Opus LLC FUTURES

September 2012 Month End Comments

Our long-held bullish soybean and corn positions were punished this month. There are several different reasons for the decline in prices, here are just a few:

- Harvest progress kicked into high gear over the past few weeks. Producers have been aggressive selling their crops, as elevators and other commercial firms have created several incentives to move the grain quickly. In addition to the strong incentives offered, producers also understand they run a risk when storing corn infected with alfatoxin (a fungus that can cause damage to the crop, normally more prevalent in years with high temperatures), and this created another incentive for aggressive producer sales. The producers essentially have no reason to store their crop this year (in addition to the incentives, the market is also inverted which should entice up-front sales), and this cash market selling pressure really weighed on basis levels and strongly affected the futures markets. *Thought – the pressure created by this heavy selling should be short-term in nature. It will also be interesting to watch how the market handles alfatoxin-infected corn. There are strict requirements on how much alfatoxin corn is allowed in livestock feeding, with the requirements on dairy the toughest. This could negatively influence ethanol production margins, because while alfatoxin is fine in ethanol production, the by-products must be very closely monitored for their alfatoxin levels and may not be suitable for livestock feed.*
- Anecdotal yield reports, most notably in the case of soybeans, have been coming in better than expected. This was surprising to me, as my crop trip earlier this summer really painted a negative picture of soybean yield potential. However, the Corn Belt has received rainfall since my trip, and it certainly is possible the crop will yield better than the data from my trip would suggest. *Thought – It does look like soybean yields could indeed turn out better than the USDA (and I) expected. It is important to note that some of the better yields we are hearing right now are the areas that were treated best in terms of precipitation this summer, and as such should be doing better than the overall crop.*
- The market was just completely "over-bought". Funds had continued to pile into the market, but the combination of lower cash markets and reports of better than expected yields created speculative fund liquidation that began to feed on itself. The late-comers to the bull market have been abused.

So, with all of that being said, what does this mean to our overall long-term thoughts on corn and soybean prices going forward? In the case of both corn and soybeans, the livestock industries still appear to be slow to ration demand. We see the carcass weights of cattle, hogs, and poultry continue to exceed expectations, and this implies continued strong feed demand. The lower prices we've seen this month will do little to slow down that feed consumption.

Export demand is a different story. While US corn supplies remain tight, international supplies are ample. South America had very strong production this past season, and their prices are aggressive undercutting US demand. EU importers have also been able to take advantage of ample Ukrainian supplies of late as well. That said, I do expect US corn export demand to improve a little in the months ahead. Wheat prices have rallied lately (more on that in a second) and the available supply of competing inventory is slowly but surely being cleaned up. Soybean export demand remains stellar. The USDA's export projection of 1,055 million bushels is comically too low.

I remain cautiously bullish on both corn and soybean prices over the coming weeks/months. In the case of corn we are long the market but we are spreading this with a short position in wheat. As noted above, the wheat market, due to slowing export supplies out of the FSU region, has essentially priced itself out as a feedgrain. This will leave world feed importers to rely more heavily on corn, which should bring the price spread between the two

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commodities closer together. I also note that winter wheat planting here in the US is going pretty well in most parts of the country, and with an average winter wheat crop supplies will be ample.

I remain bullish on soybeans as well, but I admit my top-end price projections must be moved lower. In addition to the better than expected yields, data now points to the fact that we will actually have larger than previously expected soybean acreage this year, which will also add to production. On top of this, the USDA has raised their estimate for 2011 soybean production by roughly 38 million bushels in their Quarterly Stocks report. We are now looking at an overall supply of soybeans that could be 150-200 million bushels larger than we were anticipating just one month ago, which is a huge swing. However, the USDA has lulled the market somewhat by using comically low demand estimates in their balance sheets. This newly found supply will easily be sucked up by the "real" market demand that the USDA had previously discounted. The end result is that the balance sheet will be basically unchanged. In addition, we also need to keep in mind that this demand on US soybeans is still expected to be very front-end loaded, meaning the next 6 months will see extremely aggressive US soybean demand. That will make for interesting logistical constraints that the market will have to deal with. While I don't believe soybeans need to make a run much further than the previous highs near $18, I do strongly feel they are grossly underpriced at current levels.

Though the grain markets have been my primary focus over the past several years, with prices already at very high levels, I am looking towards other markets for better risk/reward opportunities. I believe the livestock markets offer some interesting prospects in the months ahead, as these markets have to deal with the effects of these high feed prices.

I am long term bullish on feeder cattle prices. The cattle industry is now working on its second consecutive year of liquidation following drought conditions. In 2011, the southern plains experienced significant drought, leading to calf herd liquidations in/around that area. This was partially offset then by operations further to the north, but now in 2012 the drought has spread to Nebraska and surrounding areas and the nation-wide calf herd is shrinking further.

The wild card on feeder cattle prices remains corn, because if corn prices move dramatically higher again demand for feeders will remain somewhat subdued. That said, I do feel strongly that the corn market will have trouble near/over $8/bu (and that is a key reason I am short wheat against corn) and additionally, even with higher corn prices the supply of feeders in the months ahead will be very limited. I feel that the spring contracts could potentially take a run at their contract highs and perhaps the summer months could push further higher.

In the short term, I am also leaning friendly toward fed cattle. Fed cattle prices have sold off sharply in the latest week, and I feel this sell-off is a bit overdone. The latest Cattle on Feed report from the USDA confirmed early 2013 fed cattle supplies will be tight, and as such I do expect fed cattle prices to bounce in the short term. I do think there is a limit to how high fed cattle prices can go, as domestic beef demand has been slowing at these beef prices. I do not anticipate this being a long-held position, but rather one that will be short-term in nature to take advantage of movements in the cash markets.

While September's performance has clearly been a disappointment, I remain very confident and excited about our direction going forward.

Regards,
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