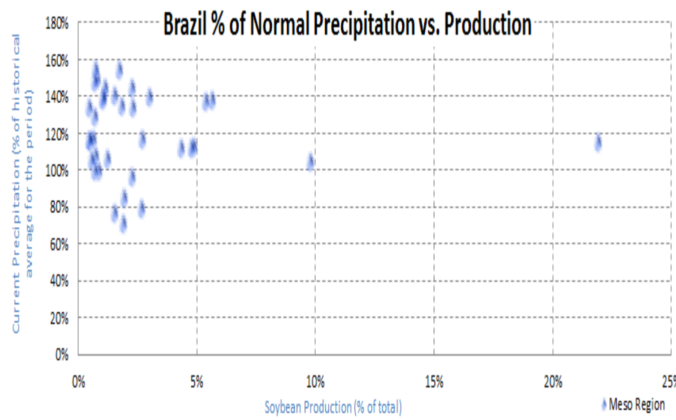
January 8 , 2015

Monthly Agriculture Market Notes:

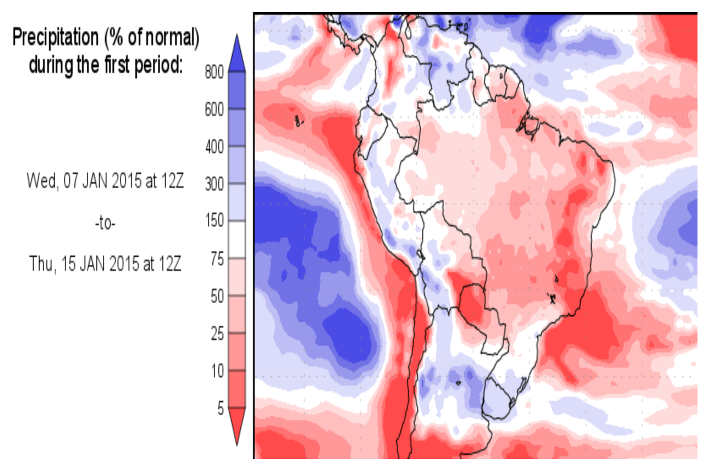
In the final days of 2014, the global soybean market was starting to show some signs of what I would call rational behavior. Cash markets for both soybeans and soymeal have both quieted following the sharp October rally. US export premiums have declined significantly as the October rally created massive internal domestic sales, refilling crush and export pipelines. Commercial ownership of soybeans soared, resulting in weaker basis both internally and at export terminals. The futures board, though reluctantly, was following cash lower through the end of the year, and it probably didn't hurt that some long liquidation out of SF contract in first notice was seen.

But that sense of "rational" behavior has quickly abandoned the market since the start of the New Year. From my vantage point, there are two key issues that have created this sudden change in sentiment.

The most immediately obvious change is the forecast in northern Brazil has turned dramatically drier. However, keep in mind that the large majority of the Brazilian soybean crop has been amply watered to this point. That means there is not a moisture shortage today. Whether or not there will be a shortage of moisture at the end of January remains to be seen. Certainly the forecast is not very generous with its projections for rainfall during this period, however we don't need "normal" amounts of rainfall to maintain crop conditions. As it is, I suspect this drier pattern will certainly take the top end off of what could have been a "special" crop, but that it will not be near a disaster and Brazilian production will still easily be a record this year. For the record, I am still forecasting Brazilian production of 94.0 mmt, which is equal to the latest WASDE estimate but well below Brazi's CONAB production estimate last month of 95.8 mmt. CONAB will update their estimate later this week and WASDE will give an update next week. I think it is too early to see any significant shift from either group, but I'll closely monitor both reports.



The above breakdown showing Brazilian precipitation against production shows most of the key production regions have been well-watered to this point.



The question now becomes, what was the top-side of the crop up to this point? Additionally, how much of that potential might we lose with the above forecast for drier than normal conditions through a large portion of Brazil?

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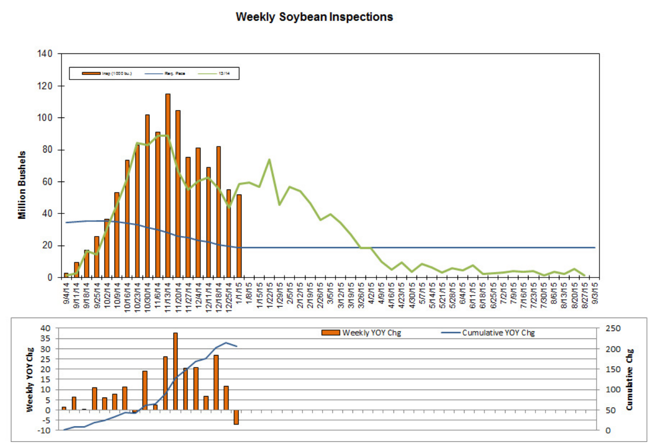
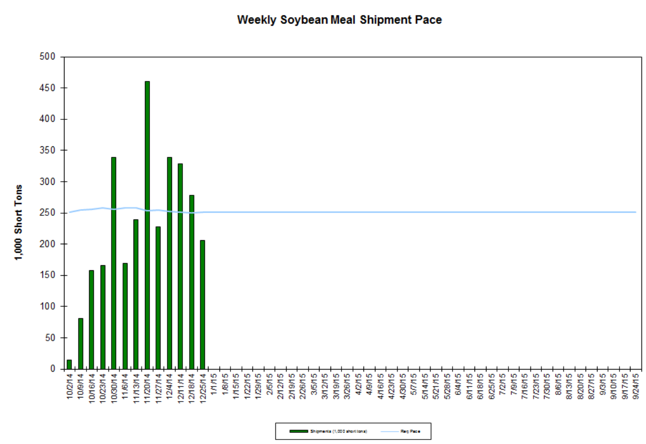
The other item that has taken the market's interest in the past few sessions is the announcement of additional old crop soybean business to China. I'm not entirely sure why the market seems so captivated by this new business. Essentially all that has happened is that certain exporters have found themselves long more soybeans than they want (as noted earlier, the pipeline is amply full) and as such they are "liquidating" this position by making export sales at whatever price they can get. In these most recent sales, elevator margins are thought to be negative. The sales hardly sound bullish from this perspective, but the marketplace a) doesn't know these details or b) only sees the demand. But this demand wouldn't be there with out sharp discounts, and the discounts are temporary in nature.



Soybean shipments might struggle to maintain last year's pace in the weeks ahead. If so, it would put higher export projections at risk.

As it looks right now, even with the latest sales information in mind, export demand might actually be starting to taper off relative to my current expectations. I am assuming export demand of 1,800 million bushels, which is larger than the WASDE projection of 1,760 million but inline with several other private analysts. My assumption of 1,800 mi bu accounted for Jan/Feb shipments essentially totaling very near year ago levels, but the pace of sales is slowing down quicker than I had anticipated. It is possible that shipments over these next few weeks fail to meet this rate, and then South American shipments take over the lead of the global soybean pipeline. We'll need to monitor shipments over this period very closely.



Soymeal shipments so far this marketing year have been a big disappointment relative to sales commitments. It is highly unlikely we can even get close to the current WASDE projection of 12.8 million tons

And soybean aren't the only item underwhelming at the moment. Soymeal shipments have come in below expectations essentially the entire marketing year to date. Simply put, Jan/Feb soymeal shipments would need to obliterate previous records to keep the WASDE export projection attainable. While some new weekly shipment records are likely to be posted, I don't think we'll even come close to reaching levels that would keep the WASDE estimate in reach. As the spring rolls around, the world will obviously focus more on South American supplies, and this should lead to significantly less demand for US meal supplies.

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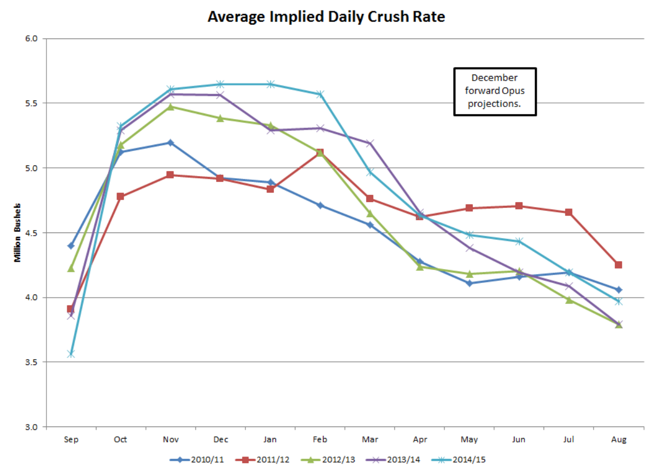
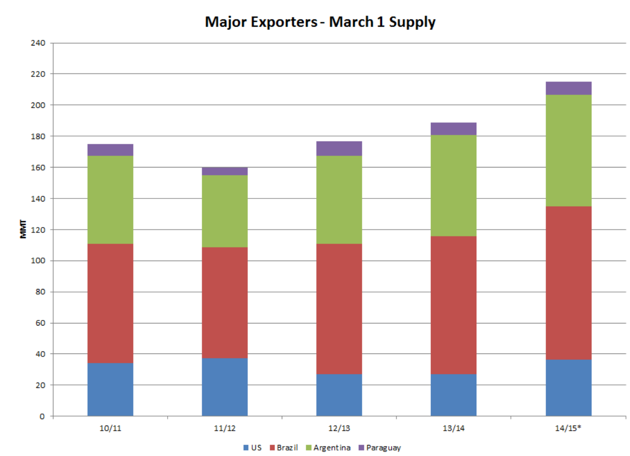
So, weaker export demand for US meal should provide some cushion for the US domestic soybean crush. Crush margins are still favorable, but after reviewing the past few months of crush data I feel comfortable backing off "maxed-out" daily crush rates going forward. With that in mind, I've lowered my crush projection since last month to 1,765 million bushels, which is roughly 15 million bushels lower than the current WASDE projection. Even at this lower rate, we'd still post new highs in the daily average crush rate over the next few months, as shown in the chart to the right.



Even while the US crush rate is expected to post new highs in the coming months, it seems likely now that WASDE is overstating total crush demand.

The bottom line with soybeans is that I'm still bearish for the same reasons I have been bearish for months (despite price action being "uncooperative"). US March 1 supplies will stand at the largest level we've seen in several years while (as noted above) demand appears to be waning. Meanwhile, South America, even with some minor losses over the next few weeks, is on the brink of another record soybean crop.

The chart to the immediate right sums up the global soybean supply very nicely. The chart assumes Brazilian production of 94 mmt, Argentine production of 55 mmt, and Paraguayan production of 8.5 mmt...all are reasonable (if not conservative). March 1 soybean supplies from these four major world exporters will hit a new record high this year and exceed last year's level by more than 25 million tonnes.



Soybean supplies in major exporting countries continue to swell.

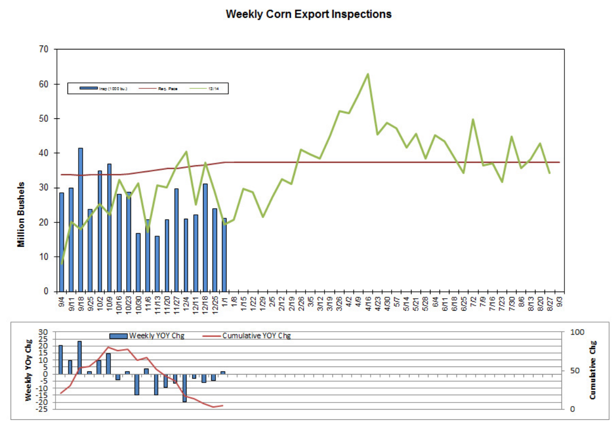
The one caveat here is an issue I mentioned in last month's update—the willingness of the Argentine farmer to sell his soybeans. Argentine farmers are already thought to be sitting on *at least* 7 mmt of old crop stocks, and current weather conditions favor a very solid crop this year. It would seem reasonable to expect the Argentine farmer to need to move *something* after harvest. Additionally, the government has begun to whittle away at the Argentine farmer's credit access in an attempt to force sales. I suspect movement out of Argentina will be somewhat improved compared to last year, if for no other reason than there are just more soybeans. That said, I still believe the level of Argentine farmer sales will be one of the most important factors to watch for soybean prices in the months ahead.

Moving briefly to corn, I still don't have a strong short to medium term bias for price direction here. The situation for corn has actually shifted pretty dramatically in just the past few weeks. Earlier in the marketing year most were questioning the WASDE export projection as too high and the ethanol grind as too low. Instead, today I'd argue the reverse might be the case.

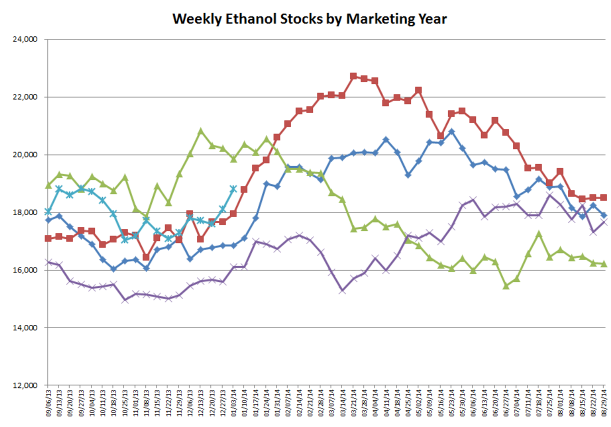
Yes, corn shipments continue at a completely anemic pace. The chart to the upper right shows export inspections are running well below the average pace needed to match the WASDE projection. That being said, total commitments so far this marketing year are only down 4% from last year compared to current projections for a 9% YOY decline. Commitments and outstanding sales seem inline with a level that would support the current 1,750 million bushel estimate. Additionally, there are still lots of question markets surrounding Brazil's safrina corn production as well as corn supplies out of Ukraine.

On the other hand, what once seemed like a sure-thing to bust previous demand expectations, the ethanol grind now has a lot of question marks. The entire price structure of ethanol has changed in recent weeks, in large part due to the collapse in crude/gas prices. Ethanol production margins are still positive for now, but ethanol is now a premium to gasoline which will deter "discretionary" ethanol blending. This lack of discretionary demand could lead to a surge in ethanol inventories, which will further weigh on ethanol prices and eventually production margins. In fact, were it not for such strong DDG and corn values right now, ethanol production margins might already be turning negative.

Without any major supply-side shocks from the USDA in their Annual Crop Production report next week, I would expect the combination of the above two items to have a temporarily



Corn export shipments aren't inspiring at the moment, but we were expecting export demand to be loaded towards the back half of the marketing year.



Watch the weekly EIA data for building ethanol stocks. This could weigh on production margins and eventually drag on demand.

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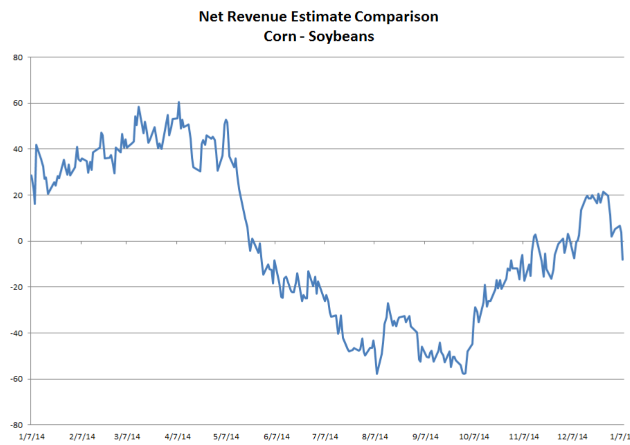
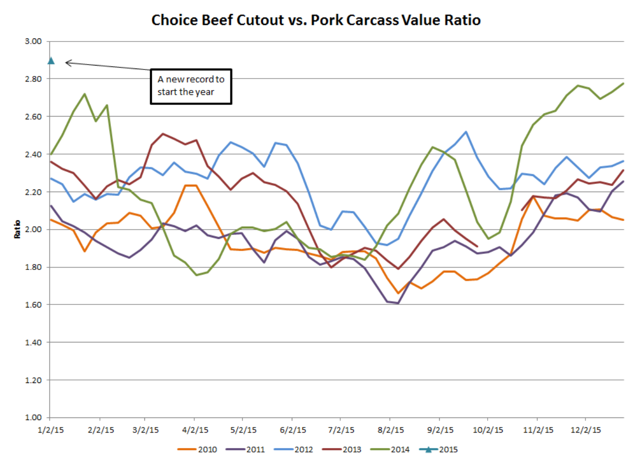
negative impact on corn prices in the short to medium term. That being said, the one true issue on everyone's mind for corn price direction is 2015 acreage. The net revenue calculation shown to the right shows that corn prices have closed the gap against soybeans in recent months, but the reports from seed companies imply otherwise. Monstanto's recent quarterly outlook showed optimism toward soybean seed sales while noting corn sales were running behind.



It doesn't feel that corn futures have done a strong enough job in their price rally to secure additional acreage from soybeans.

The potential tug of war between what appears to be a negative old crop balance sheet (again, assuming no supply shocks from the USDA) and what could turn into a positive new crop balance sheet makes calling near/medium term corn price direction very difficult.

Turning quickly to the live cattle market, I have started to establish some bearish positions and plan to add to these positions in the near future. Simply put, packer margins are absolutely abysmal with live cattle prices at these levels. In the past, the packers could potentially hope to push beef prices higher through kill cuts or other methods, but now that pork and poultry production has already ramped up, beef is already very richly priced vs. the competition. These cattle prices, or perhaps better-stated...these negative packer margins are unsustainable and something will have to give. With pork and poultry production in full expansion, I believe it will have to be the beef market and cattle that break. Additionally, I expect spring cattle supplies to be well above year ago levels and we should not forget that the dairy cow kill will likely be larger than some anticipate due to the recent collapse in milk prices. I believe live cattle futures could be in the process of forging a long term top.



Beef prices, as compared to pork prices, are priced at record-high expensive levels.

Regards,
David Zelinski

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