March 7, 2015

Agriculture Market Highlights:

We're two months in to 2016, yet to begin March we're basically sitting at the same level as we saw to start the year. It has been a quiet, choppy, and frustrating start to 2016. Unfortunately, I'm not sure if this is set to change soon. I envision continued choppy and sideways price action potentially for another 3-5 weeks ahead.

To be clear, the fundamental data as we know it today without question points towards the direction of lower prices. The US corn export program never really got off the ground and with Argentina's new crop harvest beginning, US demand prospects are unlikely to improve. The US soybean export program is winding down with the world's demand focused on new crop supplies from Brazil and Argentina. US domestic demand of both soybeans and corn is steady at best. Globally, all major production regions are coming off strong crop levels and supplies are abundant. US domestic farmers have taken note, or perhaps more importantly their bankers have. As such, physical grain movement in the US has accelerated in the past few weeks.

So with all of the above in mind, why is the price outlook so uncertain? The primary culprit in this price confusion is the looming beginning of the US planting and growing season. The futures board typically assigns a level of "weather premium" in prices heading into the growing season, consider this an above-market price level just to factor in weather risk in the months ahead. This is normal and reasonable of course, but the matter seems more complicated than usual this year. For starters, its been a long time since not only US but global cash markets have been so well-supplied with product at this time of year (for example, combined South American production soybean production is likely a record). The *global* cash markets see selling pressure from producers on bounces, which allows risk premium to become under-valued at times. On the other side of the coin, it seems forecasters that are rarely certain of a forecast for ***next week*** seem to be ***locked-in*** on this summer producing a challenging situation for crops in the US. This is leading to optimism among farmers and spec traders alike that a rally could lie ahead if and when these forecasted problems develop.

Essentially, we're nearing a fork in the road ahead and just about everyone knows it. Until we get into the US planting season, neither bull or bear is going to feel especially comfortable pressing his or her bias in the market. If planting season is wet or we see delayed planting for any other reason, prices will rally. Whether or not this rally would be sustained would depend on weather later in the summer, of course. If planting progresses smoothly, which it seems few are expecting at this point, the market would eliminate a good percentage of the above mentioned "risk premium" to prices and would trade sharply lower. Bears wouldn't yet be safe in that scenario, however, as summer weather could still create complications for crops. Still, the weather during planting season, specifically in Apr/May, will be the next major catalyst that will spark trade in corn and soybeans outside of the recent range-bound levels we've seen since fall last year. Unfortunately, while we can see this fork in the road ahead, we're not quite there yet and must try to wait out the nearby choppiness we're likely to endure.

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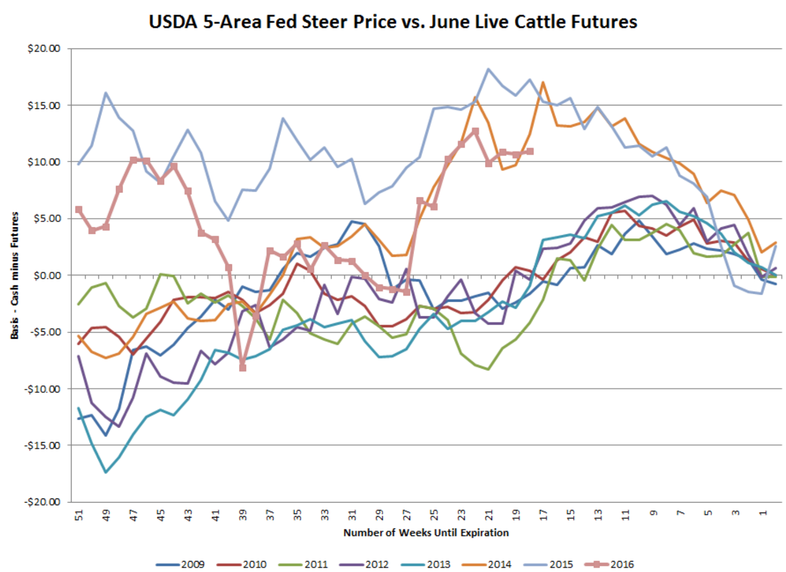
We do have a small position in livestock currently, so let me explain the reasoning there. The points behind owning cattle at the moment breakdown as following:

1. Strong kill rates relative to the level of placements over the past 2-3 months (if not longer).
2. Poor winter weather conditions through major feedlot areas this winter have kept placements behind schedule, meaning backing up fed cattle supplies until later in the year.
3. The poor winter weather conditions have also contributed to keeping cattle on feed a bit longer than would normally be the case.

This all breaks down into a pretty favorable position for both the April and June live cattle contracts in my opinion. Weather conditions have improved of late in the Plains, so placements are likely to pick up a little but this will likely not have an influence on fed supplies until later in the summer or even this fall. It seems possible we could be looking at our tightest supply of fed cattle late spring and early summer, which also corresponds with the potential for seasonal beef demand.

I've placed our positions in the June contract, despite the fact that the April contract might have more upside. The reasoning is shown in the chart here, showing a history of basis levels vs. the June contract. This chart shows cash prices minus the June contract going back several years. As you can see, we're looking at a historically wide basis (cash minus futures) right now. Even if I were to turn out to be wrong on cash cattle trade, the June contract is still sitting at a very wide discount to cash. This spread will converge eventually, and I believe cash cattle will be strong enough that June futures have to rally to make that convergence happen. Even if cash isn't strong, June futures shouldn't need to weaken as greatly as it is already sitting at this sharp discount.



Respectfully,
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