September 2013 Month End Comments

The month of September turned into a very favorable one for our positions. We were short corn and soybeans for a good portion of the month while being long cattle. All of these positions worked to our benefit. Starting by looking at the grain markets, corn and soybean futures stumbled through the month of September for a number of different reasons. Primarily, early harvest reports have been circulating and these reports have indicated better than expected yields for corn while somewhat more "mixed" results for soybeans. The strong corn yield reports pushed corn prices close to YTD lows as the market had previously been pricing in worse yields. If you recall from my commentary last month, based on our crop trip experience we had a good inclination that yields were likely to outperform, but even our estimates might end up proving too low.

As noted, the soybean yields have come in a bit more "mixed," with some reports of better than expected yields and others looking less rosy. However, the market has pessimistically priced in a lower than USDA-estimated yield and production level in my opinion. Based on my estimated yield range potential for soybeans (as noted in last month's commentary, I believe there is a very high probability the yield will come in between 41-42 bpa), I believed the market was "offsides" on its ideas for soybean production potential and established short positions in the second half of the month. As additional yield reports rolled in, the market started to leak lower as yield ideas started to turn higher. Finally, on the last day of the month, the USDA reported a quarterly stocks figure in soybeans that was sharply higher than the market anticipated, causing additional downside pressure to prices.

Our position in the livestock market was successful last month as well. We have been long December and February live cattle, and both contracts move steadily higher during the past month. This was in part due to the USDA's Cattle on Feed report showing fewer cattle on feed placements last month, which fits our view on longer-term supply issues. Additionally, the end of Zilmax feeding went into effect around the middle of the month. The initial results show a pretty dramatic drop in cattle carcass weights following its removal. Admittedly, we aren't exactly sure yet if this might be a one-time situation, but our view is that the removal of Zilmax will certainly result in a decline in beef production…at a time when cattle supplies are already turning tighter.

I continue to expect downside in corn and soybean prices through the short and long term. The call on corn is much easier to make. Corn yields are, simply put, fantastic. This originally took several in the market by surprise but now others have come around to our line of thinking. The speculative community seems to be in agreement that corn values are headed lower in the long term, which actually will make the trade a bit more difficult. It will likely be a long and slow drag lower, as the specs have already shorted the market heavily. Additionally, commercial end users are scaling-in to hedges and cash purchases as prices move lower. The corn supply "pipeline" was very tight, and this early new crop harvest will be met with aggressive demand. Over the long term, however, corn supplies are ample and the US still faces heavy competition in the export arena. Corn prices are heading lower and perhaps could hit the $3 level in the not too distant future.

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From what I can tell, the market remains mostly bullish to soybeans, making my bearish stance look contrarian. I am perfectly happy to be in that position, and to be quite honest part of my bearish stance is based on the fact that the market remains overly subscribed to long soybean positions. I think production could surprise to the upside, and even if production turns out to be similar to the latest USDA estimate, the spec longs are "all dressed up with nowhere to go." Yes the initial export program for new crop soybeans will be large, but by our calculations Chinese buying interest is likely to wane in coming months as they seem to be mostly covered through at least the end of the year. The focus will quickly shift to South American production prospects, and those prospects look good for soybean production right now as we are expecting a large shift in acreage away from corn to more soybeans. Soybean production could be strongly higher than last year, which would dramatically hurt US soybean demand prospects for the second half of this marketing season and into next year.

I remain friendly to cattle futures as well. USDA data is expected to show further declines in feedlot placements in the coming months. This is expected to lead to a shortage of available cattle into 2014 and beyond. On top of that, the lack of Zilmax feeding will mean smaller average carcass weights. Some will argue that this decline in carcass weights in small, and it might turn out to be, but we simply don't know how big an impact it will make and it certainly doesn't help in light of the smaller feedlot placements. Finally, expect 2014 to be the year that true heifer retention begins in earnest. With cheaper feedgrain prices and better pasture conditions thanks to an improved weather pattern in the Plains, heifers will be retained for breeding rather than put on feed for slaughter. This, on top of the already light feedlot placements, will keep slaughter-ready cattle supplies tight in 2014. It also isn't a quick turnaround for herd replenishment. Cattle have a roughly 9 month gestation period and calves aren't weaned from their mothers for another 6-9 months. On top of that they'll spend, on average, another 180 days in a feedlot (in this case maybe longer as I would suspect these new calves will be placed on feed at relatively light weights). The bottom line here is that if we are looking at the start of significant heifer retention, which I believe we probably are, then it will be another 2+ years before these new calves are ready for slaughter. In the meantime, cattle supplies will be tight and the market will be moving higher. A complicating factor is that chicken and pork production have already started to expand, which will mean stiffer competition vs. beef prices. This possibly put a cap on cattle prices at some point, but I don't think we're even close to that level yet.

Thank you,
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