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April 19, 2015

**Agriculture Market Highlights:**

A lot has changed in just the past two weeks and thus I thought it necessary to send a mid-month update to explain the changes in our thought process. First note that we've exited our positions in live cattle. The positions were modestly positive in total, but recent losses have cut our performance there since the beginning of April. It appears live cattle futures are returning to their highly volatile and unpredictable ways, and that is not a market I want anything to do with at the moment.

Our attention is singularly focused on the grain and oilseed markets. Over the past several months I have pointed out my expectations for lower prices, and obviously the recent rally in soybean prices has taken me by surprise. While I was initially reluctant to "believe in" the price strength, deep analysis into long term supply and demand projections has made me change my tune. I am cautiously friendly to soybean and soymeal prices at present, and I believe corn could follow these markets higher in the months ahead. Soyoil had become the leader of the soy complex, but I believe that role will eventually shift to meal and as such I believe "oilshare" will weaken over the long term. I am presently agnostic towards wheat prices.

These are very dramatic and somewhat sudden changes in my sentiment. Obviously the unexpected price strength has played a role in this shift in sentiment, but there has been a major change in fundamental data during this period as well. Simply put, South American soybean crops have been considerably reduced relative to our expectations at this point last month.

Early this month Conab, Brazil's equivalent to the USDA, released a soybean production estimate of 98.9 mmt. This is considerably smaller than their prior 101.2 mmt and certainly smaller than what the market had been anticipating. We knew there had been various problems with Brazil's growing season, but up to this point we were of the belief that the crop had managed to handle the adversity well enough to post solid yields. Upon closer inspection of the Conab 98.9 mmt production estimate, I have found that I now believe *this* figure to still be optimistic. For example the state of Mato Grosso, the largest soybean producer in Brazil, is shown by Conab to have larger expected yields than local officials in Mato Grosso indicate. Additionally, the state of Rio Grande do Sul, the third largest producer, is experiencing heavy rainfall during harvest and this is likely leading to production losses in the state. My bias is towards an even smaller Brazilian production figure when all is said and done, perhaps something as small as 97-98 mmt which would essentially be equal to last year's production. Considering at this point last month we were expecting a Brazilian crop of 101-102 mmt, we've reduced soybean supply in our grids of at least 3-4 mmt here.

Turning our attention now to Argentine soybean production, throughout the growing season Argentina had received mostly very favorable weather. Expectations for yields and production were very high, and many (if not most) believed we were on pace to match or potentially exceed last year's record production. In the past few weeks, the weather conditions have shifted. Extremely heavy rains have pummeled the Argentine production regions just as harvest was starting to get underway. We've harvested an estimated 9 mmt of Argentine soybeans so far this year, which is 11 mmt less than we had harvested at this point last year. This will create delays to Argentine crushing and exports, potentially pushing some additional old crop export business (both beans and meal) to the US. More importantly, however, the excessive rains are likely leading to production losses. Right now it is very difficult to quantify losses, but a conservative estimate might be a 2 mmt decline in production relative to prior expectations. There are commercial contacts implying they believe the production losses will turn out even larger.

The bottom line is: we can *conservatively* state that South American production levels are off *at least* 5 mmt from what most were carrying in their supply/demand grids at this point last month. That would be the equivalent of almost 200 mil bu. That lost supply has to be made up somewhere, and in my opinion it will it will come out of the previously well-supplied US balance sheets. The rally we've seen in soybeans over the past few weeks is an acknowledgement that the 16/17 balance sheets are tightening and a "re-pricing" of summer weather-risk premium.

I have attached prospective US soybean balance sheets below. You'll first note I am assuming a slightly smaller old crop carryout than WASDE is currently projecting. I might be too conservative here if Argentine harvest remains badly delayed, as it could shift bean and meal export business to the US for Jul/Aug. In the new crop balance sheet, you 'll see I'm assuming a sharp increase in both US crush and exports. Remember that in addition to smaller than previously expected South American crops this year, next year's total soybean production in South America is likely to be greatly reduced. Argentine farmers have a huge incentive to shift to planting more corn vs. soybeans. For starters, Argentine farmers have been essentially all-soy in their "rotations" for the past few years, so switching to an *actual* rotation would likely benefit them in terms of farm/soil management. Additionally, the export tax on corn (and wheat) has been eliminated while the soybean export tax remains at 30%. This gives the Argentine farmer a price incentive to plant more corn as well.

US Soybean Supply and Demand (Million Bushels/Million Acres)

| | USDA 11/12 | USDA 12/13 | USDA 13/14 | USDA 14/15 | USDA 15/16 Apr | Opus 15/16 | USDA 16/17 | Opus 16/17 | Lower Yield |
|---|---|---|---|---|---|---|---|---|---|
| Planted Acres | 75.0 | 77.2 | 76.8 | 83.3 | 82.7 | 82.7 | 82.2 | 83.5 | 83.5 |
| Harvested Acres | 73.8 | 76.2 | 76.3 | 82.6 | 81.8 | 81.8 | 81.3 | 82.6 | 82.6 |
| Abandoned Acres | 1.2 | 1.0 | 0.5 | 0.7 | 0.9 | 0.9 | 0.9 | 0.9 | 0.9 |
| Yield | 41.9 | 39.8 | 44.0 | 47.5 | 48.0 | 48.0 | 46.7 | 46.1 | 44.0 |
| Carryin (Sep 1) | 215 | 169 | 141 | 92 | 191 | 191 | 445 | 428 | 428 |
| Production | 3,094 | 3,034 | 3,358 | 3,927 | 3,929 | 3,926 | 3,797 | 3,808 | 3,634 |
| Imports | 16 | 36 | 72 | 33 | 30 | 30 | 30 | 30 | 30 |
| **Total Supply** | 3,325 | 3,239 | 3,570 | 4,052 | 4,150 | 4,150 | 4,272 | 4,266 | 4,092 |
| Crush | 1,703 | 1,689 | 1,734 | 1,873 | 1,870 | 1,860 | 1,900 | 1,900 | 1,900 |
| Exports (Census) | 1,360 | 1,320 | 1,647 | 1,843 | 1,705 | 1,715 | 1,825 | 1,900 | 1,900 |
| Seed | 90 | 89 | 98 | 97 | 96 | 97 | 125 | 94 | 94 |
| Residual | 2 | 1 | 0 | 48 | 34 | 50 | 0 | 35 | 35 |
| **Total Use** | 3,155 | 3,098 | 3,478 | 3,861 | 3,705 | 3,722 | 3,850 | 3,929 | 3,929 |
| **Carryout (Aug 31)** | 169 | 141 | 92 | 191 | 445 | 428 | 422 | 336 | 163 |
| **Stocks/Use** | 5.4% | 4.6% | 2.6% | 4.9% | 12.0% | 11.5% | 11.0% | 8.6% | 4.2% |

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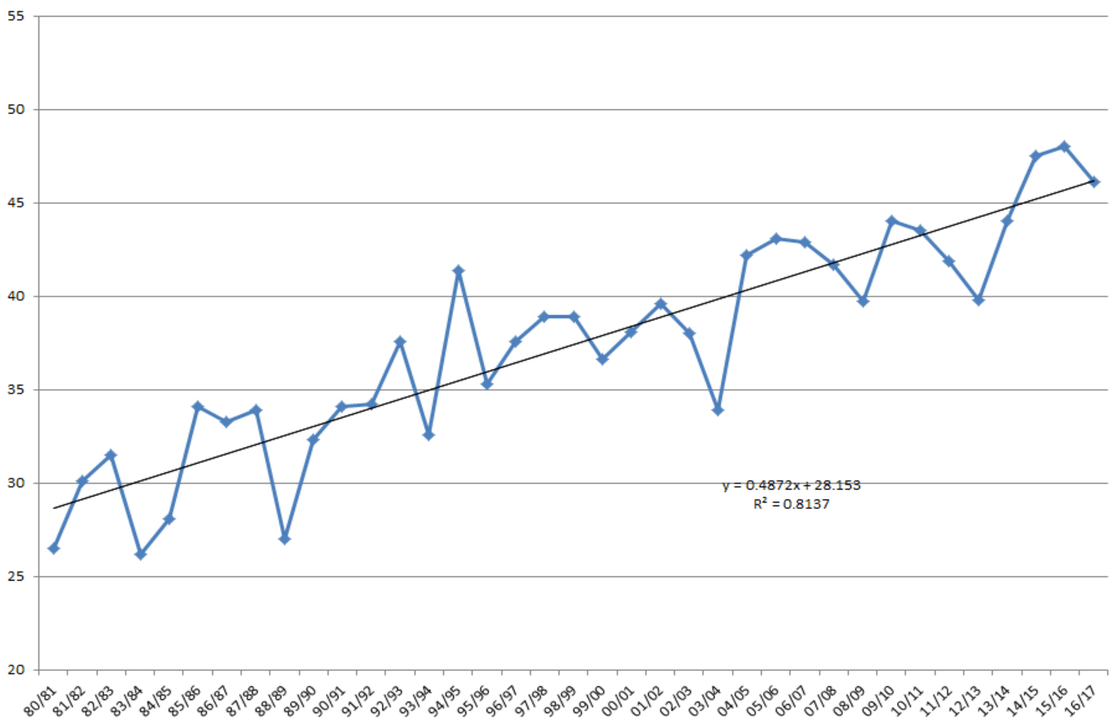
Note the column on the far right shaded in red. This shows what the balance sheet could look like with some weather adversity this summer along with my demand projections. This illustrates my point earlier that the soybean market has to "re-price" its summer risk premium to a more appropriate level. Keep in mind, a 44 bpa national soybean yield was considered very good until the past two years.

**US Soybean Yield History**




The baseline scenario, assuming a trendline yield, shown on the prior page is not necessarily strikingly bullish, but it might support the argument that the low prices we saw earlier this year might have set a multi-year bottom in place. A lot will still hinge on actual acreage (expected to be up from the March USDA figure, but how much?) and final yield.

Turning my attention briefly to corn, prices set new lows following the shockingly large March USDA planting intentions figure, but have since turned around and have steadily worked higher over the past several weeks. Again, I think you can link a majority of the price strength towards a resizing of South American production estimates and a re-pricing of summer risk premium.

South American production concerns come primarily out of Brazil. Brazil produces two crops of corn each year, a summer crop and a winter "safrinha" crop. Earlier this month Conab lowered their production estimate for the summer crop, which is currently being harvested. The crop is now off about 1 mmt from our prior expectations and off almost 3 mmt from last year (due mainly to smaller planted area). However, the summer crop in Brazil is of less importance to the global market than the safrinha crop, and that is where the

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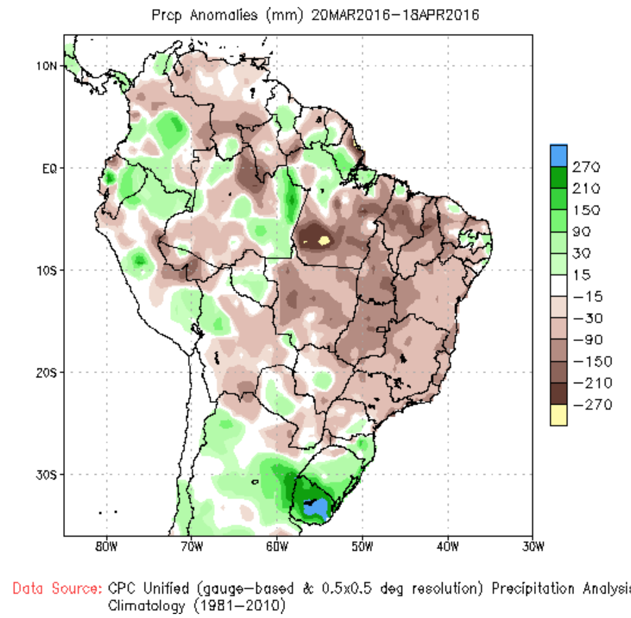
problems are truly developing. The map to the right shows the 30-day precipitation anomaly in South America. For starters, you can see the above mentioned excessively wet conditions in Argentina and southern Brazil. For corn, what matters here is the dry conditions shown in northern Brazil. The state of Mato Grosso accounts for almost 40% of the safrinha corn crop, and it has seen well below normal precipitation (and above normal temps) over the past month. The current forecast shows these conditions are likely to persist for the next two weeks as well. We are getting deeper into the year and this means, climatologically, we are getting into a drier and drier time period for this region. The longer we go without rain, the less likely it is that we'll get a crop-saving rain in this area. The market is slowly backing off its safrinha production estimates, but it will be a long way before we can truly quantify any production losses.




The world has become very accustomed to "cheap" Brazilian corn over the past few years, and it now appears that might be about to change. Brazil is highly unlikely to even come close to replicating its corn export program of the past year, and that will add corn export demand to the US balance sheets for the final parts of this year and especially for the 16/17 balance sheet. I have attached prospective figures below. Note that I am assuming a slightly higher export figure this year than WASDE. My export projection for next year is considerably larger than what was presented in the USDA Outlook Forum, but it accounts for far less Brazilian competition next year.

US Corn Supply and Demand (Million Bushels/Million Acres)

| | USDA 11/12 | USDA 12/13 | USDA 13/14 | USDA 14/15 | USDA 15/16 Apr | Opus 15/16 | USDA 16/17 | Opus 16/17 | Yield Reduction |
|---|---|---|---|---|---|---|---|---|---|
| Planted Acres | 91.9 | 97.2 | 95.4 | 90.6 | 88.0 | 88.0 | 93.6 | 92.5 | 92.5 |
| Harvested Acres | 84.0 | 87.4 | 87.7 | 83.1 | 80.7 | 80.7 | 85.9 | 84.8 | 84.8 |
| Abandoned Acres | 7.9 | 9.8 | 7.7 | 7.5 | 7.3 | 7.3 | 7.7 | 7.7 | 7.7 |
| Yield | 147.2 | 123.4 | 158.1 | 171.0 | 168.4 | 168.4 | 168.0 | 165.5 | 160.0 |
| Carryin (Sep 1) | 1,128 | 989 | 821 | 1,232 | 1,731 | 1,731 | 1,861 | 1,852 | 1,852 |
| Production | 12,360 | 10,780 | 13,829 | 14,216 | 13,601 | 13,601 | 14,431 | 14,034 | 13,568 |
| Imports | 29 | 162 | 36 | 32 | 50 | 50 | 40 | 50 | 50 |
| **Total Supply** | 13,517 | 11,932 | 14,686 | 15,479 | 15,382 | 15,382 | 16,332 | 15,936 | 15,470 |
| Feed and Residual | | | | | | | | | |
| Total Feed and Residual | 4,548 | 4,335 | 5,036 | 5,315 | 5,250 | 5,250 | 5,425 | 5,400 | 5,400 |
| Food, Seed, and Industrial | | | | | | | | | |
| Corn for Ethanol Fuel | 5,011 | 4,648 | 5,134 | 5,209 | 5,250 | 5,250 | 5,225 | 5,275 | 5,275 |
| Other FSI | 1,426 | 1,396 | 1,367 | 1,359 | 1,371 | 1,370 | 1,375 | 1,375 | 1,375 |
| Total FSI | 6,437 | 6,044 | 6,501 | 6,568 | 6,621 | 6,620 | 6,600 | 6,650 | 6,650 |
| Total Domestic Use | 10,985 | 10,379 | 11,537 | 11,883 | 11,871 | 11,870 | 12,025 | 12,050 | 12,050 |
| Exports (Census) | 1,543 | 731 | 1,917 | 1,864 | 1,650 | 1,660 | 1,700 | 1,946 | 1,946 |
| **Total Use** | 12,528 | 11,111 | 13,454 | 13,748 | 13,521 | 13,530 | 13,725 | 13,996 | 13,996 |
| **Carryout (Aug 31)** | 989 | 821 | 1,232 | 1,731 | 1,861 | 1,852 | 2,607 | 1,940 | 1,474 |
| **Stocks/Use** | 7.9% | 7.4% | 9.2% | 12.6% | 13.8% | 13.7% | 19.0% | 13.9% | 10.5% |

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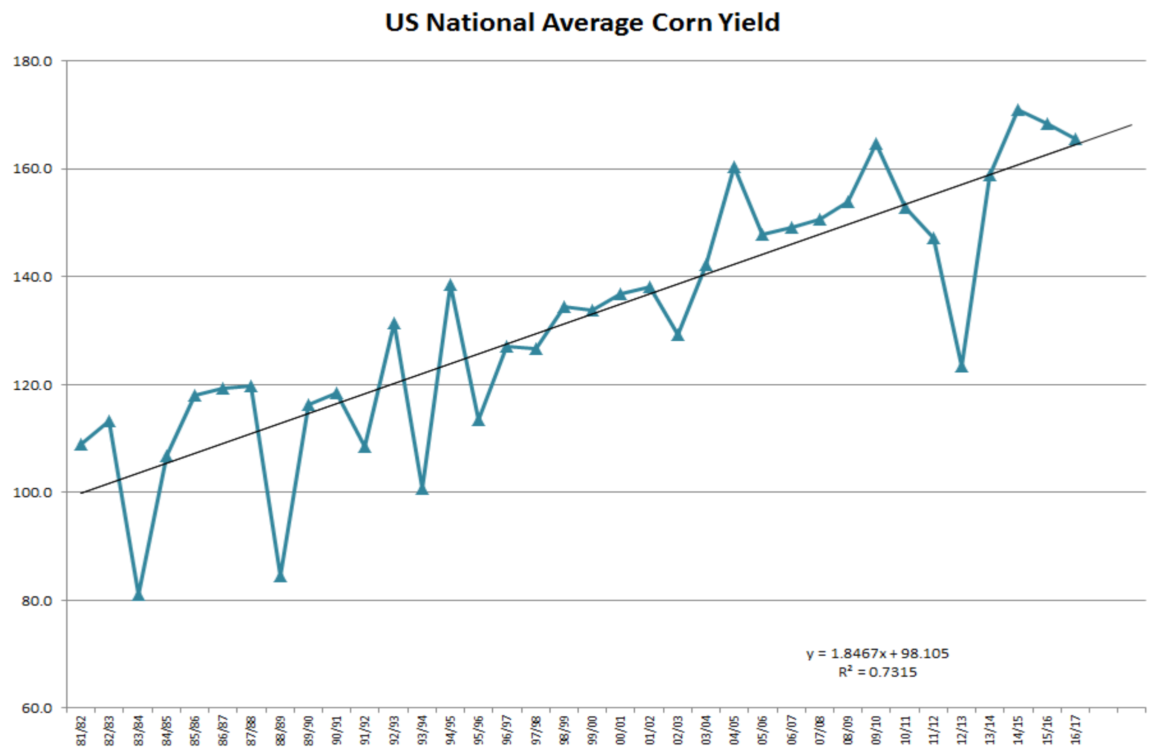
You'll note that my "baseline" scenario is hardly bullish. With a trendline yield (my trendline is lower than USDA) next year's carryout could exceed this year even with the sharp increase in demand. However, the recent rally is likely in response to the far-right column, which illustrates what *might* happen with a sub-par yield this summer. The market is repricing itself to account for this risk. Though a 160 bpa national average yield would certainly be far less than what we've seen in the past few years, it wouldn't look like a major outlier based on history.




To summarize...soybean prices might have put in a multi-year low near $8.50/bu earlier this year as South American production appears to have peaked and demand trends continue to look higher. Corn supplies might still look burdensome in the US this fall if weather cooperates this summer, but for now the market will maintain some risk premium to account for the "what-if" in weather forecasts.

Certainly soybean prices have already moved a long way in a short time frame. That <u>will</u> leave it vulnerable for corrections. Additionally, planting weather and conditions appear favorable for both corn and soybeans at the moment, so this might also apply some near term pressure on prices. Based on the above comments, it might sound like I believe this will be a "runaway" bull market, but that could not be further from the truth. In the end, corn and soybean prices will be ultimately determined by how they're treated by the weather this summer...and that is <u>always</u> the case. However prices were just too low heading into the summer after accounting for production losses in South America...and those production figures might be getting smaller still.

The bottom line here is that I find that I must have an upward bias to soybean and soymeal prices over the medium to long term. I believe the trend has shifted, and rather than selling beans/meal on rallies like we have done successfully over the past year we must now focus our attention to buying beans/meal on breaks. In the case of corn, I am also slightly constructive, as the spec community still appears largely offsides there heading into the critical summer months. That said, in the end I view corn as a likely follower of price action rather than a leader.

Please do not hesitate to reach out to me with any questions or comments.

Respectfully,

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