June 2013 Month End Comments

During May, the market was very concerned over the pace of planting for both corn and soybeans. As June progressed, drier and warmer weather prevailed in most areas of the country and the crops were eventually planted. There is certainly an argument to be made that not all of the intended acreage was planted, but at this point in the summer that doesn't really matter. The only thing that matters going forward is the weather and how the crop is treated by Mother Nature.

To that point, the month of June provided corn and soybean crops with near ideal weather conditions. Aside from northeastern IA and southeastern MN where conditions were too wet and crop conditions suffered, timely rainfall and mild temperatures have encouraged plant growth. After a slow start, the crops are getting "caught-up" and it finally feels and looks like summer around the Corn Belt.

Corn and soybean production prospects look very strong, although we certainly need weather to cooperate going forward. Temperatures in the last week of July and the first week of August will be especially important to the corn crop as that is likely to be the peak of pollination. Currently, the corn plant is determining the size of the ear; specifically, the plant is determining how many rows of grain its ear will have. This is obviously an important step in the corn yield process, and most of the crop is being treated very well during this process. Poor weather going forward will reduce yield potential of course, but for now things are progressing well.

It should be noted, however, that soybean production has greater uncertainty. The soybean crop generally depends on favorable weather conditions in the first few weeks of August to achieve maximum yield potential. With the delayed planting, that timeframe is likely pushed back a few weeks. That could mean cooler temps as we approach fall, but it might also mean drier conditions. There is also the threat of early freezes in northern portions of the country that might diminish yield potential as the crop was planted so late. This is allowing new crop soybeans to keep a bit more risk premium in their prices than new crop corn futures, which have steadily eroded over the past several weeks.

With all of that in mind, the corn and soybean markets are stuck in a middle-ground of sorts, waiting to see how yield potential and final production shape up this year. New crop values are likely to trend lower if weather remains cooperative.

Wheat prices have followed corn values lower over the past month, which has proven beneficial to our positions. However, there have been some significant changes to the supply and demand landscape that makes me pause and consider what might lie ahead for wheat values. The US winter wheat harvest continues to move along, with yield reports continuing to beat expectations. That said, there is some concern that harvested area might be lower than initially expected and this could actually limit wheat production potential relative to current expectations. Additionally, the lower prices have stirred heavy buying interest from Chinese end users who are looking for quality wheat to blend with their low-quality harvest this year. The wheat purchases from the Chinese are not entirely unexpected, but the market is now attempting to gauge

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just how low it should allow wheat prices to move in the short term as production remains unclear and demand is starting to push higher. Interestingly, outside of improved Chinese (SRW) and Brazilian (HRW) export demand, US export prospects don't look especially bright. Black Sea production has improved this year and offers for export from this destination are sharply undercutting US wheat values currently. Even with the Chinese import demand, I suspect the USDA forecast for 975 million bushels of 13/14 wheat export might be a bit optimistic.

After significant downside moves during the month of June and uncertain production prospects, I am somewhat expecting the markets to "take a breather" in the short term. In the longer term, I remain bearish to corn, soybean, and wheat markets overall. However, I think the markets have done their job to the downside for now. With that in mind, I have lightened my downside exposure to the markets for the short term. For now, I cannot determine how long the "short term" might be.

Instead, I have established a spread position of long corn vs. short wheat. I expect this spread to narrow as the wheat demand tables still greatly depend on feed demand. Without especially strong feed demand, the wheat balance sheet becomes much looser than currently expected - even with thoughts of "strong" export demand because of China. I believe that unless this CU-WU spread narrows from current levels (at the time of writing the spread is roughly 135 cents), feed demand for wheat will decline.

Admittedly, there are some complicating factors in my analysis of that spread. For starters, it remains uncertain how much wheat the Chinese might buy. I am currently penciling in Chinese imports of US SRW at around 4 mmt, and if that is the case I don't expect them to make many more big "splashes" with major purchase announcements in the short term. However, if my assumption on their demand proves to be light, I will have to reevaluate my position here. Additionally, the basis on wheat vs. corn in key feeding areas is a significant factor to consider. It is possible that the CU-WU futures spread may not need to move as greatly as I suspect if spread between the cash grains (and basis) moves independently and allows wheat to move into feed channels at a greater rate than I am currently anticipating. These factors, along with ongoing wheat harvest results, will be closely monitored in the days and weeks ahead to determine the appropriateness of this spread.

I have re-entered the livestock market, but this time I am taking a long position. It is my belief that cattle futures are close to making a bottom, though I admit that the heavy-weight placements could provide a bit more pressure on the nearby August live cattle futures contract. I have established long positions in the February 2014 contract and will be looking to add to this position in the near future. What the cattle market seemed to forget so far in 2013 is that before the cattle futures could turn bullish (based on drought-reduced herds), the market first had to turn bearish as the herd was liquidated. We were able to take advantage of the downtrend in futures prices earlier this year and now we are looking for price appreciation into 2014.

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The "flood" of liquidated cattle is mostly over at this point. Our projections are for cattle placements to decline dramatically in the months ahead. This, combined with likely smaller cow kills, will lead to greater competition amongst packers for the available cattle supply and higher prices. The cow kill has been elevated for some time now and the cow herd is relatively "clean" at the moment. The dairy cow herd has become younger and more efficient as a result of this cow liquidation, and with the prospects for lower grain prices ahead the industry won't be looking to cull cows at such a rate. So, with a smaller fed cattle supply and less cows available for slaughter, the cattle industry will struggle with supply in the long term. I believe the "real" bull market in cattle prices is now set to begin.

Regards,
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