

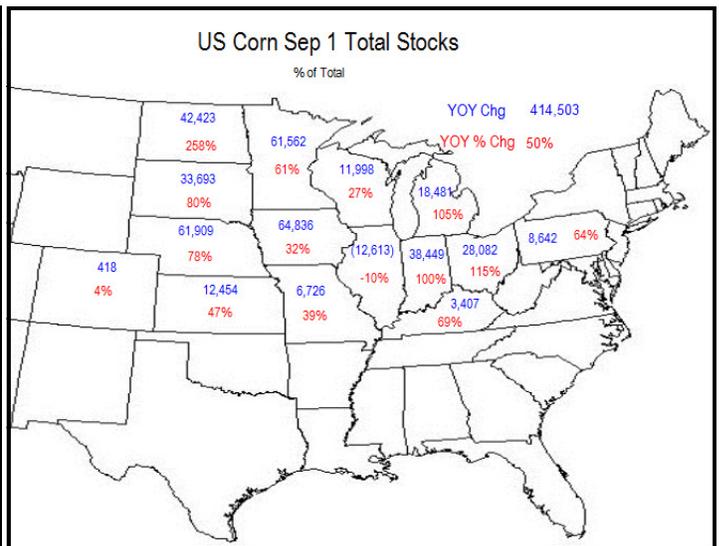
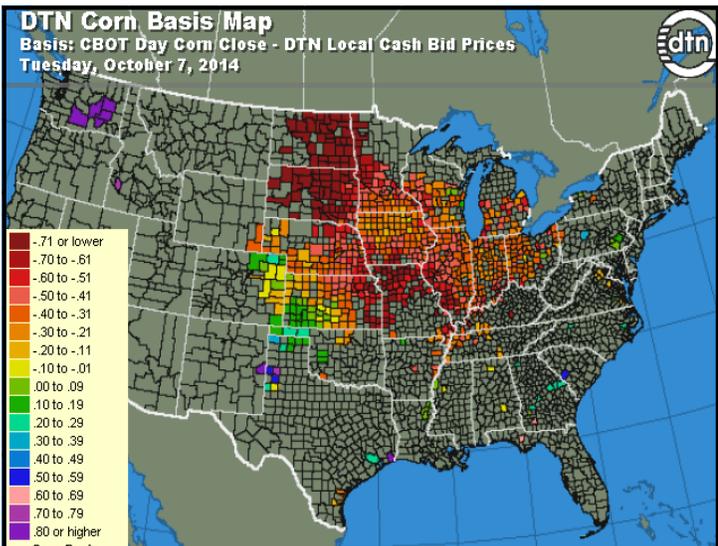
October 6, 2014

Monthly Agriculture Market Notes:

A lot has happened in the past month, but very little has changed in terms of our overall thoughts on market direction over the medium to long term. Over the past few weeks, the corn and soybean harvest has begun, although progress for now is moving a bit more slowly than average. This is due to a relatively mild summer that has not “pushed” crops toward maturity as well as late-spring planting in some areas of the country. Early yield reports sound very strong, which has been expected. It is worth noting, however, that the early yield reports we’ve seen to this point are coming primarily out of what should be the best area in the country this year. Yield reports have turned a bit more variable as harvest progress has spread further west. If you’ve read prior monthly commentaries, you know that I am not as optimistic towards corn and soybean yields as many other observers. I still expect the crops this year to be records, but I’m just not as convinced as some others that the records will be smashed in such a convincing manner as some suspect. That being said, whether I’m right or wrong on the yield this will not matter a great deal to my long term market thoughts.

My primary focus for now remains a play on 2015 acreage prospects. Yes, Spring 2015 is a long way off, but the considerations that will shape the eventual acreage mix are just now starting to come in to focus. I remain of the opinion that the market will have to react relatively soon in an effort to prevent significant acreage losses in corn, if they can even be prevented at all.

In fact I do think a loss in corn acreage in 2015 is completely unavoidable. At this point in time, in my opinion, it is only just a matter of how much corn acreage is lost. To illustrate my point, I will focus my attention primarily on the Northern Plains states of North Dakota and South Dakota. I want to first point out information contained in the NASS 9/30 Quarterly Stocks report. Shown to the bottom right is a map showing state-level changes in Sep 1 corn stocks through key Corn Belt states. It also shows the percentage change from last year’s ending stocks levels. Note the huge increases in corn inventories in the northwestern Corn Belt. Some of the ECB states posted a higher percentage increase, but keep in mind these ECB states were hit harder from the 2012 drought and had a little more ground to make up. The bottom line is, corn inventories in the northwestern Corn Belt are swelling into what should



be a record harvest. It is no wonder that basis levels in the northwestern Corn Belt are among the worst in the country. A recent map showing the national basis levels is also attached on the bottom of the previous page.

Another way of looking at this significant increase in corn supplies in the northwestern Corn Belt is shown below. The following table takes a “what-if” look at ending stocks by state with some assumptions on the 14/15 season. The first assumption is to take the NASS Sept production estimate for each state, though many would argue these estimates are too low. The second assumption is to assume equal demand in each state for 14/15 as what was seen in the 13/14 season. This assumption makes sense considering WASDE, and a lot of private analysts, are assuming total US corn demand to be relatively flat YOY.

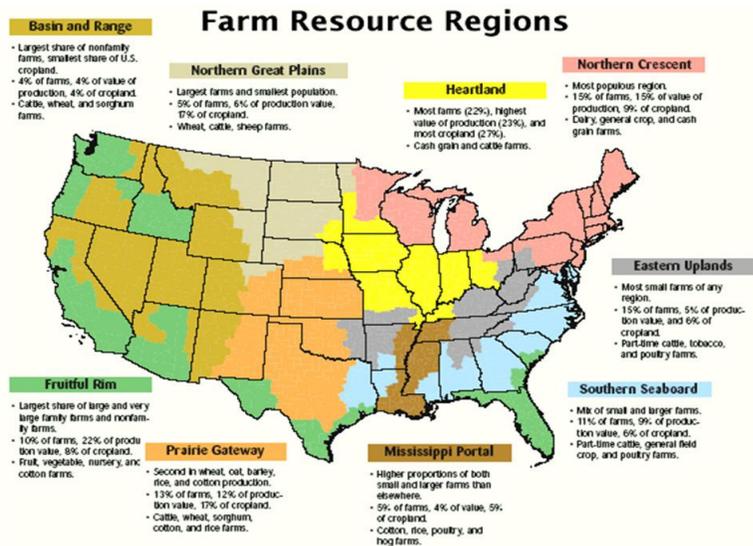
	2013 Sep 1 Stocks	2013 Production	13/14 Total Supply	2014 Sep 1 Stocks	Implied Disappearance	Implied Stocks/Use	2014 Production ?	14/15 Total Supply?	Assumed Equal Demand	Assumed Stocks	Assumed S/U
Eastern Corn Belt											
IL	127,555	2,100,400	2,227,955	114,942	2,113,013	5.40%	2,289,200	2,404,142	2,113,013	291,129	13.80%
IN	38,632	1,035,450	1,074,082	77,081	997,001	7.70%	1,076,400	1,153,481	997,001	156,480	15.70%
KY	4,947	243,100	248,047	8,354	239,693	3.50%	214,600	222,954	239,693	-16,739	-7.00%
MI	17,640	348,750	366,390	36,121	330,269	10.90%	362,880	399,001	330,269	68,732	20.80%
OH	24,365	661,980	686,345	52,447	633,898	8.30%	622,920	675,367	633,898	41,469	6.50%
Western Corn Belt											
IA	203,627	2,161,500	2,365,127	268,463	2,096,664	12.80%	2,442,000	2,710,463	2,096,664	613,799	29.30%
MN	101,165	1,304,000	1,405,165	162,727	1,242,438	13.10%	1,360,000	1,522,727	1,242,438	280,289	22.60%
MO	17,227	435,200	452,427	23,953	428,474	5.60%	562,770	586,723	428,474	158,249	36.90%
NE	79,386	1,623,500	1,702,886	141,295	1,561,591	9.00%	1,566,250	1,707,545	1,561,591	145,954	9.30%
WI	43,901	445,300	489,201	55,899	433,302	12.90%	510,300	566,199	433,302	132,897	30.70%
Northern Plains											
ND	16,447	396,000	412,447	58,870	353,577	16.60%	376,200	435,070	353,577	81,493	23.00%
SD	42,203	808,680	850,883	75,896	774,987	9.80%	814,000	889,896	774,987	114,909	14.80%

*Sep NASS

**WASDE total demand 14/15 13,605
13/14 total demand 13,600

The point here is to illustrate that corn inventories in ND and SD, along with a few other western Corn Belt states, are expected to continue to swell under current baseline production and demand assumptions. This would mean that there would be no relief to the current basis pressure the region is seeing, and in fact it would likely get worse.

Obviously this raises interesting questions about what to think about *next* year. The USDA’s ERS has some pretty useful information on cost of production by region that is helpful for these purposes. Note the map here showing the ERS’s regional breakdown. Going forward I’ll be looking at the “Northern Great Plains” region as shown on the map. I understand





that a key portion of South Dakota’s production is not included in this region (the southeastern corner of the state), but I’m merely trying to illustrate the overall situation for the entire area here. Shown below is a breakdown of the ERS’s estimates on cost of production and returns per planted acre (excluding government payments) for this region. Their data obviously ends with 2013, but you’ll see I have added a column (highlighted in orange) for 2014. I have kept all of the cost of production estimates unchanged and have highlighted my assumptions on yield and price in yellow near the bottom. Obviously there will be some hedges and forward contracts in place that will mean not all bushels will receive this price level, but again, keep in mind this is for illustrative purposes to show what the current state of affairs in this region is today with current prices.

The key value to look at is the calculation for “value of production less operating costs”. The implication shown here is we are getting towards levels, at current prices, where the farmer cannot cover his cost of production. With inventories in this region expected to build further in the 14/15 marketing year, as shown above, the prices farmers in this region are going to get aren’t likely to get much better.

This clearly doesn’t bode well for corn area in this region for 2015. In fact we already saw a slight decline in corn area in this region in 2014 with the math on corn looking a bit less friendly. Now the math on corn looks downright negative.

For comparison, on the following page, I have also performed the same sort of look on cost of production on soybeans for this region. The same format applies. I kept production costs unchanged and used my own estimates for yield and price. The key thing to note on this chart is that soybeans remain well above operating costs.

Corn production costs and returns per planted acre, excluding Government payments, Northern Great Plains, 2010-2013 1/					
Item	2010	2011	2012	2013	2014
dollars per planted acre					
Gross value of production					
Primary product: Corn grain	574.56	655.69	706.20	530.70	337.50
Secondary product: Corn silage	1.18	1.87	0.89	0.81	0.81
Total, gross value of production	575.74	657.56	707.09	531.51	338.31
Operating costs:					
Seed	80.03	82.83	90.16	95.76	95.76
Fertilizer 2/	94.88	124.68	132.39	129.82	129.82
Chemicals	18.34	18.34	19.27	20.01	20.01
Custom operations 3/	16.16	16.46	16.79	17.45	17.45
Fuel, lube, and electricity	26.75	32.62	31.76	32.47	32.47
Repairs	26.86	27.69	28.52	28.80	28.80
Purchased irrigation water	0.75	0.76	0.78	0.81	0.81
Interest on operating capital	0.26	0.15	0.21	0.14	0.14
Total, operating costs	264.03	303.53	319.88	325.26	325.26
Allocated overhead:					
Hired labor	3.17	3.20	3.35	3.41	3.41
Opportunity cost of unpaid labor	26.59	26.87	28.09	28.63	28.63
Capital recovery of machinery and equipment	95.85	101.68	106.77	109.82	109.82
Opportunity cost of land (rental rate)	75.46	82.12	92.48	100.61	100.61
Taxes and insurance	8.85	9.31	9.50	9.59	9.59
General farm overhead	18.08	18.64	19.20	19.39	19.39
Total, allocated overhead	228.00	241.82	259.39	271.45	271.45
Total, costs listed	492.03	545.35	579.27	596.71	596.71
Value of production less total costs listed	83.71	112.21	127.82	-65.20	-258.40
Value of production less operating costs	311.71	354.03	387.21	206.25	13.05
Supporting information:					
Yield (bushels per planted acre)	144	119	110	122	150
Price (dollars per bushel at harvest)	3.99	5.51	6.42	4.35	2.25
Enterprise size (planted acres) 1/	390	390	390	390	390
Production practices: 1/					
Irrigated (percent)	19	19	19	19	19
Dryland (percent)	81	81	81	81	81

1/ Developed from survey base year, 2010.

2/ Cost of commercial fertilizers, soil conditioners, and manure.

3/ Cost of custom operations, technical services, and commercial drying.

Source: Compiled by ERS using Agricultural Resource Management Survey data and other sources.

Clearly the simple math shown here would seem to imply that soybeans will be greatly favored in this area for 2015. In addition to competition from soybeans, corn will also compete with small grains (such as oats, barley, etc) for acreage in this region.

This region of the country, which appears burdened with surplus corn supplies, will be interesting to keep an eye on. When the market starts to consider 2015 acreage projections, it'll be interesting to see where the early guesses are drawn.

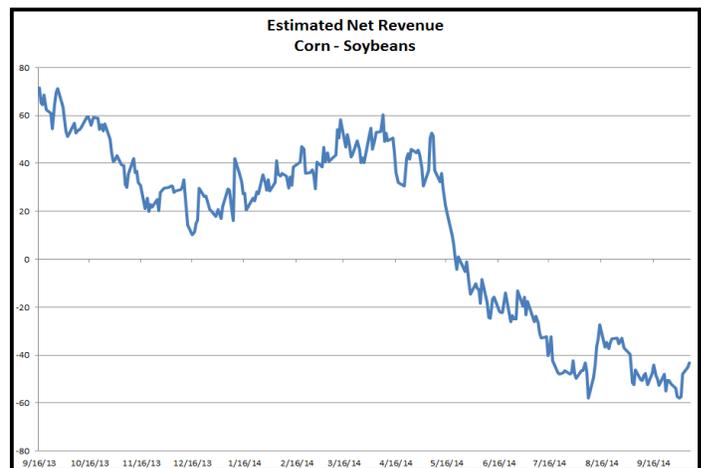
Another way of looking at the relative "worth" of corn area vs. soybeans is shown in the chart below. I included this chart in last month's update, but the data is current through the time of writing. The chart estimates net revenue of corn vs. soybeans with certain assumptions on yield, basis, and cost of production. The relative "value" of corn has bounced a little vs. soybeans over the past few sessions, but to even consider that corn has a chance of maintaining this year's current acreage, you'd probably want to see that figure near the even level. That is a long way to go.

The discussion above shows that key production states of ND/SD are likely to lose major corn area in 2015 as burdensome local supplies weigh on basis and push corn's gross revenue near or below cost of production. The chart to the right indicates that corn acres might be tough to justify on a national level as well. So the obvious question is, why does it matter? What difference does it make if we lose corn area in 2015 if one of the main reasons why we lose this area is due to over-supply in the first place? The hopeful answers to that question are shown on the balance sheet on the following page.

Soybean production costs and returns per planted acre, excluding Government payments, Northern Great Plains, 2012-2013 1/

Item	2012	2013	2014
dollars per planted acre			
Gross value of production			
Primary product: Soybeans	519.48	421.43	340.00
Total, gross value of production	519.48	421.43	340.00
Operating costs:			
Seed	54.63	57.52	57.52
Fertilizer 2/	20.07	19.68	19.68
Chemicals	16.07	16.69	16.69
Custom operations	8.37	8.70	8.70
Fuel, lube, and electricity	18.37	18.37	18.37
Repairs	26.94	27.21	27.21
Purchased irrigation water	0.00	0.00	0.00
Interest on operating capital	0.09	0.07	0.07
Total, operating costs	144.57	148.24	148.24
Allocated overhead:			
Hired labor	2.23	2.27	2.27
Opportunity cost of unpaid labor	14.45	14.73	14.73
Capital recovery of machinery and equipment	103.16	106.10	106.10
Opportunity cost of land (rental rate)	88.47	96.25	96.25
Taxes and insurance	8.82	8.90	8.90
General farm overhead	14.19	14.33	14.33
Total, allocated overhead	231.31	242.58	242.58
Total costs listed	375.88	390.82	390.82
Value of production less total costs listed	143.60	30.61	-50.82
Value of production less operating costs	374.91	273.19	191.76
Supporting information:			
Yield (bushels per planted acre)	37	33	40
Price (dollars per bushel at harvest)	14.04	12.73	8.50
Enterprise size (planted acres) 1/	511	511	511
Production practices: 1/			
Irrigated (percent)	2	2	2
Dryland (percent)	98	98	98

1/ Developed from survey base year, 2012.
 2/ Commercial fertilizer, soil conditioners, and manure.
 Source: Compiled by ERS using Agricultural Resource Management Survey data and other sources.





The balance sheet below shows how the 15/16 balance sheet might look with a significant loss in acreage next year. That being said, one thing you'll probably instantly notice is my production estimate for 14/15 is lower than consensus. I still suspect the market has become a bit carried away with production expectations for this year's crop. Again, I base that on my own observations from my annual crop trip and various yield models that have served me well over the years. Might this year's "outlier" crop make those models and the crop trip analysis different this year? Yes, that is a possibility and certainly one I've considered extensively.

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

	USDA 11/12	USDA 12/13	USDA 13/14 Sep	Opus 13/14	USDA 14/15 Sep	Opus 14/15	Opus 15/16
Planted Acres	91.9	97.2	95.4	95.4	91.6	91.0	87.5
Harvested Acres	84.0	87.4	87.7	87.7	83.8	83.5	80.5
Abandoned Acres	7.9	9.8	7.7	7.7	7.8	7.5	7.0
Yield	147.2	123.4	158.8	158.8	171.7	171.0	163.0
Carryin (Sep 1)	1,128	989	821	821	1,181	1,236	1,900
Production	12,360	10,780	13,925	13,925	14,395	14,279	13,122
Imports	29	162	35	36	30	30	12
Total Supply	13,517	11,932	14,781	14,782	15,607	15,545	15,033
Feed and Residual							
Total Feed and Residual	4,548	4,335	5,175	5,102	5,325	5,350	5,400
Food, Seed, and Industrial							
Corn for Ethanol Fuel	5,011	4,648	5,125	5,147	5,125	5,150	5,150
Other FSI	1,426	1,396	1,375	1,380	1,405	1,395	1,325
Total FSI	6,437	6,044	6,500	6,527	6,530	6,545	6,475
Total Domestic Use	10,985	10,379	1,675	11,629	11,855	11,895	11,875
Exports (Census)	1,543	731	1,925	1,917	1,750	1,750	2,000
Total Use	12,528	11,111	13,600	13,546	13,605	13,645	13,875
Carryout (Aug 31)	989	821	1,181	1,236	2,002	1,900	1,158
Stocks/Use	7.9%	7.4%	8.7%	9.1%	14.7%	13.9%	8.3%

One last thing to consider for the corn balance sheet above. It isn't just the US that is looking at corn prices and costs of production. Corn area around the world is likely to shrink and inputs into corn production are likely to be scaled back. Beyond the harvest of this year's record US crop, 2015 corn production is likely to be in retreat around the world. This could put further pressure on US supplies in terms of export demand, perhaps more than what is shown above.

At this point it probably sounds like I am *bullish* corn, but the truth is, I'm really not. I just believe further downside to corn prices from current levels is fairly limited. On the other hand, I suspect there remains significant downside in soybean prices. I have attached current balance sheet thoughts for soybeans on the following page. My production estimate for this year's soybean crop, as in the case of corn, is below consensus...but not as dramatically. You can see the prospects for higher soybean area in the US next year and what that does to the soybean balance sheet and carryout.



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

	USDA 11/12	USDA 12/13	USDA 13/14 Sep	Opus 13/14	USDA 14/15 Sep	Opus 14/15	Opus 15/16
Planted Acres	75.0	77.2	76.5	76.8	84.8	84.8	87.5
Harvested Acres	73.8	76.2	75.9	76.3	84.1	84.1	86.5
Abandoned Acres	1.2	1.0	0.6	0.5	0.8	0.7	1.0
Yield	41.9	39.8	43.3	44.0	46.6	47.0	45.0
Carryin (Sep 1)	215	169	141	141	130	92	453
Production	3,094	3,034	3,289	3,358	3,913	3,953	3,893
Imports	16	36	80	71	15	15	10
Total Supply	3,325	3,239	3,509	3,570	4,058	4,060	4,356
Crush	1,703	1,689	1,730	1,734	1,770	1,800	1,800
Exports (Census)	1,360	1,320	1,645	1,647	1,700	1,700	1,700
Seed	90	89	99	98	92	102	90
Residual	2	1	(94)	(1)	22	5	20
Total Use	3,155	3,098	3,379	3,478	3,583	3,607	3,610
Carryout (Aug 31)	169	141	130	92	475	453	746
Stocks/Use	5.4%	4.6%	3.8%	2.6%	13.3%	12.6%	20.7%

The obvious implication here is that either corn prices “should” work harder to secure additional acres in 2015 or soybeans should work to lessen the expected increase in acreage in 2015. As noted above, I’m not convinced there is much corn prices can do to prevent a decline in acreage in the Northern Plains. That area’s infrastructure/logistics is just not equipped to handle the current corn supply. With that in mind, I think it is a foregone conclusion that soybean area will gain in 2015 at the expense of corn. Right now it is only a matter of how much.

I will maintain my position in long December 2015 corn contracts while short November 2015 soybean contracts. I think we are in the very early stages of the market’s acceptance of this reality.

Respectfully,
David Zelinski
Opus Futures, LLC

Disclaimer:

The information contained herein has been taken from trade and statistical services and other sources we believe are reliable. Opinions expressed reflect judgments at this date and are subject to change without notice. Opus Futures, LLC does not guarantee that such information is accurate or complete and it should not be relied upon as such.

There is risk of loss in trading futures and options and it is not suitable for all investors. PAST RESULTS ARE NOT NECESSARILY INDICATIVE OF FUTURE RETURNS. This document contains only commentary on economic, political, or market conditions and is not intended to be the basis for a decision to enter into any derivatives transaction. The contents of this commentary are for informational purposes only and under no circumstances should they be construed as an offer to sell or a solicitation to buy or sell any futures or options contract. This material cannot be copied, reproduced, modified, or redistributed without the written consent of Opus Futures, LLC. No one has been authorized to distribute this for sale.