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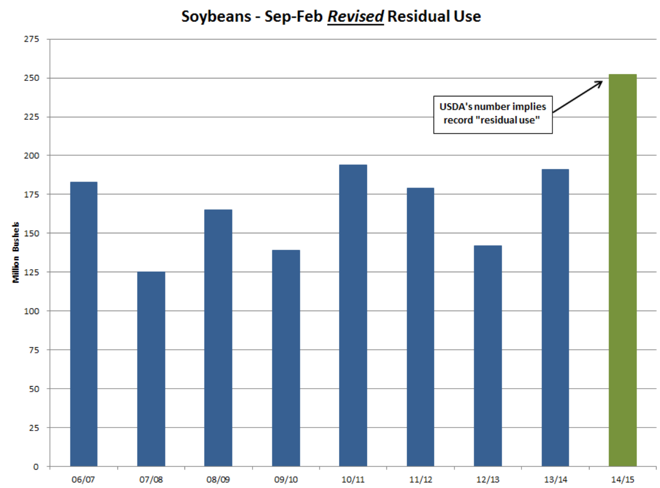
April 7, 2015

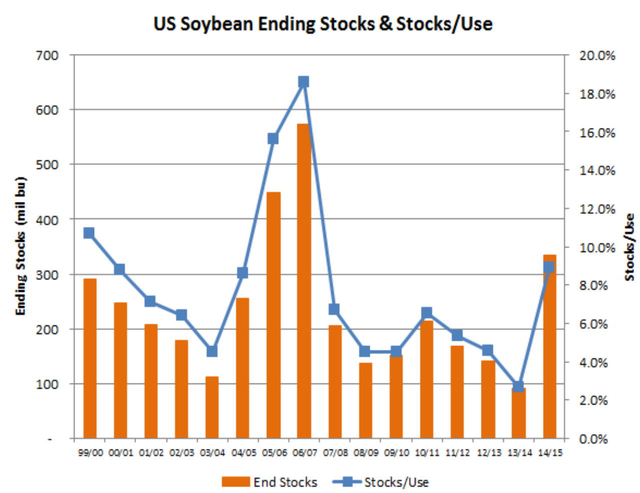
Monthly Agriculture Market Notes:

At the end of last month, the USDA threw us a bit of a curve-ball on its Quarterly Stocks report. Their report showed a sharply smaller March 1 soybean stocks figure than most analysts (myself included) had expected. The stocks figure would imply, as shown in the chart to the right, what would be record "residual" use of soybeans in the first half of the marketing year. More likely, the stocks number probably implies that last year's soybean crop was overstated. The graphic to the right shows *revised* H1 residual use, and once (if?) NASS gets around to revising last year's production total, this year's H1 residual will likely fall back inline within the recent range.



First half marketing year soybean residual consistently comes in a fairly narrow range. This year's March 1 stocks estimate would imply a much higher residual level. A revision (lower) to last year's production total will likely eventually bring this year's residual use total back in line with the trend.

This surprising number created enough uncertainty for me to liquidate remaining old crop soybean shorts almost immediately, and judging from the market 's reaction to the number...many others were doing the same. However, having had some time to digest the numbers completely, fear of a significant rally in old crop soybean futures seems overblown. Though this undoubtedly will change the projection on old crop ending stocks, the market remains amply supplied. Does it really matter if the old crop carryout is under 350 million bushels? Note the graphic to the right showing a recent history of soybean stocks-to-use ratios and ending stocks. In the case of the 14/15 estimate, I have aggressively increased residual use to 75 million bushels (a 50 million increase from the last WASDE estimate) and this cuts ending stocks to 334 million bushels. Even with that aggressive cut to soybean supplies, this is the largest ending stocks level we've seen in nearly a decade.



Even if one were to assume aggressive cuts to US soybean supplies based on the March 1 stocks figure, the US market is still looking at its highest ending stocks level in nearly 10 years.

And of course that completely ignores the fact that both Brazil and Argentina are looking at record production levels. Estimates of production in both countries have been quietly creeping higher in the past month. The chart on the following page shows the sharp but steady increase in global soybean supplies over the past few years. The world is amply supplied with soybeans, regardless of one

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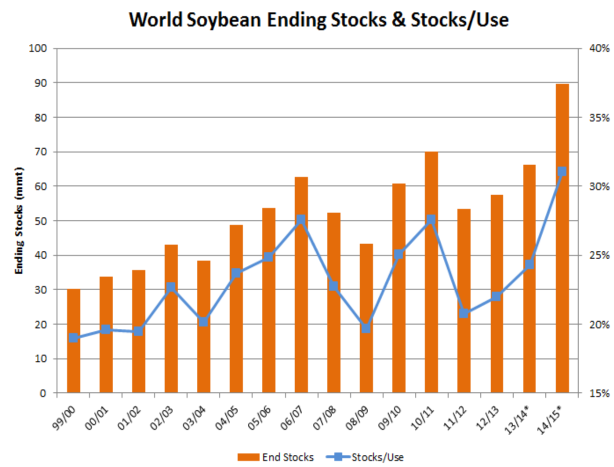
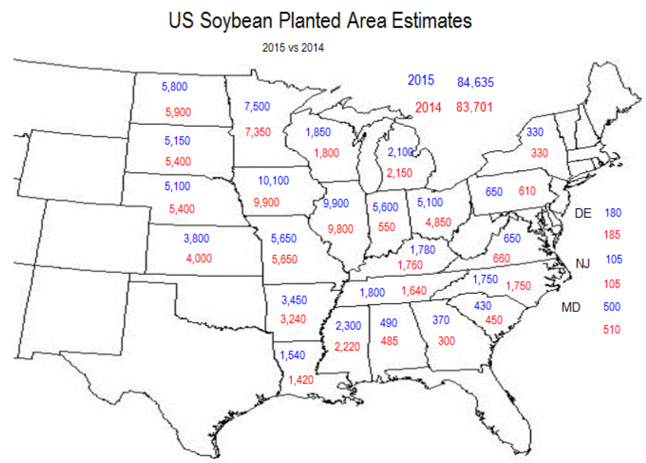
individual USDA report showing slightly smaller US stocks than expected.

Of course, one problem with viewing the total world soybean stocks is that a large percentage of Argentine supplies are essentially off the market as farmers hoard soybeans in an effort to hedge against inflation and, in general, government policy. However, it has been our view for some time now that an eventual devaluation of the Argentine peso is inevitable and probable around the time a new administration (post-Fernandez) takes the reigns late this year. A recent USDA attache report seemingly agrees with this assessment noting *"the market anticipates farmers unloading large amounts of soybeans in December 2015—January 2016, which would coincide and compete with US soybean exports."* The attache report goes further noting the Argentine *"stocks bubble will begin to break due to a conflation of factors: currency devaluation pressure, farmer indebtedness, and a surging industry demand. Producers, crushers, and the government can only play the game of chicken so long before someone will have to cave."* Again, this matches our long-held belief that these Argentine supplies must eventually make their way to the market. It now seems like a bullseye is drawn on late 2015 and/or early 2016 for this possible development.

Considering all of the above, and combined with solid prospects for US production in 2015, one really has no choice but to remain long-term negative to soybean prices. New crop futures especially have significant downside if our views of Argentine stocks sales are eventually realized. Also, it is important to keep in mind that expectations for US soybean production in 2015 could actually increase from current levels. The initial USDA acreage projection for soybeans, at 84.6 million acres, is likely to turn out to be too small. Seed companies report excellent soybean seed sales (at the expense of corn) and initial wet weather in the southern US this spring is likely to switch some corn intentions to soybeans. It appears that it will take significant adverse weather in summer 2015 to derail the bear case in soybeans.



Global inventories are swelling due to significant increases in production while Chinese soybean demand growth begins to plateau.



The initial USDA soybean area projections appear to be a little "light". I am expecting the June Acreage report to show additional soybean acres.

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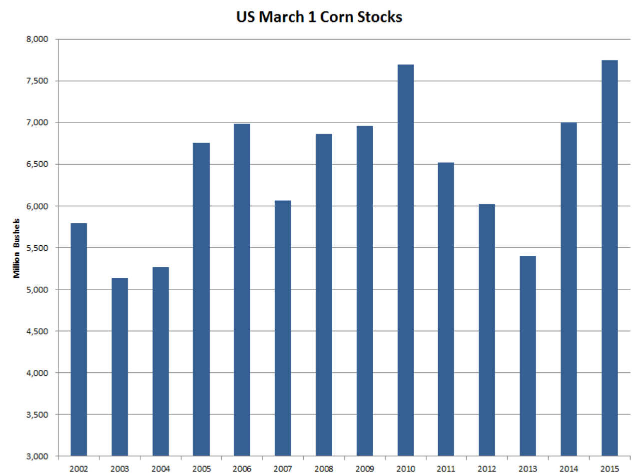
The USDA stocks report last week held a major surprise for the corn market as well. In this case, March 1 corn stocks were much larger than anticipated. At 7,745 million bushels, US March 1 corn supplies are the largest since 1987. The general market's bias was to own corn vs. short positions in both soybeans and wheat. This trade has been viciously unwound since the report was released and some analysts are now pushing their old crop corn carryout back closer to 2 billion bushels.

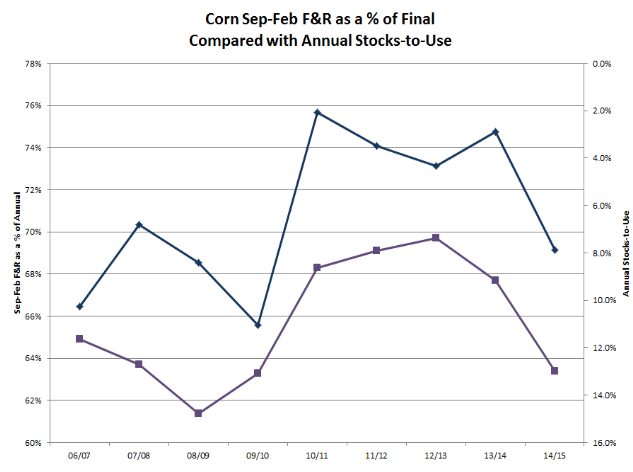
I feel the sudden pessimism surrounding the old crop corn balance sheet is possibly a bit overdone. There is a sudden shift now to cut the feed/residual component of the balance sheet aggressively, but I'm not sure if WASDE will be as aggressive initially as most private analysts. Note the graphic to the right. This shows Sep-Feb corn feed/residual use as a percentage of the annual figure. In the case of 14/15, I am still using the latest WASDE figure of 5,300 million bushels, though they will probably post a slight revision lower in their next update. I've plotted this against the annual ending stocks-to-use ratio, and again I'm using the latest WASDE projections for the 14/15 figure. Note the stocks-to-use ratio axis is inverted to better show the relationship here.

In the past few years, we've seen a higher percentage of feed/residual accounted for in the first half of the marketing year. As shown in the graphic, this coincides with relatively "tight" corn supplies during the same period. Obviously corn supplies are far from tight this year, which might coincided with a more even distribution of feed/residual disappearance during the course of the marketing year.

For this reason, I'm hesitant to become overly negative to old crop corn prices due to the perception of a looser balance sheet, but as noted in last month's update, corn futures are not bullish without a summer 2015 weather problem in the US. Simply put, I will remain neutral to corn futures for the near term until a new supply or demand catalyst changes the environment.



US March 1 corn inventories are the largest since 1987.



Aggressive cuts to feed/residual projections based on the March 1 stocks report might be a bit premature if quarterly disappearance turns out to be more evenly distributed this year.

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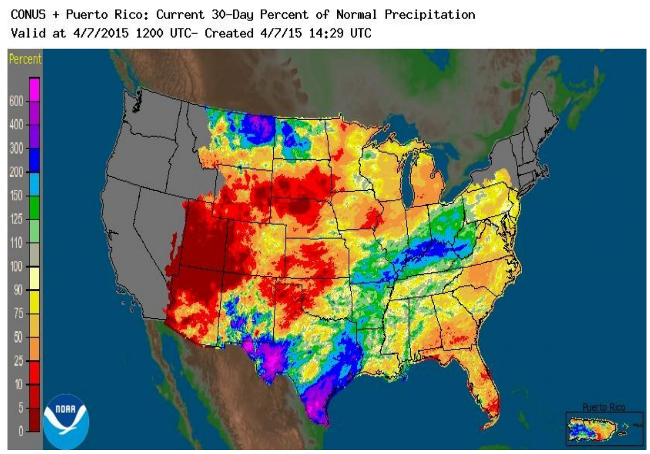
Looking briefly at wheat, I have a neutral bias for the moment. The Southern Plains have been dry during the winter, which has caused deterioration of wheat conditions over the past month. That said, the weather pattern appears to be changing to an environment that would produce better chances for moisture. This will be watched closely over the coming weeks, but if weather does improve, wheat futures will struggle mightily as US prices are already well above current international levels.



NWS precipitation analysis shows a big portion of HRW country receiving only meager rainfall amounts during the past 30 days.

Cattle futures over the past month have worked off their oversold nature and now appear to be in a position to sell again. Typically, the cash market seasonally peaks around this time every year. Beef prices remain firm, but this is largely due to packer kill reductions due to especially poor margins. Though cattle and beef supplies appear tight, it looks like cattle futures could become a bit wobbly in the near term if the cash market does indeed start to stall out.

Regards,
David Zelinski

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