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FOCUS ON FUTURES
Friedberg Mercantile Group Ltd. Volume 25, No. 6 August 25, 2023

Cotton: Dry weather underpins bullish trend

In late June, the Chinese government announced that it would be releasing cotton from state stockpiles. Prices were already pressing against the low of the range at the time, and new lows followed (Chart 1). On July 19 the government said that the cotton would be available in late July.

In the interim, the market turned its attention to US crop weather, and the market rallied to the top side of the seven-month-old trading range.

About 40% of the US crop is grown in Texas, which has been beset by all manner of weather problems. In the early part of the planting season, some key regions experienced excessive precipitation, which did not allow plants to take root. Those acres will not be harvested. Now we have drought-like conditions. The current forecast for Texas cotton areas (as at July 24) was 0% to 20% chance of rain over the next seven days.

And it's not just Texas. Georgia and Arkansas, the number-two and three producing states, which together typically produce almost as much as Texas (Chart 2), have been dry, and have been receiving only a sprinkle of rain. Mississippi, the fourth-largest producing state, has been the lone holdout with good weather.

This brings into question the USDA's estimate for the 2023-24 harvested-to-planted ratio. In the July crop report, the estimate was actually revised upwards, to 85.9% from 83.5%. Looking at the past several years, last year's 53% ratio was a disaster. The highest ratio was 91.5% in 2021-22. Otherwise, the average ratio for the three seasons prior to that was 74.8%.

At this point it is difficult to envision a ratio that would be much higher than the historical norm. The most recent weekly progress report shows that crop conditions keep slipping. The good-to-excellent portion of the crop fell 2 percentage points, to 45%. Last year at this juncture of the season, that figure stood at 38%, and we know how that turned out. But in 2021-22, 60% of the crop was in the good-to-excellent category.

In 2022-23 the acres that were harvested achieved an extraordinary yield of 951 pounds per acre (ppa). But in terms of the national average, that was an anomaly. The average of the five previous seasons was 858 ppa. At present the USDA's estimate is 831 ppa. Depending on how the weather behaves from here on in, that yield estimate could be subject to revision as well. This is particularly a concern because the dry weather is widespread.

Not to be overlooked, the USDA lowered planted area in the June 30 acreage report, to 11.09 million acres, the smallest area since 2016-17. This adds an additional layer of vulnerability.

On the global front, Chinese cotton area for 2023-24 is estimated to be 10% lower than this past year. The USDA production forecast is 27 million bales, down 12%. Pakistan is expected to return to a normal crop after last year's devasting floods. The other significant producers, India and Brazil, are estimated to see their output fall slightly from 2022-23.

On the demand side, US exports had a bit of an uptick in June, but weekly sales fell back into seasonal norm for this late in the year. At present, shipments stand at 11.2 million bales, well shy of the USDA's 12.9-million-bale estimate. With a few weeks remaining in the marketing year, that target will not be reached.

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Still, the US remains the world's biggest exporter, and a crop failure remains a vulnerability to world trade. Brazil is the number-two exporter, and as mentioned, output is expected to be flat.

December cotton came down just enough to trigger our stop at 77¢ per pound. Should you have ignored the stop, by all means, maintain the position. If you were stopped, the market is volatile, and we recommend reestablishing a long position on a pullback to 83.5¢. Place stops at 80¢, close only. *[By Sholom Sanik, July 24, 2023]*

Chart 1 –ICE December cotton

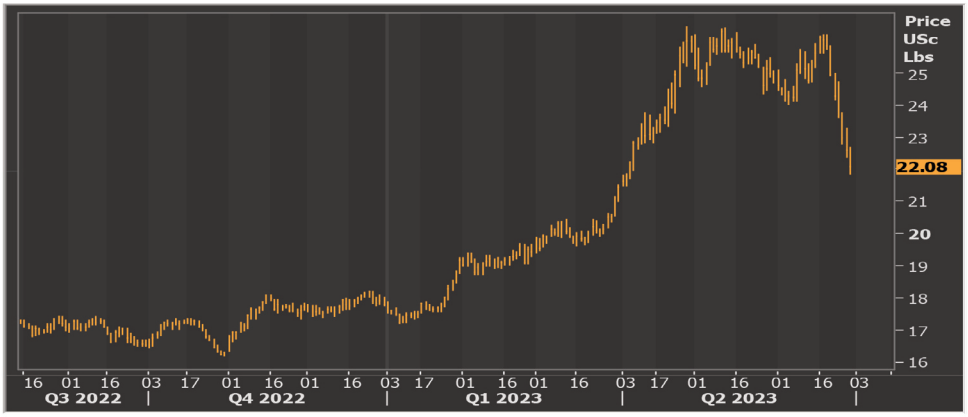


Chart courtesy Reuters

Chart 2 – US coton production by state

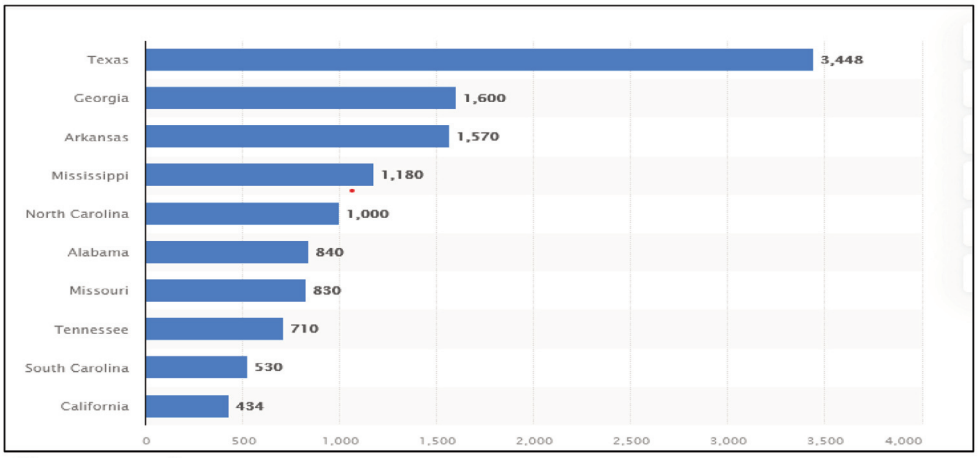


Chart source: Reuters

SOYBEANS

Can the USDA be right?

November new-crop soybeans have rallied $2.50 per bushel after the USDA's June 30 acreage shock (Chart 3). The USDA shaved 4 million acres off its original March 30 planting intentions report. It came as a complete surprise to analysts, who were expecting planted area to be little changed (see *Focus on Futures*, July 4).

More confusion for market participants followed. Hot and dry weather has persisted throughout the growing season, and crop conditions have deteriorated. The USDA's first estimate of the season for the good-to-excellent portion of the crop in late May was 62%. That figure now stands at 54%. Yet the July 12 comprehensive monthly crop report kept the bushel-per-acre yield at a record 52, unchanged from the June estimate. Obviously, the market has chosen to focus on what is more current information – the weather.

Even more strange is that the USDA did indeed slash yields for the US corn crop from its initial estimate for record yields. By-and-large, soybeans are subject to the same climatic conditions as corn. All eyes will be trained on the August 11 crop report to see if the USDA adjusts its forecast

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for record soybean yields to account for the weather, which almost certainly had some adverse effect on crops.

Among other producing nations, the early forecast for 2023-24 for Brazil calls for another record crop of 163 million tonnes, up from 156 million tonnes this year. Argentina had a crop failure in 2022-23, producing only 25 million tonnes. Output is expecting to bounce back to normal levels in 2023-24. The USDA estimate is 48 million tonnes. Regardless, these South American crops are not available until mid-2024, so it will not have much impact on the near term.

On the demand side, the July USDA crop report lowered its estimate for the outgoing 2022-23 exports, to 53.89 million tonnes, from 54.43 million tonnes. Even that is a bit high. Current shipments stand at 49.9 million tonnes. With five weekly reporting periods remaining in the marketing year and weekly shipments averaging about 250,000 tonnes, it is doubtful that we'll hit that target.

For the new marketing year, the estimate was slashed by a chunky 3.4 million tonnes (125 million bushels), to 50.35 million tonnes (1.85 billion bushels). And there is justification for this revision. Forward new-crop sales stand at 4.0 million tonnes. In the three previous years on this date, US exporters already had commitments for an average of 10 million tonnes. So the season is not off to a great start in this regard.

We do not believe that export demand is going to be a swing factor. As we've said many times in the past, China grows a fraction of its requirements – 17% – and it will be a steady buyer of US soybeans. The primary issue is that the USDA took its traditional conservative approach and did not react to the realities of a US 2023-24 crop that is in stress. If the July estimated yield of 52 bpa becomes, say, 50.5 bpa, we'd lose about 125 million bushels. Ending stocks would fall to about 4% of consumption, down from 6% in 2022-23. That would be the lowest US carryout since the 2012-13 era, a period in which soybeans spiked to $17.00 per bushel (Chart 4).

We are long November soybeans as per our July 4 recommendation. Raise protective sell stops, from $12.50 to $13.00, close only.

[By Sholom Sanik, July 26, 2023]

Chart 3 – CBOT November soybeans

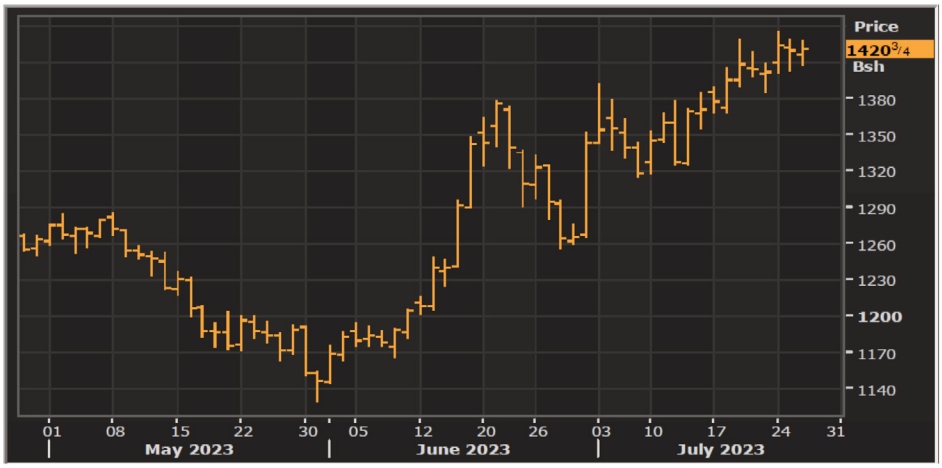


Chart courtesy Reuters

Chart 4 – CBOT soybeans monthly nearest contract



Chart courtesy Reuters

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COCOA

Just the facts

On August 7 cocoa prices spiked to a 12-year high. The market cleared the top of the previous range with a rather majestic $142-per-tonne rally, unusual even for cocoa. The ensuing reversal was equally majestic – for bears, that is (Chart 5).

We are quite certain that the sudden surge to new highs was not related to the development of any fresh bullish fundamentals. In fact, if anything the opposite is true.

Rather, an unsustainable speculative fervor engulfed the market. Commodity funds built a net-long position that reached over 50,000 contracts – very high for either long or short positions. With general commodity sentiment turning bearish and first notice day around the corner, the inevitable liquidation commenced. Chart 6 shows that open interest has nosedived by close to 65,000 contracts since late July.

Output in the Ivory Coast remains steady. Mid-crop production for 2022-23 stopped falling *vis-à-vis* the previous season in early June (Chart 7). Given the manner in which prices shot up – outperforming every agricultural commodity on the board – one would think that the world's largest supplier was on the brink of impending disaster. Not so. With one month or so remaining in the mid-crop season, output will clearly end about 100,000 tonnes below 2021-22. However, that is still above the three previous years, during which production averaged 2.13 million tonnes.

One distinct problem of analyzing this market is that little information is available on Ghana, the world's second-largest producer. The most recent production estimate for 2022-23 came in April, at 575,000 tonnes. That was about 10% higher than the previous season's output. In 2021-22, output fell to 683,000 tonnes, from a record 1.047 million tonnes a year earlier. Earlier season forecasts called for a recovery to 750,000 tonnes. The April estimate is in line with those forecasts. But Ghana remains a wild card.

Turning to the demand side, the International Cocoa Organization (ICCO) estimates that world grindings will grow by 3% in 2022-23. The last leg of the rally began in mid-July, coinciding with a headline that grinding in the Ivory Coast, the world's largest processor, grew by 11% year-over-year in the second quarter. But, in fact, global grindings are flat. Europe fell by 5.7%, Asia was down 6.5%, and North America tumbled 11.6%. Cumulatively, for these four principal processing regions, grindings grew by less than 0.3% (Table 1).

Table 1 – Second-quarter cocoa grinding for principal regions

	Q2 2021-22	Q2 2022-23	
Ivory Coast	470,449	522,825	11.133%
European Union	364,081	343,283	-5.712%
Asia	228,895	213,977	-6.517%
North America	115,899	102,493	-11.567%
TOTAL	**1,179,324**	**1,182,578**	**0.276%**

Chart source: Reuters

The ICCO estimates that there will be a global production/consumption deficit of 142,000 tonnes. If the second-quarter grind statistics are a reflection of where we stand on demand, that deficit would actually be smaller by about 75,000 tonnes.

It is quite true that a production scare in the Ivory Coast is noteworthy. As illustrated, we believe that this late in the crop year a worst-case scenario is no longer a factor. For that matter, weather that will affect the coming 2023-24 crop has been favorable. So, it is not as though we need to worry about next season.

We were stopped out of our short position recommended on July 12 at $3,500 per tonne, basis December. We declare that this bull market has ended. At this time, we suggest reinstating short positions in December cocoa, currently trading at $3,350. Place initial stops at $3,500, close only.

[By Sholom Sanik, July 7, 2023]

Chart 5 – ICE US September cocoa

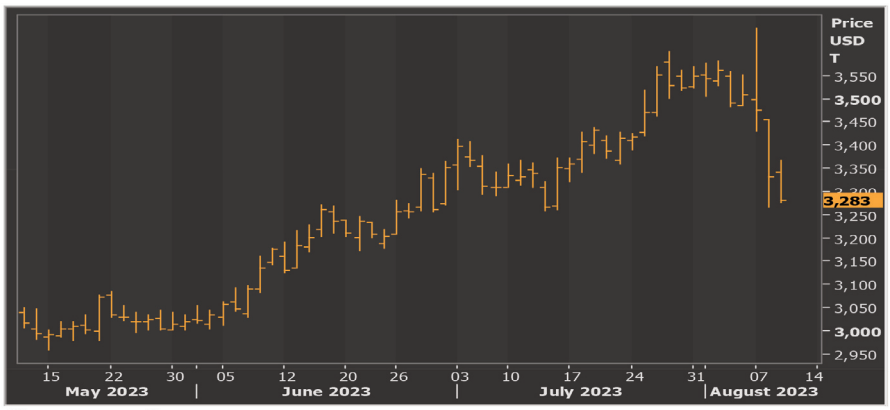


Chart courtesy Reuters

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Chart 6 – ICE cocoa open interest

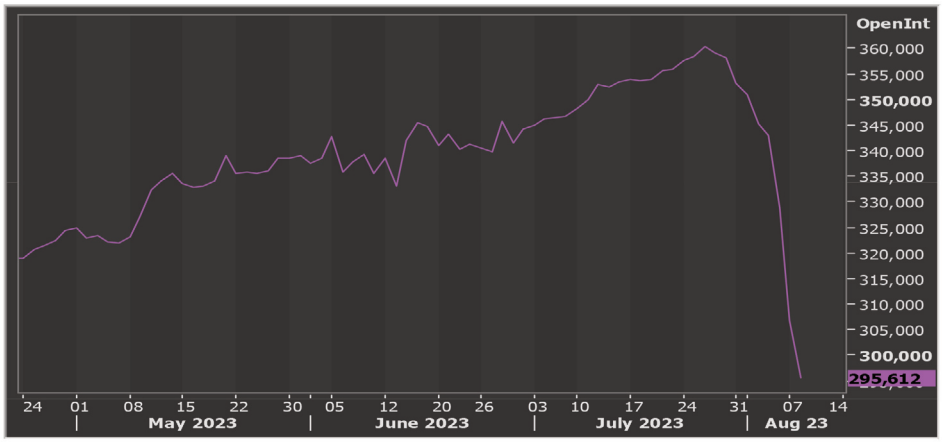


Chart courtesy Reuters

Chart 7 – 2022-23 Ivory Coast arrivals *vis-à-vis* 2021-22

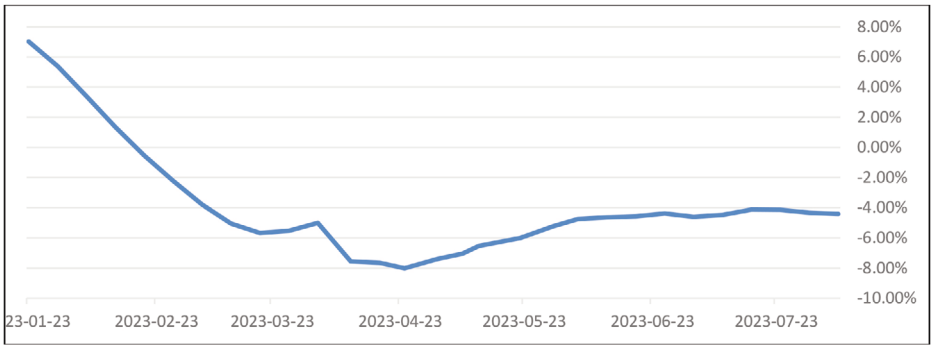


Chart source: Reuters

SUGAR

A little tired, but still a bull

Sugar prices have been drooping, with developments in Brazil being the primary focus. Production is exceeding expectations. Early estimates were in the 38-million-tonne neighborhood, but we're now seeing forecasts that are closer to 41 million tonnes. That's up from 34 million tonnes last year.

The cane crop is also looking better than it was a couple of months ago, but the main driver of rising sugar output is the ethanol/sugar ratio. Over the past few seasons, 55% of the cane crop was devoted to ethanol. Early-season estimates hovered around 52%. During the past two bi-weekly reporting periods, ethanol output has crept below 50% for the first time since Brazil became the world's largest user of ethanol. Definitely a bearish factor, but just one cog in the wheel.

Indian production estimates have been slipping, albeit not by as much as Brazil's have been rising. Recent estimates are running at about 31.5 million tonnes, down roughly 2.5 million tonnes from previous forecasts.

However, there are a number of other issues regarding India. First and foremost, the Indian government banned sugar exports several months ago, but with a loose timetable that indicated it would not allow sales abroad into 2024. Now, it has announced that there will be no exports for the entire 2023-24 marketing year.

With the latest production revisions, we estimate that 2022-23 Indian ending stocks will fall to roughly 4 million tonnes. Average ending stocks over the previous five years were about 14 million tonnes.

Furthermore, looking ahead to next year, El Niño has resulted in irregular precipitation. Earlier this summer, the monsoon seemed to be providing enough rain to build subsoil moisture for the coming crop. However, the first two

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weeks of August have been very dry. Meteorologists say that an 11-day dry spell is a record for August dating back to 2002. Of course, it is still quite early to forecast output for the 2023-24 crush season, which begins in November. But it is clear that with 2022-23 inventories at such low levels and a questionable outlook for the next crop, the restrictive export policy will be maintained for the foreseeable future.

One recent development that did not attract much fanfare is output in Thailand, the world's third-largest producer and second-largest single-country exporter. Thailand is still struggling from two consecutive years of drought in 2019-20 and 2020-21, which saw output fall to 8 million tonnes, from 14 million tonnes in the two previous seasons. Average output in 2021-22 and the current season is about 10 million tonnes. Sugar analyst Czarnikow recently forecast that production for 2023-24 will nosedive to 7.5 million tonnes, citing the same dry conditions we are seeing in India. Again, perhaps a bit too pessimistic and very premature. However, it does provide a glimpse into what may be in store for Asian exporters.

At the moment, while it is true that Brazil's excellent season is compensating for India and Thailand's shortfalls, it is doing that and not much more. Estimates for the global production/consumption balance are about flat. A recent Reuters poll of analysts puts the production/consumption balance for the upcoming 2023-24 season at a 2.1 million tonne deficit.

Remain long March 25¢ calls, as per our June 30 recommendation.

[By Sholom Sanik, August 24, 2023]

Chart 8 – ICE March sugar



Chart courtesy Reuters

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