September 7, 2016

Agriculture Market Highlights:

It was another especially difficult month for our positions. The market's single focus remains on US crop productions prospects, while very impressive demand projections continue to be ignored. Our own personal trip around the Corn Belt did not overwhelm us in terms of crop yield potential. It seems the market has overshot on corn yield projections. Soybeans are notoriously difficult to predict and basing yield projections off an August crop trip is a good way to look foolish, but we can say definitively that pod/bean counts did not give us an indication that a massive new record yield is on tap. That said, we can't simply continue to ignore the market's insistence that the crop is indeed ~50bpa+, so we have adjusted our positions towards calendar spreads rather than being flat price long.

Oddly enough, as we have become bullish towards calendar spreads again it seems the overall market is taking the other side. There have been several articles written over the past week discussing a "shortage" of storage capacity for crops this fall, implying US farmers will have to "puke" and sell crops at prices much lower than they would otherwise hold out for. While I do think there will be some highly localized "distressed" sales of grains this fall, I think the hype surrounding these articles has largely been overdone. Additionally, this again seems to be an instance where the overall marketplace is forgetting about an impressive demand base going forward over the next 4-6 months (at least).

US Soybean Quarterly Supply and Demand

	06/07	07/08	08/09	09/10	10/11	11/12	12/13	13/14	14/15	15/16	16/17
Carryin (Sep 1)	449	574	205	138	151	215	169	141	92	191	199
Production	3,197	2,677	2,967	3,359	3,329	3,094	3,034	3,358	3,927	3,929	4,092
Sep-Nov Imports	2	2	3	3	4	3	4	7	8	6	7
Total Supply	3,648	3,252	3,175	3,500	3,484	3,311	3,207	3,506	4,027	4,127	4,298
Sep-Nov											
Crush	459	467	420	445	443	412	452	446	439	470	484
Exports	374	328	387	536	622	425	618	677	812	792	975
Seed	-	-	-	-	-	-	-		-	-	-
Residual	113	97	92	181	141	105	171	229	248	151	195
Total Use	946	892	899	1,162	1,206	942	1,241	1,352	1,499	1,413	1,654
Stocks (Dec 1)	2,701	2,360	2,275	2,339	2,278	2,370	1,966	2,154	2,528	2,715	2,644
Stocks/Use	286%	265%	253%	201%	189%	252%	158%	159%	169%	192%	160%
Needed Sales	495	316	691	1,021	1,051	724	1,068	1,204	1,400	1,222	1,455
Needed/Use	52%	35%	77%	88%	87%	77%	86%	89%	93%	86%	88%
Needed/Crop	15%	12%	23%	30%	32%	23%	35%	36%	36%	31%	36%

Shown above is an estimate of the 16/17 Q1 soybean balance sheet with recent history shown. It should first be noted I'm assuming a much smaller 16/17 carry-in than WASDE due to sharply stronger exports. Looking at Sept/Oct/Nov demand for 16/17, my crush projection only shows a modest YOY increase, but my export figure is sharply higher YOY. Remember that the "new crop" export program has essentially already started, however, starting basically in mid-July. There is no reason to believe monthly export shipments won't continue to trend upwards from here. As August shipments are likely to total 140-145 mil bu, I have plugged in September shipments of 155 and October and November go up from there. Also keep in mind that this pace of exports from the US would really just keep world exports roughly unchanged YOY due to a sharp reduction in Brazilian exports during this quarter (down roughly 4 mmt YOY).

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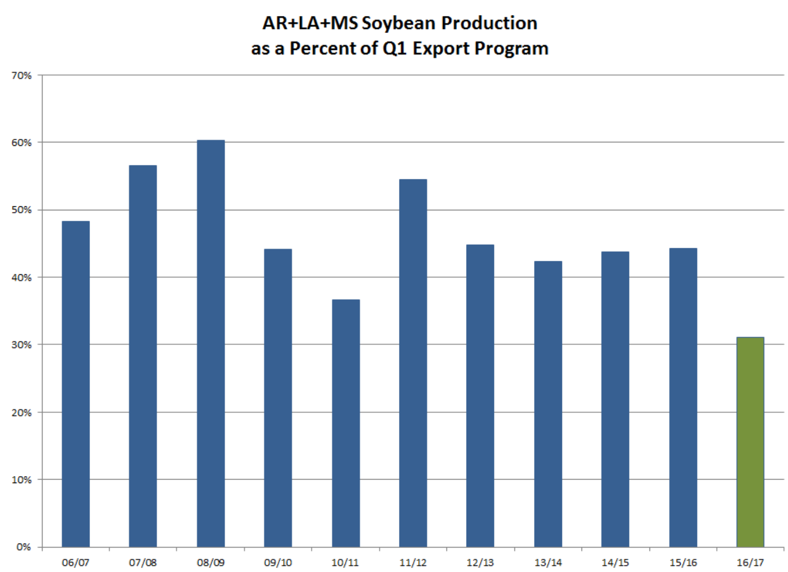
Add it all together and you've got the largest total Q1 demand base on the sheet. Then note the area shaded in pink at the bottom of the balance sheet. Of the total use in Q1, roughly 88% of this will need to be fulfilled by new crop production (the remainder, old crop carry-in). Of perhaps more interest, this means roughly 36% of the total crop needs to be brought to market *immediately* to fulfill this demand base. First, note that this assumes ProFarmer's 49.3 bpa yield projection (higher than the current USDA estimate). Second, note that this would correspond to levels that saw sharp rallies in both flat price and calendar spreads in previous years. Combine all of that with the fact that the Delta crop will make up a very small percentage of the Q1 export program, and the export market will be more reliant on "upstream" supplies and perhaps the delivery system.



To summarize, I feel that once the market finally trades its largest production/supply figure, focus will shift to an exceptionally strong demand base and this support flat price and spreads. My focus for now is spreads as it is still difficult to ascertain from what level flat price will find support.

Turning our attention now to corn, below is my Q1 16/17 corn balance sheet in the same format as the earlier soybean balance sheet. My old crop ending stocks figure is slightly larger than WASDE's estimate due to a slightly smaller export figure, but otherwise I have no major issues with WASDE's old crop projections. The biggest difference between my figures and the USDA here is my corn production estimate: I'm assuming a 171.5 bpa yield figure vs. the August NASS estimate of 175.1 bpa. This comes after our mid-August crop trip through key production states as well as extensive yield modeling for states where we could not travel. I feel

US Corn Quarterly Supply and Demand

	06/07	07/08	08/09	09/10	10/11	11/12	12/13	13/14	14/15	15/16	16/17
Carryin (Sep 1)	1,967	1,304	1,624	1,673	1,708	1,128	989	821	1,232	1,731	1,715
Production	10,531	13,038	12,092	13,092	12,447	12,360	10,780	13,829	14,215	13,601	14,852
Sep-Nov Imports	1	2	3	1	5	4	35	15	5	13	14
Total Supply	12,499	14,344	13,719	14,766	14,160	13,491	11,804	14,665	15,452	15,345	16,581
Sep-Nov											
Feed & Residual	2,159	2,387	1,978	2,017	2,069	1,825	2,082	2,312	2,226	2,172	2,310
Food/Seed/Ind	811	986	1,219	1,380	1,582	1,613	1,469	1,550	1,614	1,631	1,590
Exports	596	693	449	467	452	406	221	350	401	303	525
Total Use	3,567	4,066	3,647	3,864	4,103	3,844	3,771	4,212	4,241	4,106	4,425
Stocks (Dec 1)	8,933	10,278	10,072	10,902	10,057	9,647	8,033	10,453	11,211	11,238	12,156
Stocks/Use	250%	253%	276%	282%	245%	251%	213%	248%	264%	274%	275%
Needed Sales	1,599	2,760	2,020	2,190	2,390	2,712	2,747	3,376	3,004	2,363	2,696
Needed/Use	45%	68%	55%	57%	58%	71%	73%	80%	71%	58%	61%
Needed/Crop	15%	21%	17%	17%	19%	22%	25%	24%	21%	17%	18%

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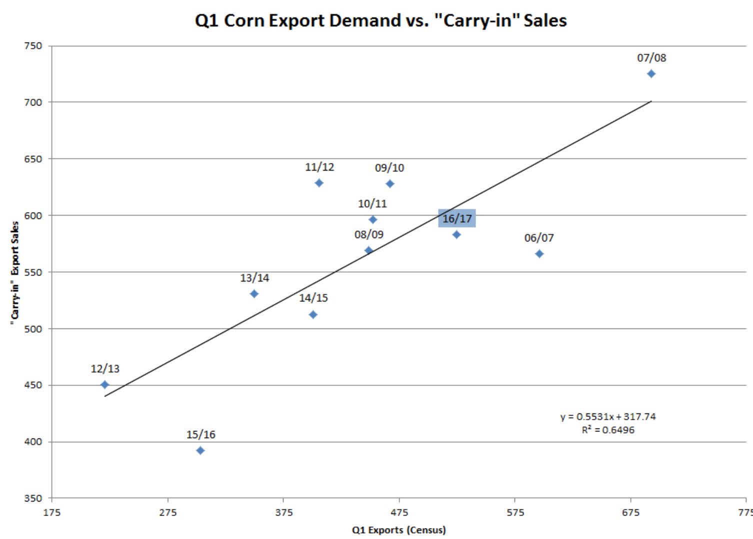
highly confident that the NASS projection from last month will prove too high, but the question is by how much?

The feed and residual, and FSI figures in the balance sheet have very little thought involved. They're simply seasonalized figures based on an annual projection. In both cases, my F&R and FSI figures are smaller than the WASDE annual figures. The figure that is up for debate right now is export demand, which I am currently plugging in at 525 mil bu for the quarter. This is the highest level of Q1 corn exports we've seen in several years, but note that carry-in sales figures (NMY sales and rollover) are actually a very good indicator of Q1 total export demand. My export projection even assumes a slowdown in Q1 of 16/17 vs Q4 of 15/16 due to a shift in focus to soybean shipments...but I'm not entirely convinced if that is correct. Once again this surge in Q1 export demand is driven largely by Brazil's absence following their crop losses this past spring. Q1 export demand will comprise roughly 11% of the total Q1 demand, which is the highest level we've seen in quite a while. I do wonder how cash markets will respond to this added "pull" from the export channels.



The total amount of corn needed in the above scenario doesn't set off any alarms, but corn spreads are already trading ~70% of full-carry. Given the uncertainty surrounding what such a strong Q1 export pull will mean to cash markets and the likelihood that the crop is overstated, I feel that corn spreads might offer some value here as well.

It has been a tough summer as my focus has been on demand while the market's has been on supply. That supply focus will come to a halt in the next 45 days or so as we narrow in on crop production estimates. I think this shift should lead to a bottom in flat price and spreads, and I am positioning accordingly.

Respectfully,
David Zelinski
Opus Futures, LLC

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