September 8, 2014
Monthly Agriculture Market Notes:

Crop Trip Recap:
My colleagues and I conducted our annual corn and soybean crop trip from Aug 12-20. As always, the trip was focused on key production areas in crop-critical states such as Illinois, Iowa, Minnesota, Nebraska, and South Dakota. This year's trip covered just under 3,000 miles in these states to collect objective yield samples. The samples taken are compared against our database from previous trips, which date back to 2005.

In the case of corn, one thing that might turn out to haunt this year's crop is the overall lack of uniformity as one travels around the Corn Belt. Driving these key production states, you would cross back and forth into areas that had too much rain early in the season, to areas that had too little rain late in the season, to areas that had received ample and timely rainfall all season. There were areas in Nebraska that showed signs of early heat stress in addition to recent moisture stress (though it has rained since our trip). Northern portions of Iowa showed major holes in fields following the wet spring, and this carried over somewhat into southern Minnesota. Northern Illinois and northeastern Iowa showed stress from dry conditions on our trip (though, again, it has rained in these areas since our trip).

What I'm trying to point out here is that it could become difficult to achieve current lofty market expectations for corn yields when there are several localized problems. These problems don't necessarily detract from what has otherwise been an outstanding season for production prospects. Indeed—I still expect the national average corn yield to score a new record high. However, I feel, and more importantly our data shows, that these relative "sore spots" could become a drag on yields in the grand scheme of things when all is said and done.

The data from our trip initially implied a national average corn yield of 166.1 bpa. With solid rainfall totals in some of the dry areas we visited on the trip, I'm inclined to raise that yield projection a little, perhaps to a range of 167-169 bpa. This is clearly well below consensus thoughts on the corn crop this year, and I do not take it lightly that I am off-consensus by such a wide margin. This only comes after a tireless review of our crop trip data and other proprietary yield models...and this has served me very well over the past several years. Is it possible that these methods are less effective in "outlier" production years? Maybe...time will tell.

Trying to put a solid production/yield estimate on soybeans following a mid-August crop trip is a good way to look foolish. The wide range of maturation from year to year during this timeframe makes comparisons to previous crop trips difficult. One thing we did note almost universally across our trip is that we were counting more pods on soybean samples than in most years past. The crop development just seemed to be moving along faster than normal this year, which came as a surprise considering the relatively cool weather seen this summer had many arguing for just the opposite. The exception to this rule came in parts of northern Iowa and southern Minnesota, where planting had been slowed due to wet spring weather. Otherwise, most of the soybean samples were a bit more mature than we're accustomed to seeing.

Driving around the country, the vast majority of soybean fields looked very nice. The samples we pulled, as noted above, had several pods to count and most showed the possibility to add more pods should weather cooperate. We did pass a few cases of potential SDS, and since our trip there have been many reports of SDS popping up around the country. Whether or not this becomes a quantifiable problem remains to be seen, but I doubt it will be a significant issue.

Our crop trip data initially implied a national average soybean yield of 46.0 bpa, but once again I'm tempted to add a bit more to that level considering good weather since our trip. There is one major problem in trying to guess a soybean production estimate this year; the WASDE balance sheets have made it painfully obvious that NASS has understated last year's crop by a wide margin, and this comes after they were forced to revise 2012's production level higher as well. Whether or not we can properly guess the soybean crop size really depends on whether NASS gets it right initially. This makes our models and comparisons difficult to use.

But the bottom line from our crop trip results is that I am leaning towards **corn production that is below current market consensus and soybean production that is inline with current market consensus.** Trading this thought process is going to prove to be very difficult. Even if my below-consensus corn projection turns out to be correct, it might be several months before seeing any confirmation from NASS reports. Anecdotal yield reports continue to point towards "record" yields, which makes complete sense considering even I am calling for a record national average yield. The market will see these reports as confirmation of its higher bias...i see these reports as just confirmation of what we should already know.

Market Thoughts:

As noted above, the markets are going to turn much more tricky to trade in the coming weeks. For now it is still "easy" to be short all agricultural commodities, from wheat to soybeans to corn, but I don't think that will last forever. The market's *perception* currently is that both corn and soybean crops continue to get bigger and bigger. I don't necessarily disagree based on recent weather, but as noted above my starting point on corn is much lower than the overall market's. On the other hand, my thought on soybean production potential is relatively inline with current market perceptions.

Looking forward, the focus of the market will gradually start to shift away from production and more towards demand. Focus on demand trends has taken a back seat this summer in favor of forecast watching and yield model tinkering. This lack of attention on demand will eventually come back to haunt some.

Over the past few months it has become very popular to "pick-on" corn demand for the 14/15 marketing year. There are some legitimate concerns over demand, but overall I think these concerns are being overblown to this point. I have attached my expectations for the corn balance sheet on the following page. First note that I am assuming a 168 bpa national average yield, which is the midpoint of my 167-169 expected range.

A quick glance at the demand estimates shows that I am a bit more optimistic on corn demand than most. For starters, I think feed & residual use will have to be increased for a few reasons. Many argue there is no reason for a YOY increase in the F&R number as animal numbers have yet to strongly rebound, but I make the case that feeding rates

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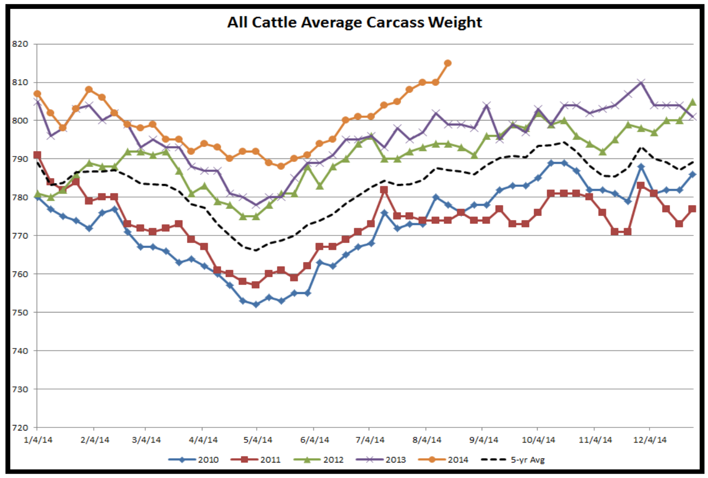
are higher than usual per animal. Note the graphic to the right showing cattle carcass weights are at record levels. It simply pays the feeder to keep the animal in the feedlot longer as the value he receives for the cattle outweighs the added cost of “extra” feed. In addition, we also have to keep in mind that a big portion of the F&R use number is “residual”, and we have studies that show that the residual component tends to increase in low-priced environments. With corn prices at their lowest level in several years and with on-farm storage capacity continuing to grow, I suspect we will see larger than currently anticipated “residual” use of corn this year.



US Corn Supply and Demand (Million Bushels/Million Acres)

	USDA 10/11	USDA 11/12	USDA 12/13	USDA 13/14 Aug	Opus 13/14	USDA 14/15 Aug	Opus 14/15	Opus 15/16
Planted Acres	88.2	91.9	97.2	**95.4**	**95.4**	**91.6**	**91.0**	**90.0**
Harvested Acres	81.3	84.0	87.4	**87.7**	**87.7**	**83.8**	**83.5**	**82.5**
Abandoned Acres	6.9	7.9	9.8	**7.7**	**7.7**	**7.8**	**7.5**	**7.5**
Yield	152.8	147.2	123.4	**158.8**	**158.8**	**167.4**	**168.0**	**163.0**
Carryin (Sep 1)	1,708	1,128	989	**821**	**821**	**1,181**	**1,181**	**1,654**
Production	12,447	12,360	10,780	**13,925**	**13,925**	**14,032**	**14,028**	**13,448**
Imports	28	29	162	**35**	**35**	**30**	**30**	**20**
Total Supply	14,182	13,517	11,932	**14,781**	**14,781**	**15,243**	**15,239**	**15,122**
Feed and Residual								
Total Feed and Residual	4,792	4,548	4,335	**5,175**	**5,175**	**5,250**	**5,350**	**5,400**
Food, Seed, and Industrial								
Corn for Ethanol Fuel	5,021	5,011	4,648	**5,120**	**5,120**	**5,075**	**5,150**	**5,100**
Other FSI	1,407	1,426	1,396	**1,385**	**1,385**	**1,385**	**1,385**	**1,375**
Total FSI	6,428	6,437	6,044	**6,505**	**6,505**	**6,460**	**6,535**	**6,475**
Total Domestic Use	11,220	10,985	10,379	**11,680**	**11,680**	**11,710**	**11,885**	**11,875**
Exports (Census)	1,835	1,543	731	**1,920**	**1,920**	**1,725**	**1,700**	**2,000**
Total Use	13,054	12,528	11,111	**13,600**	**13,600**	**13,435**	**13,585**	**13,875**
Carryout (Aug 31)	1,128	989	821	**1,181**	**1,181**	**1,808**	**1,654**	**1,247**
Stocks/Use	8.6%	7.9%	7.4%	**8.7%**	**8.7%**	**13.5%**	**12.2%**	**9.0%**

My ethanol consumption forecast is also above current market expectations. Most seem to feel that a steady level of domestic gasoline demand will serve as a cap on ethanol production. I don’t strongly disagree, but I note that ethanol production margins remain very profitable at the moment, which would not argue for a slowdown in production from current levels. It is also worth noting that US ethanol exports continue to grow. I am of the opinion that 14/15 ethanol production will be no less than what was seen in 13/14, and could likely turn out to be slightly higher.

But the biggest question mark for corn demand in 14/15 is exports. Much has been written this summer about the supply of “competing” feedgrains in the world. Indeed, Europe is sitting on a very large feed-wheat crop that will certainly limit their corn import needs this year. There is also an argument that supplies of South American and Ukrainian corn will limit US corn exports next year. Again, there is some truth to this as well; but I strongly feel the market has become overly complacent here. For starters, feed-wheat consumption is not something that we see strongly offsetting corn demand except in cases where corn prices are high. For example, following the 2012 drought when corn prices were high it was important to watch the corn-wheat price relationship and feed wheat supplies. Corn prices are near their lows, so this will not be a global issue this year (though certainly an EU-specific issue). On the second thought that South American and Ukrainian supplies will offset US demand, I am currently anticipating exports out of these areas to be slightly ahead of last year, but nothing dramatic. It seems to be a popular opinion that Argentine farmers will be more willing sellers of corn as they store their soybeans. I instead believe that Argentine farmers will hoard both crops as best as they can. Forecasts for higher corn exports and lower corn stocks are misguided in my opinion. Time will tell. My current projection for 14/15 corn exports is actually slightly lower than the latest WASDE estimate at 1,700 million bushels. Right now, I feel I might actually be too low with that estimate rather than too high.

Now switching gears to the 14/15 soybean balance sheet, I think the opposite can be stated about the market’s perceptions on soybean demand vs. corn demand. I feel the market is leaning too optimisticly on US soybean demand. **I want to point out here that the balance sheet below is assuming some very optimistic demand projections...some that are probably unattainable. I have done this intentionally...I have tried to pump the soybean balance sheet up with as much demand as possible to see how it would look in that situation. I the end, I think demand could turn out to be less than shown here.**

US Soybean Supply and Demand (Million Bushels/Million Acres)

	USDA 10/11	USDA 11/12	USDA 12/13	USDA 13/14 Aug	Opus 13/14	USDA 14/15 Aug	Opus 14/15	Opus 15/16
Planted Acres	77.4	75.0	77.2	76.5	76.5	84.8	84.8	85.2
Harvested Acres	76.6	73.8	76.2	75.9	75.9	84.1	84.1	84.2
Abandoned Acres	0.8	1.2	1.0	0.6	0.6	0.8	0.7	1.0
Yield	43.5	41.9	39.8	43.3	43.3	45.4	46.0	45.0
Carryin (Sep 1)	151	215	169	141	141	140	136	481
Production	3,329	3,094	3,034	3,289	3,289	3,816	3,869	3,789
Imports	14	16	36	80	80	15	15	10
Total Supply	3,495	3,325	3,239	3,509	3,510	3,971	4,020	4,280
Crush	1,648	1,703	1,689	1,725	1,725	1,755	1,775	1,800
Exports (Census)	1,501	1,360	1,320	1,640	1,640	1,675	1,650	1,700
Seed	87	90	89	99	99	92	99	90
Residual	43	2	1	(94)	(90)	19	15	20
Total Use	3,280	3,155	3,098	3,369	3,374	3,541	3,539	3,610
Carryout (Aug 31)	215	169	141	140	136	430	481	670
Stocks/Use	6.6%	5.4%	4.6%	4.2%	4.0%	12.1%	13.6%	18.6%

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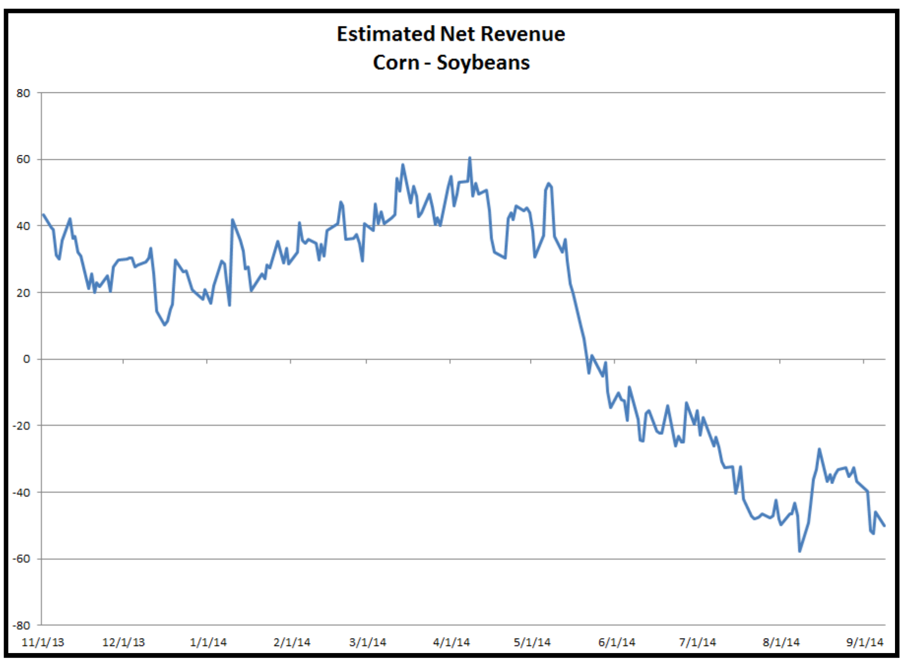
The crush estimate shown above is very aggressive. This factors in a very optimistic rate of US soymeal export demand. I do not think meal export demand will turn out quite so strong in the end. Export demand for the first half of the marketing year is expected to be exceptionally strong, and this is shown by the record level of new crop export commitments on the books. The “problem” for meal demand/exports will come in the second half of the marketing year. Meal values in South America have already sunk below US prices, and it is having trouble finding a home. It looks as if YOY meal demand, outside of China, will probably be down slightly from last year. Combine the already weakening South American meal situation with what could be another round of solid soy production (area estimates in both Brazil and Argentina are higher this year) could leave South America “swimming” in beans and meal in spring 2015. This would likely undercut US soybean and meal demand in the second half of the year.

I feel a bit more confident the soybean export projection shown in the balance sheet is attainable. Chinese demand continues to run at an aggressive pace and for now, Chinese crushers have solid margins. As noted above, there is risk that South American supplies could undercut US demand in the second half of the marketing year, but that is typically when we see US export shipments tail off anyway, so it should have less effect on the bean export program.

2015 Acreage Thoughts:

In addition to the 14/15 balance sheets, I have also attached some preliminary projections on 15/16 balance sheets. The demand projections are, of course, very preliminary in nature and a lot can change that could make these estimates look different in the future. Instead, the key area to focus on right now is 2015 acreage. While on our crop trip, we had the pleasure of meeting with several different farmers/producers. One question we asked each one was, “what are your planting intentions for 2015?”. Without exception, each one answered they were expecting to plant more soybeans next year. Theses producers are just responding to the market’s signal. The graphic to the right estimates net revenue of corn vs. beans with certain assumptions on yield, basis, and cost of production. Under these assumptions, the current price of SX’15 is telling the market to add to soybean area at the expense of corn again in 2015.



My 15/16 preliminary balance sheets are showing what is essentially a 1 million acre shift from corn into soybeans. Based on the this revenue chart and from anecdotal reports as mentioned above, I think an argument can be made that the shift could be even bigger. With just a quick glance to the 15/16 ending stocks line, you can automatically tell the market cannot "allow" this to take place. Of course, this assumes that my projections for 14/15 production and demand turn out to be correct. Still, even if you were to assume I'm too low on my production estimate and the national average corn yield is 170 bpa, the corn balance sheet would still look a bit too snug against soybeans.

With this in mind, <u>my key position in the markets right now is a spread of new crop (2015) corn futures vs new crop soybean futures.</u> I believe corn values need to gain versus soybeans to prevent a further acreage shift away from corn. Additionally, as noted previously, I am of the opinion that the risk is towards stronger than anticipated corn demand while there is risk of lower than expected second-half soybean demand. This position may take time to play out, but I think it should be handsomely rewarded over the long haul.

Respectfully,
David Zelinski
Opus Futures, LLC

9047 Poplar Avenue, Suite 101, Germantown, TN, 38138
Tel: 901-766-4446 • Fax: 901-766-4406
www.opusfutures.com