected in recent data.

Cameroon, which is steadily becoming a more significant player in both crop size and grindings, saw grindings increase by 8% in 2008-09, to 205,000 tonnes. Estimates for 2009-10 are for a further 5% to 10% jump in grindings.

One of the fascinating features of the fantastic rise in cocoa prices is the relative absence of speculative participation. Chart 6 shows that there has been no buildup in open interest, even though prices have risen by 50% over the past year. And the open interest has not shifted to London either, as illustrated by Chart 7. Commodity funds are long in about the same proportion as they were when the open interest peaked in 2007 (Chart 8), but without the huge volume, the counter-trend corrections tend to be more tame.

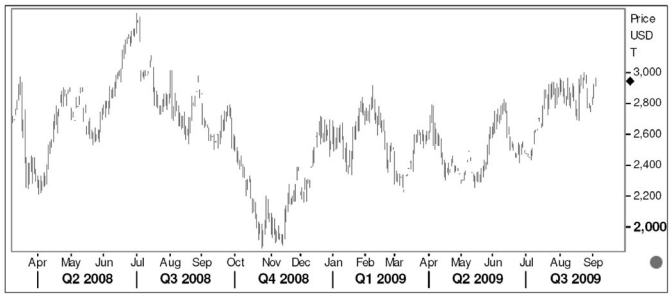
A complete return to normal crop size in the Ivory Coast would be bearish, but there is no evidence that the poor-fertilizer-cover issue has been resolved. The only progress that has been made in terms of providing incentives to farmers to grow bigger and better crops was the September 2 announcement that the Ivorian government was cutting the oppressive export tax by 10%. Exporters passed the cost on to farmers by paying them less for beans. This measure will put more money in the hands of farmers to pay for crop inputs.

The ICCO estimates the global production/consumption deficit at 73,000 tonnes. We maintain that the deficit will be larger than that once the improvement in demand is factored in.

We continue to recommend holding conservative long positions. *[September 3, 2009]*

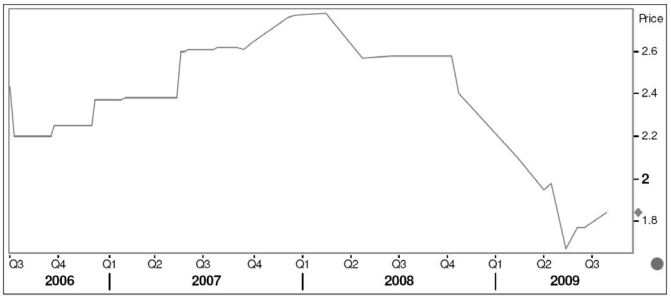
©2009 by Friedberg Mercantile Group Ltd. Reproduction in whole or in part prohibited.

Chart 3 – Nearest contract cocoa



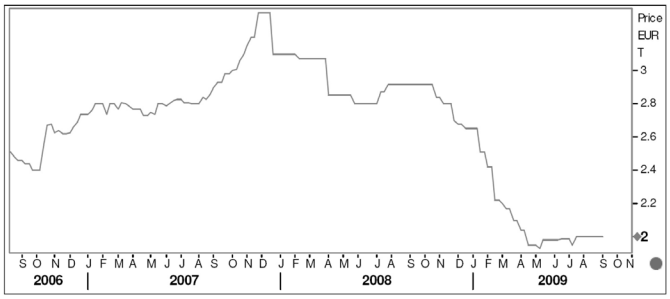
Courtesy Reuters

Chart 4 – Asian cocoa butter ratio



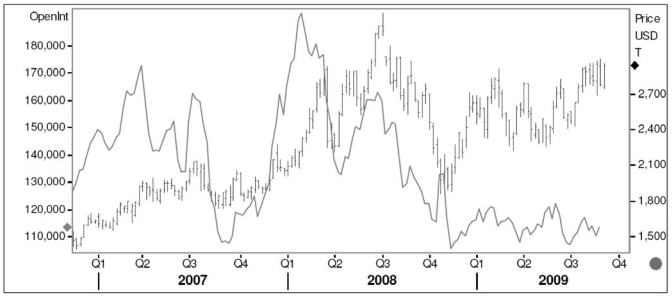
Courtesy Reuters

Chart 5 – European cocoa butter ratio



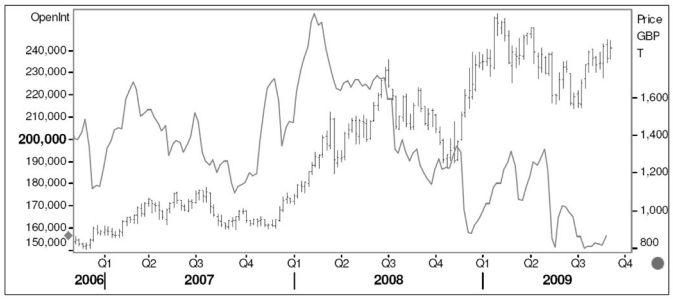
Courtesy Reuters

Chart 6 – Weekly ICE cocoa (bar), open interest (line)



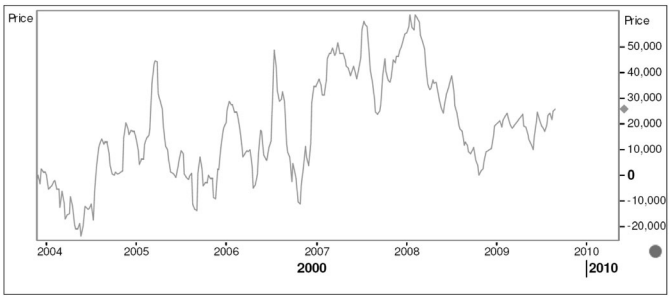
Courtesy Reuters

Chart 7 – Weekly London cocoa (bar), open interest (line)



Courtesy Reuters

Chart 8 – Commodity fund net-long position



Courtesy Reuters

CORN

Can prices fall back to pre-bull market levels?

Corn prices are slipping towards the $3-per-bushel level and have ample reason to do so. After a strong, but very brief, rally in early August, the market began to anticipate – accurately as it turned out – a bearish August crop report. Back in July, the USDA announced that it was going to resurvey 2009-10 US corn area because of a suspiciously high acreage that did not seem to account for late planting and abandonment. Many analysts – including us – assumed that acreage would be revised downwards. It was only a question of by how much.

Not so. The USDA kept the planted acreage figure at 87 million acres, virtually the same as the June 30 acreage report. The average guesstimate was 86.33 million acres, with some estimates as low as 85 million acres. Moreover, the estimate for the average yield was increased sharply, to 159.5 bushels per acre (bpa), up from the 153.4 bpa July estimate. The net result would be a crop of 12.761 billion bushels, up from the 12.29-billion-bushel July estimate. Output will be 5.4% above 2008-09 production of 12.10 billion bushels, and shy of the record 2007-08 harvest which reached 13.038 billion bushels. On September 3, grain analyst Informa raised its estimate for yield to a record 162.6 bpa, which would produce a 13.01 billion bushel crop.

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

The explosive growth in the ethanol component of US usage was the primary reason for the bull market that took corn prices to over $7 per bushel. Aside from the assistance of the general commodity bull market, the corn market had to figure out how to allocate the US corn crop between the feed and fuel. Ethanol usage rose from the corn equivalent of about 1 billion bushels at mid-decade to the current estimate of 4.2 billion bushels. Although the size of the average US crop was also increasing by several billion bushels, feed demand was growing as well. The recession acted as a savior, because while ethanol usage continued to grow, US feed demand plummeted in 2008-09 by 650 million bushels, and foreign feed demand for US corn fell by 600 million bushels.

Forecasts for these two demand categories have been increased for the 2009-10 marketing year, which began on September 1. Exports are expected to grow by 250 million bushels, or 13.5%, while feed usage is estimated to increase by only 50 million bushels, or less than 1%. Both are still dramatically below their respective, pre-recession, 2007-08 totals. With meat and poultry production down 3.5% in 2008-09 and expected to fall further into 2009-10, it is understandable that USDA is taking a cautious approach in estimating increases that are based on the hope for an economic recovery.

Another short-term – and potentially long-term – bearish factor is the collapse of natural gas prices, which has lowered the price of nitrogen fertilizer. This increases the profitability of corn farming and in turn inspires larger plantings.

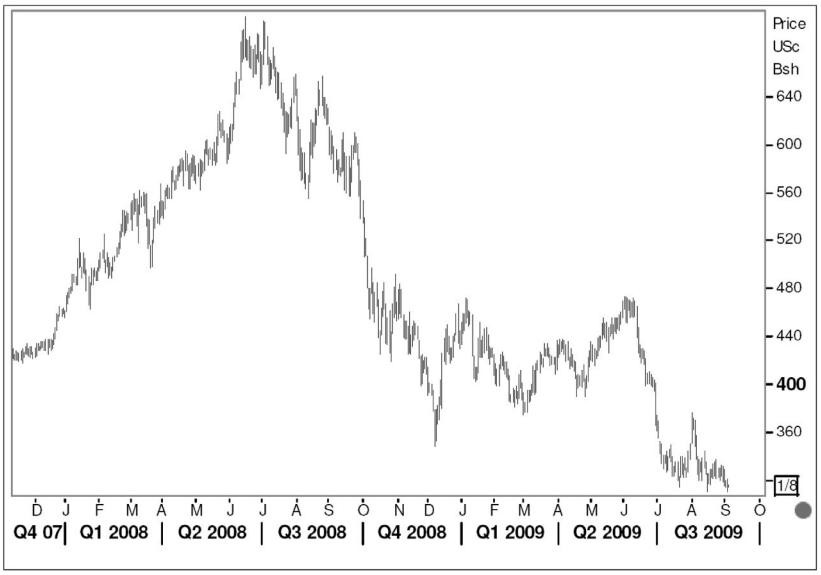
The problem with the bear case, though, is that after everything is tallied up, we've made little if any progress in ensuring that US corn supplies will be able to accommodate the growing ethanol market. US ending stocks as a percentage of consumption are estimated at 12.6% in the August crop report, a bit higher than the July estimate, but still down from 2008-09 ending stocks of 14.3% of usage and substantially below the more comfortable pre-bull-market level of about 18%.

We can muddle through if the supply and demand sides remain as they are. But we remain somewhat skeptical of the fantastic yield estimates for a crop that was planted late and may be subject to early harvest in some regions because of frost fears.

More significantly, the ending stock estimates are based largely on the assumption that there will be very little improvement in consumption. Perhaps, for now, but ultimately, economies around the globe will stabilize, and the trend towards growth of food consumption in developing nations will get back on track. The US is the supplier of last resort, and it will be tapped for its corn supplies.

We caution against trying to be short this market. On the contrary, we view current price levels as the new price floor. Maintain long positions. *[September 3, 2009]*

Chart 9 – December corn



Courtesy Reuters

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

COTTON

Without an uptick in demand, prices will head south

December cotton moved to a one-year high in early August, only to see most of a 20%, two-month rally vanish over the following few sessions (Chart 10). What was so bullish, and what became so un-bullish in such a hurry?

Answering the second question first, the August 11 USDA crop report contained almost no changes for either the US or foreign balance sheets. But just about all data for both the supply and demand sides that have trickled in over the past few weeks have been negative.

Over the past six months, monthly US mill consumption has averaged 260,000 bales, more than 20% below year-ago levels. There has been no indication that this slump is about to end any time soon. Of course, we know that US mill consumption is in a perpetual decline, because the manufacturing base has shifted to low-labor-cost countries. Chart 11 shows that up until a few years ago, US exports were increasing by roughly the amount that domestic mill consumption was declining. Then, exports peaked even while mill usage continued to slip.

Add to the mix a general apathy about the progress of the improvement in the economy, and the market was ripe for a correction.

So why were prices strong until a few weeks ago? The market had been focusing strictly on the supply side. When the production picture in key cotton-producing nations stabilized, traders shifted their attention to the demand side, which as illustrated, is weak.

US farmers planted 9.05 million acres of cotton for the 2009-10 crop, down from 9.47 and 10.83 million acres in 2008-09 and 2007-08, respectively. Although the recent crop progress report shows that only 51% of the crop is in good to excellent condition, weather in US cotton region has generally been favorable. The August crop report downgraded the harvested-to-planted ratio slightly from the July estimate, to 85%, but this would still be significantly higher than the 80% ratio we saw in 2008-09. With yields about the same as last year, the resulting 13.21-million bale crop would still be larger than last season's harvest of 12.82 million bales.

Furthermore, the weaker-than-normal monsoon in India received much attention, and there was a strong possibility that the crop would be affected. The USDA is forecasting a crop of 25 million bales, up from 22.5 million bales last year, and in mid-August that seemed to be in jeopardy. As it turns out, Indian cotton regions have been receiving the necessary precipitation, which should make the USDA estimate attainable.

Global ending stocks are projected to be 51% of consumption. That is down from last year's 56% and compares with an average of about 50% since 2005. The bull market in 2003 that saw prices spike to $1.15 per pound occurred with a global carryover of 46% of usage. Even with demand at current levels, we are heading into a second consecutive year of production/consumption deficits. The supply side is obviously subject to revisions, but at this point, with the harvest around the corner in the US, China, and India, we have a fairly good idea of how much new supply we'll be working with over the next 12 months. Not so for the demand side.

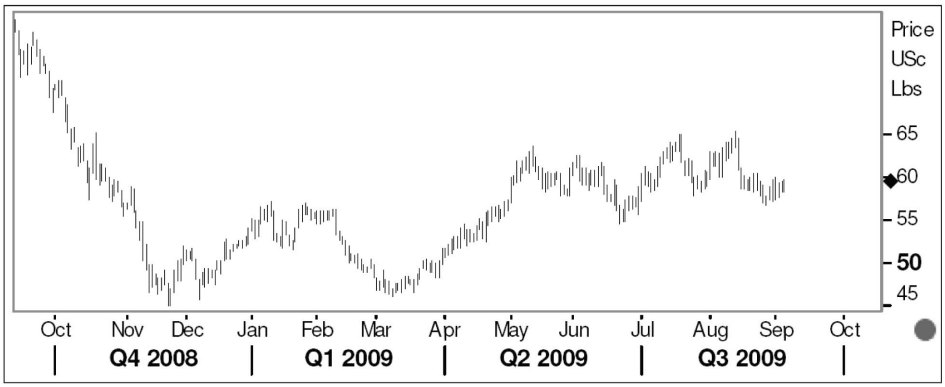
The USDA forecast for 2009-10 US exports is 10.2 million bales, 77% of last season. Weekly commitment data show that we are running at 70% of last year. That is a bit misleading, however, because this comparison also includes outstanding exports carried over the previous season compared with outstanding sales from 2007-08. Since the marketing year began on August 1, commitments are running at an average weekly rate of 220,000 bales, which is actually more than adequate to achieve the USDA target for 2009-10. And once sales start to pick up, they tend to come in clusters. It is much too early to write off the possibility that there is latent demand in the system that will appear if and when the economy gets back on track.

In conclusion: The drop in world production can no longer sustain this bull market if there is no help from the demand side. We recommend hanging on to long positions, but to now use a 56.50 stop close, basis December.

[September 8, 2009]

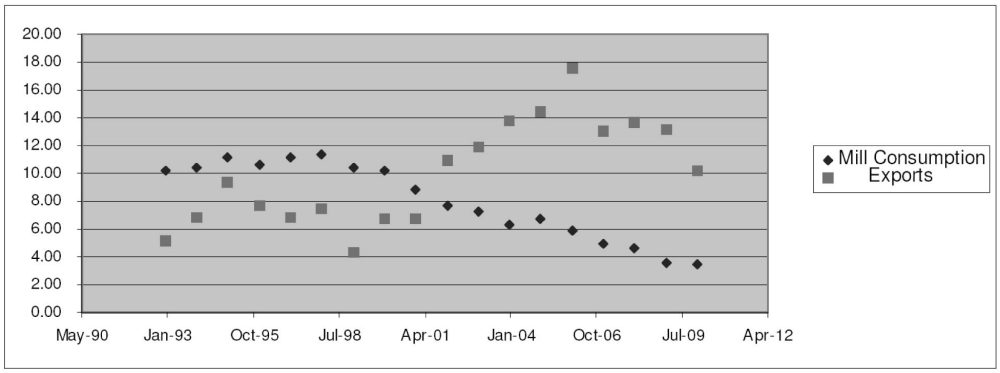
©2009 by Friedberg Mercantile Group Ltd. Reproduction in whole or in part prohibited.

Chart 10 – December cotton



Courtesy Reuters

Chart 11 – US cotton exports and domestic mill consumption



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.