FRIEDBERG'S
FOCUS ON FUTURES
Friedberg Mercantile Group Ltd. Volume 24, No. 4 July 22, 2021

Cotton: an enduring bull

On the surface, the action in the cotton market may present a bit of an enigma. Many commodity markets took a thrashing in June – the agriculture complex, precious and base metals, and softs. New-crop December cotton sold off as well, but while other markets continue to struggle near the lows of their respective ranges, cotton has climbed back close to its recent highs (Chart 1). Its stronger performance against new-crop corn and soybeans, which in many regions in the US share the same weather conditions, is obvious (Chart 2).

Demand

But it all makes sense. China grows about two-thirds of its domestic needs. Until the 2012-13 marketing year, it would import the balance of its requirements. Imports peaked at 24 million bales in 2011-12. Then the government decided to sell off its inventories to supply the domestic mill market. In the years that followed, imports from all sources imploded. Then came the trade war and subsequently Covid. Chinese imports from all sources bottomed in 2017-18 at just over 5 million tonnes.

This past season, imports began to recover. With just over a month remaining in the 2020-21 marketing year, the USDA estimates that Chinese imports will climb to 12.5 million bales. US sales to China account for just over 5 million bales, 90% of which has been shipped. Last year at this time that figure was 3.5 million bales.

We believe that as we slowly climb out of the pandemic era, Chinese demand will continue to grow alongside pent-up demand for clothing. Chinese imports of cotton are used to produce clothing that end up back in the US and other Western countries. We have been monitoring the St. Louis Fed's Advance Retail Sales: Clothing and Clothing Accessory Stores indicator. As is depicted in Chart 3, the indicator took a nasty dive during the worst moments of Covid-related lockdowns and has now made a full recovery. As such, we expect Chinese import demand will remain strong.

Supply

This may be particularly true in light of the fact that Chinese farmers have not responded with a larger crop. In 2020-21 China produced 29.50 million bales of cotton and forecasts are calling for a smaller harvest in 2021-21. In its June crop report, the USDA revised its already smaller forecast for Chinese output downward by 750,000 bales, to 26.75 million bales.

The March 31 Prospective Planting report put cotton area for 2021-22 at 12.04 million acres, the same as the previous season. One well-regarded private analyst we follow believes that this figure is too high and that we will see downward revisions as the growing season progresses. Perhaps this will come as early as June 30 when the US updates its planting estimates.

The quality of the US crop itself was suspect as it began to grow, but has improved materially. As of the most recent USDA weekly crop progress report, 52% of the crop is rated good-to-excellent, up from 45% in the previous week. Last year at this time the crop was struggling with only a 40% rating for the top category. It is still very early, and weather will play a role as we go forward.

We are long December cotton as per our April 9 recommendation. Raise sell stops to 82¢, close only.

[By Sholom Sanik, June 25, 2021]

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Chart 1 – ICE December cotton



Chart courtesy Reuters

Chart 2 – Relative performance of cotton vs. soybeans (top), vs. corn (bottom)



Chart courtesy Reuters

Chart 3 – St. Louis Fed's Advance Retail Sales: Clothing and Clothing Accessories

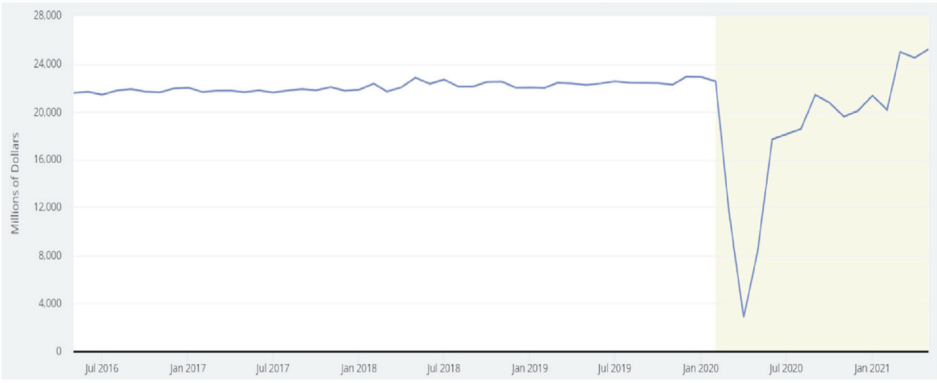


Chart courtesy US Census Bureau

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CORN

Wrong again!

While US farmers were planning the size of their 2021-22 corn crop, calculations would have been based on profitability at $4.50 per bushel. The March 31 USDA planting intentions report was based on those calculations. As we've discussed previously (see *Focus on Futures*, April 1), the USDA estimate was materially below the average of analysts' guesstimates, and as a result, new-crop December rose to over $6 per bushel.

Naturally, with prices at eight-year highs, it was widely expected that the June 30 acreage update would show that farmers would plant as a much as they could. And while they did, once again, analysts were higher by a country mile. The average guesstimate was looking for 93.787 million acres, up from the March 31 intentions estimate of 92.144 million acres, but the actual figure was 92.692 million acres.

In an encore performance of the March 31 intentions report, old- and new-crop months were up the daily 40¢-per-bushel trading limit.

Aside from smaller-than-expected planted area, there are two additional supply-side issues in the US and Brazil that could keep this bull alive.

US yields

Crop ratings continue to decline. The first weekly rating of the season was on June 1. A robust 76% of the crop was in the top, good-to-excellent category. As of the most recent update, that figure has fallen to 64%. This means that the USDA's initial estimate for record yields of 179.5 bushels per acre (bpa) is not a realistic prospect. One well-regarded analyst believes that even 175 bpa is optimistic.

Brazil

Based on planted area, Brazil was expected to cement its status as the largest competitor to US export demand. Early forecasts called for record output of 110 million tonnes, up from 102 million tonnes in 2019-20. But weather conditions have been brutal. First drought and then frost have compromised yields. The USDA's estimate for the 2020-21 Brazilian corn crop now stands at 98.5 million tonnes. Even that downward revision is now ancient history. Private analysts are currently estimating that output will be below 90 million tonnes.

Demand is strong. Accompanying the acreage update was the quarterly stocks report. US inventories as of June 1 were 4.1 billion bushels, compared with 5 billion bushels at this time last year. In itself, it was a non-event because the figure came in at 32 million bushels, or just under 1 million tonnes below expectations. In the grand scheme it was not a huge miss when compared with the acreage miss, but it did add to the bullish tone.

Chinese purchases have slowed down to a trickle, but with two months remaining in the marketing year, the US should meet the USDA's target of 72 million tonnes for total sales to all destinations. Shipments stand at 57 million tonnes and average weekly shipments have been running well over 1 million tonnes.

Far more important, though, forward commitments for the new crop are just under 16 million tonnes. Historically, new-crop commitments have averaged 3 million tonnes at this time of year. And no surprise here – Chinese purchases comprise 10.7 million tonnes of that total.

In conclusion, while US farmers did take advantage of higher prices to plant more acres, the amount was a disappointment, and for the moment, not enough to meet the needs of its new customer. If China does continue to be a regular customer of US corn – and with the volumes we're seeing – it is fair to say that the US farmer has not responded in kind. Add to that the Brazilian crop failure, and we have a *bona fide* tight market.

Remain long December corn as per our April 1 recommendation. Raise stops from $4.40 per bushel, to $5.00.

[By Sholom Sanik, July 2, 2021]

Chart 4 – ICE December corn

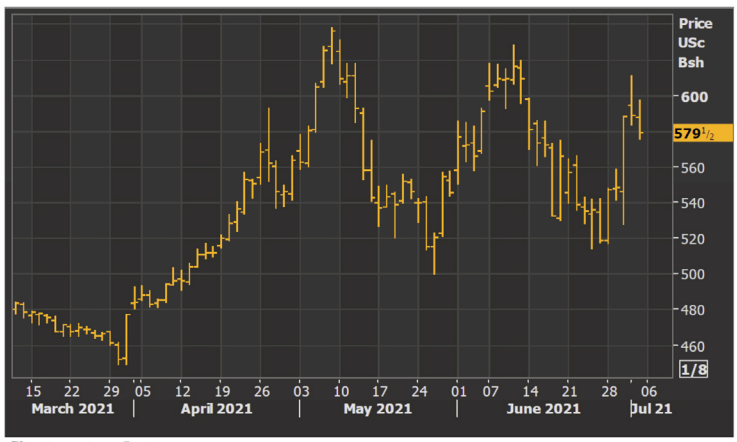


Chart courtesy Reuters

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SUGAR

The ethanol factor

There have been enough bullish developments over the past few weeks to keep sugar bulls content – all related to Brazil.

First, drought earlier in the season threatened yields. Then at the end of June, several days of freezing weather brought frost to Sao Paulo State, where roughly 60% of the country's sugar is grown. The series of inclement weather issues helped drive sugar prices to four-year highs (Chart 5). Clearly, cane output was compromised to some degree.

Sugar prices were further bolstered by the strength in crude oil prices, which took out pre-pandemic highs. As petroleum prices rose, so did the price of bio-fuel products. While ethanol demand dropped during the 2020-21 marketing year, Brazilian cane processors shifted ethanol output to sugar. Although ethanol prices rose alongside crude (Chart 6), the curtailment of production was stark, with only 54% of the cane crop headed to ethanol, down sharply from the historic norm of about 64%. But once economies around the world began to creep out of shutdown mode, traders were certain that the sugar/ethanol ratio would return to normal, which would ultimately result in a sharp pullback in sugar output. This explains in large part the sugar market's participation in the broader commodity bull market.

The problem is that the shift back to due-course ethanol production volumes has not taken place. While 2021-22 sugar output will definitely be smaller than last year, this is hardly news and is mostly on account of a smaller cane crop and a drop in yields.

Although it is still early in the crushing season, high sugar prices seem to be keeping the ethanol/sugar output ratio near 2021-21 levels, and some anecdotal evidence from individual processing companies supports this. For example, Copersucar, the largest cane processor in Brazil, said in June that its 2021-22 ethanol/sugar ratio would be roughly 54.5%/45.5%, compared with 54%/46% the previous season. The flexibility in altering the mix at this stage is limited because it has already hedged most of its sugar output.

Other smaller companies have indicated that ethanol output would grow over last year, but mills generally are pushing sugar production to compensate for the smaller cane crop and to take advantage of world prices at four-year highs.

In any case, in looking at the other two major exporting nations, supplies are ample. As we've discussed previously, Thailand, a key exporter in the Asian market, has bounced back from two years of drought and is expected to see output jump by 30% in 2021-22.

In a sign of the times, India cut its sugar export subsidy by 31% back in May. It seems that with prices at these levels, exporters no longer need as much motivation to move surplus sugar. There is no shortage of sugar availability to serve world trade.

Forecasts for the global production/consumption balance vary widely, but all estimates we've seen indicate that we will be moving from a deficit of about 4 million tonnes in 2020-21 to a surplus of several million tonnes.

For sugar bears, "fighting the tape" has been an exhausting experience. We will steer clear of making any general predictions about the broader commodity markets, but we believe that ultimately, supply/demand fundamentals will govern individual markets. As such, sugar prices will revert.

Establish short positions in March sugar, currently trading at 18.00¢ per pound. Place initial buy stops at 19.00¢, close only.

[By Sholom Sanik, July 16, 2021]

Chart 5 – ICE weekly sugar



Chart courtesy Reuters

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Chart 6 – Brazilian ethanol (reals per liter)

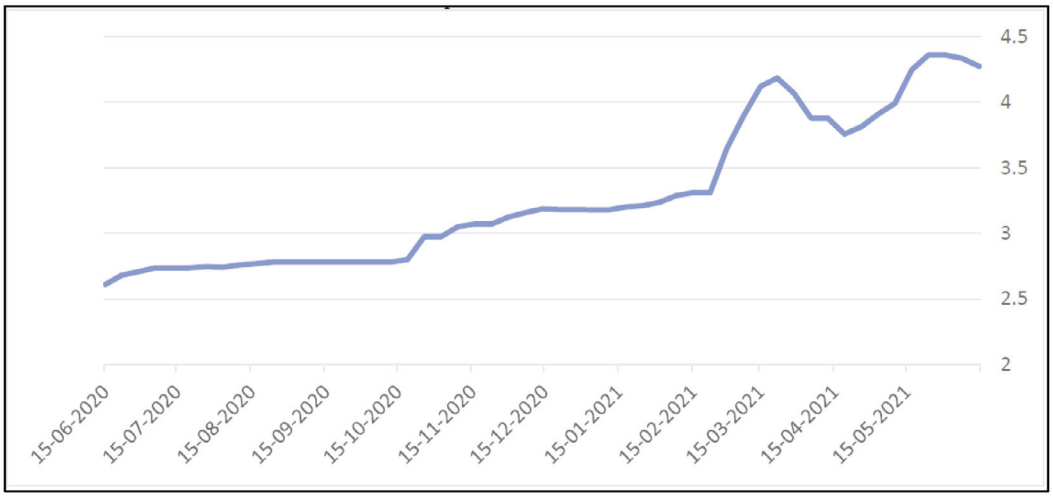


Chart source: GlobalPetrolprices.com

COCOA

A lone bear

The cocoa market carries the dubious distinction of being the only tradeable commodity that did not participate in the great bull market of 2021 (Chart 7). Chart 8 shows the performance of the Bloomberg Commodity Index against cocoa. But there is no mystery here.

Prices peaked in November 2020. At the time, due course weather worries had traders thinking that it would be a challenge for Ivory Coast to match bumper crops of the past two seasons. In fact, for several months, port arrivals lagged behind the previous year's. By the end of the main-crop harvest in March, though, arrivals pulled ahead. With only a couple of months remaining in the mid-crop season, arrivals now stand at 2.087 million tonnes, about 100,000 tonnes above last year's level.

In addition, there is an energy crisis in Ivory Coast that has reportedly kept some 80,000 tonnes stored on farms and unable to be transported to port. Aside from the fact that the arrival figure will eventually be padded with these beans, it does not seem to have created any tightness, at least as far as we can tell from price action.

The International Cocoa Organization (ICCO) estimates total Ivorian output at 2.225 million tonnes, compared with the previous record crop of 2.158 million tonnes achieved in 2019-20.

Ghana's output was even more impressive. As of earlier this month, arrivals reached 980,000 tonnes, already 130,000 tonnes above last year at this time, and the mid-crop extends through October. Production will easily surpass the previous record of 850,000 tonnes. The other West African producing nations, Nigeria and Cameroon, are harvesting normal-sized crops. New supply is abundant.

On the demand side, second-quarter grind data showed mixed results. The three traditional processing regions had – on the surface – stellar performances. The EU was up 13.6%, year-overyear. Asia was 9% higher, and North America grew by 11.7%. So the first glance at these results would seem to indicate that the demand side should be slated to sop up any excess new supplies. However, it is not as bullish as it appears. These quarterly data are year-over-year, and last year's Q2 had dismal grindings, which means that second quarter grindings were actually more on the flat side. The headlines may have caught some attention, but there was no great enigma in that the market barely blinked and just continued to trade down to fresh lows.

Moreover, Ivory Coast, which now grinds almost as much cocoa as the top grinder, Netherlands, saw second-quarter grindings fall by 22.2%.

The ICCO forecasts a global production/consumption surplus of 165,000 tonnes for the current 2020-21 marketing year. Private estimates are as high as 220,000 tonnes.

We are short as per our April 22 recommendation. Lower stops from $2,700 per tonne, to $2,500, close only.

[By Sholom Sanik, July 21, 2021]

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Chart 7 – ICE September cocoa

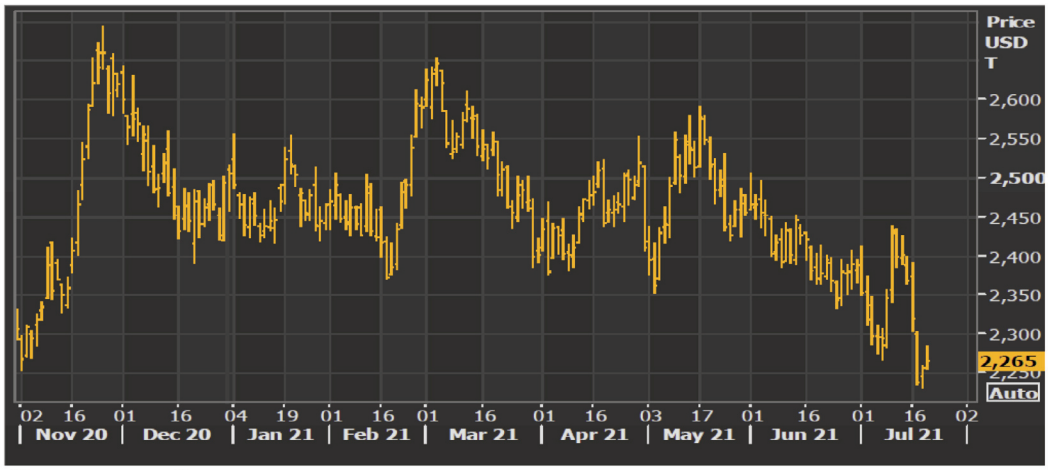


Chart courtesy Reuters

Chart 8 – Ratio of Bloomberg Commodity Index/September cocoa



Chart courtesy Reuters

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