October 2013 Month End Comments

October was a volatile month in the grain and livestock markets. The government shutdown virtually eliminated a large portion of the market data provided by the USDA for both grains and livestock, meaning trade was somewhat “blind” to things going on in cash markets and in exports. In this environment, the futures market was confused and price direction was very choppy. The first half of the month went back and forth for our positions. It wasn’t until late in the month, after the government shutdown ended, that the markets started acting as we suspected they should.

In the grain markets, the supply side of the equation continues to look bearish. The anecdotal yield reports we receive on both corn and soybeans remain very impressive. Although our crop trip showed that the market was grossly understating production potential early in the summer, it now appears that our own numbers might even have been a bit too conservative. It seems most believe the national average corn yield could approach 160 bpa and the national average soybean yield could approach 43 bpa, despite the dry weather seen this summer.

However, the other side of the price discovery equation, demand, is looking equally impressive. During the government shutdown, US exporters were very busy making sales of corn, soybeans, and soymeal. None of this was getting reported in a timely fashion due to the USDA closure. This sparked somewhat panicked buying as the market was unsure exactly how much was being sold. Now that the export sales have finally been reported, the market has calmed down a little. However, current export commitments are near record large. Demand projections are being raised almost as quickly as production expectations. Despite the expectations for overall larger supply due to better than expected yields, many suspect ending stocks projections might be little changed due to the higher demand base. This has created a tug-o-war between the bears and the bulls. As noted last month and below, I clearly fall into the bear camp.

I liquidated the long position in live cattle futures early in the month. I thought the market had become overbought and the premium of deferred futures over the nearby cash market had worked too wide. I was dead wrong, and the market continued to march higher. Prices have corrected a little to close the month, but I still feel some regret for covering that position too early.

I continue to expect downside in corn and soybean prices through the short and long term. The corn market has become very quiet. On one hand you have ample supplies and on the other hand you have farmers that aren’t willing sellers. This is creating a disconnect between the nearby cash market and the futures board. The spec community is already short corn in size, leaving the farmer as the only “natural” seller of corn left. With lots of on-farm storage, the farmer won’t be quick to sell. That said, my suspicion is that this creates some short-term opportunities in basis and spreads, but that the overall price direction will remain a slow grind lower.

The spec community overall remains bullish of soybeans, but I am taking the other side. Export commitments are exceptionally large, but I argue that supply will be ample enough to handle this demand (assuming USDA doesn’t surprise with a low production figure in their Nov. 8 Crop Production report). It is also worth noting that the bulk of the large soybean export sales announcements have already been made, so these sales reports are likely going to slow going forward. The Chinese buyers have been especially aggressive in their purchasing, aided by very favorable crush margins. However, these crush margins are not likely to stick around long with an armada of soybean cargoes headed their way in Nov/Dec. Additionally, South American

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production prospects, though still early, look exceptional and this should entice world end users to delay additional purchases. Assuming no surprise in production, I suspect the top end of the soybean price range has been established in the short term. In the medium term, there could be some price upside potential if/when specs blow out of their long positions. Assuming “normal” South American weather and a “normal” spring in the US, long-term soybean price prospects look much lower than present.

I have reinstated my short position in wheat. Due to the smaller than expected quarterly stocks figure in late September, I believe the market is overstating feed & residual use in their balance sheets. This likely won’t be “corrected” until the next stocks report in January, but in the meantime this could be a good opportunity to catch the market leaning too heavily on demand. Additionally, export demand is starting to look suspect. With the large bean and corn export programs, it’s no surprise to see wheat shipments slow down. That said, the slowdown seems a bit extreme relative to the pace needed to match current projections, and new sales commitments are running a bit slow right now as well. Overall, I think wheat ending stocks estimates should be getting larger, while most others are shrinking their projections. This position might take a bit of patience, but we have time. It also doesn’t hurt that US new crop winter wheat is being planted and emerging in the best conditions it has seen in years.

I am not interested in owning live cattle at this time, but will be monitoring the situation closely. I have instead turned my attention to hogs. I won’t compound the error in liquidating the long cattle position by chasing it here. I’ll simply watch and re-enter if I feel an appropriate situation arises. I am closely watching the hog market here. Prices have rallied aggressively due to concerns surrounding the PED (porcine epidemic diarrhea) virus. The PED situation is certainly problematic and will take the top-end off production potential. However, the lower corn prices and high current hog prices are creating an environment that encourages exceptional production levels. Hog producers have ever incentive to produce at maximum capacity. In the meantime, the rally in pork prices has pushed pork outside of the retail features. I suspect pork demand will disappoint in the weeks and months ahead and the market will be forced to re-price lower.

Thank you,
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