July 2013 Month End Comments

The corn crop critical month of July is now behind us, and in most cases weather was very favorable. The vast majority of the country has enjoyed relatively cool conditions so far this summer, and while precipitation has averaged below normal in most parts of the Corn Belt, the cooler than usual temps go a long way in offsetting this below average rainfall.

Corn crop prospects are extremely favorable. In addition to strong prospects in the key producing region of the Corn Belt, it appears that crops in the southern half of the US could be record setting. These areas have seen better than normal rainfall in many instances, and here temperatures have mostly been cooler than normal as well. This is a perfect recipe for a strong corn crop.

All of that being said, the corn crop is not yet “made.” There are still several question marks as to how much the excessive spring rainfall could ultimately drag down yields in Iowa and Minnesota. Additionally, while research shows temperatures are ultimately more important than precipitation, the lower than normal precipitation for some key areas is reason for a bit of caution towards corn yields. Finally, the crop was planted late meaning it is at risk for an early frost and loss of yield.

The same arguments can be applied to soybeans as well. August weather is typically the most important for soybean yields, so the next few weeks will be very important to determining yield potential. So far the crop has been treated fairly well, but we would prefer to see some improvement in rainfall in key Corn Belt areas. The crop was planted very late, so that makes the concern regarding frost damage more of a factor here than with corn.

It is generally my practice to assume “normal” weather beyond the next two weeks in trying to determine price direction going forward. Under that assumption, it looks like crop conditions should be strongly favorable to produce a corn yield in excess of 160 bpa, and a soybeans yield near or above 44 bpa could be in the works. In this environment, grain and oilseed prices look very negative for the medium to long term.

I will be taking my annual crop trip later this month and this will give us a good look at actual corn and soybean yield prospects. Most traders and analysts don’t bother with taking a trip, instead relying on crop condition ratings from the USDA and other private analyst guesses on crop production. This trip has consistently given me the ability to out-guess the market in most cases in the past several years. I will give a general rundown of my findings in a special update later this month.

While crop weather has certainly been the most important price-determining factor I’ve been following over the past month, there have been some interesting developments in the cash market that are worth pointing out here. Old/new spreads have collapsed in the past month as producers finally saw prices/ inverses at attractive enough levels to sell a good portion of their remaining old crop inventory. Additionally, with new crop harvest quickly approaching (some corn harvest is already taking place in LA/AR/TX), end-users can see a light at the end of the tunnel; for them, it has been a very tough few years due to extremely high grain prices following poor production. This quick and violent unwind of old/new spreads coupled with outright liquidation in old crop positions has put additional downside pressure on grain markets in the past month. I look for this to continue into August as new crop harvest picks up steam in the southern US and producers sell aggressively to take advantage of what little inverse is left.

I continue to expect downside in grain and oilseed prices in the short, medium, and long term. For now the weather forecast looks favorable enough to continue to provide favorable conditions for most crop areas. Production of both corn and soybeans will recover significantly from last year's drought-reduced levels, and with a smaller demand base balance sheets look likely to recover from tight supplies to more than ample. I think most analysts and traders are underestimating downside potential for both corn and soybeans. For starters, I believe crop production potential is greater than most probably feel, but additionally one has to realize that the investment world is no longer viewing the commodity markets in such a favorable light and I expect outflows from the traditional long-only commodity investment vehicles. More importantly, the high price environment of the past few years has spurred investment in production around the world, and the world has responded with very strong grain and oilseed production. The US has greater competition in the export arena for corn and soybeans than ever before. This will be another complicating factor for US grain/oilseed demand.

I have liquidated short wheat positions during the past month. Non-traditional demand for US wheat from China and Brazil is offsetting the fact that there isn't much demand for US wheat from traditional customers such as Egypt. US wheat export demand is looking a bit stronger than I originally anticipated, making the balance sheet turn a bit tighter for the medium term. I don't view wheat as a "bullish" market like many other traders and analysts might, but at the very least it is less bearish than corn and soybeans…so I won't focus much attention there.

I remain conservatively long the cattle market. I still hold my long February 2014 cattle positions I noted in last month's report. These haven't moved much in the past month, as the market has been stuck in a relatively narrow trading range. Strong levels of heavy-weight cattle placements are weighing on the front end of the market temporarily, but I still view the market as potentially explosive in the long run.

Note that most cows are typically bred during the April/May timeframe, meaning we should "know" at this point whether or not we're looking at significant heifer retention starting this year or if it will be delayed (at least) another year. In my opinion, an analysis of the data would imply that significant heifer retention has NOT been seen this year. Cow slaughter is running relatively in-line with year ago levels, and one would think this figure would have worked lower if there had been any decent retention of heifers. The percentage of heifers on feed combined with the heavy placement weights is another factor that implies that ranchers who had intended to keep heifers for retention once again threw in the towel and sent them to the feedlots for the usual reasons. This should set up for a significant bull run in cattle futures for 2014…if not sooner.

One factor to keep in mind is that the cow slaughter has been a big mitigating factor in alleviating some of the tighter fed cattle supplies in the past year or longer. Cow slaughter will NOT be able to continue at this pace, however. Dairy cow herds have been culled to near bare minimum levels, and additionally this liquidation of cows has improved the age and efficiency of the herds. The beef market is not overly strong at

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the moment either, another factor that discourages cow culling.

I strongly believe there is a big move coming in the cattle market in the long term. Heifer retention and herd rebuilding is at least a two-year process, meaning once the bull market in cattle resumes, it might be here to stay a while. I am currently long a small position at the moment, and will look for opportunities to get larger in the near future.

Regards,
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