November 4, 2016

Agriculture Market Highlights:

I am starting to see some light at the end of the tunnel here, though frustration has continued in the past month. Before going into what I think is going to take place in the weeks and months ahead, I do want to take a quick moment and review what has gone wrong this year.

1) May/June was the high-point of the year as we were bullish on soybeans (due to demand prospects) and the market was rallying sharply. With the benefit of hindsight, we can see that we were right (briefly) for the wrong reasons. The market was rallying but this now appears to have been mostly based on *massive* fund inflows due to several forecasts for a hot/dry summer. As that hot/dry weather did not develop, the market sold off violently. As I was looking towards demand as the key reason for the price rally (apparently incorrectly) I was surprised to see such a sharp reaction to the weather.
2) I was also slow to realize just how good the weather and yield prospects were this summer. My yield models and my own crop tour never implied soybean and corn yield potential that we've eventually realized. It's the key reason I didn't get short during the summer even after coming to the realization that supply prospects had improved enough to keep the demand-led rally at bay. I just couldn't get supply estimates as big as the rest of the market, so I was reluctant to fully embrace the short side. It shows I either need to make major adjustments to my yield models and crop tour next year or ditch them altogether. It appears the genetic/yield technology has certainly changed the equations.
3) I have become bearish to soybean futures in the past several weeks, just in time for a post-harvest yet nonsensical rally higher. We've added more than 5mmt in soybean supplies to global balance sheets and yet the market has rallied almost $1. It really makes no fundamental sense. I suspect we might be seeing a smaller version of what we saw this past spring. We're likely seeing fund investments pour into the space in anticipation/hope of crop problems in South America. I suspect if the poor weather does not materialize, the same result will be seen (sharp break).

So while it has been an extremely frustrating stretch, as noted above I do see light at the end of the tunnel. My primary focus at the moment is on a few inter-market spreads. I am long new crop corn vs. new crop soybeans as current economics encourage far too much soybean planting in the US for 2017. Admittedly, spring 2017 feels like a lifetime away right now but we have to keep in mind that insurance prices are set in February and we'll get early indications from the USDA on the planting outlook in February as well.

I am also long new crop wheat vs. old crop corn. I think wheat area will be down considerably (again) this year and yields are unlikely to replicate last year's highly impressive levels. This leaves the door open for some impressive upside *potential* in new crop wheat futures. Spreading the wheat vs. old crop corn futures should somewhat reduce downside risk as corn wants no part of lost demand due to wheat feeding.

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I also have several OTM put positions in soybeans playing for an eventual break if/when weather proves to be favorable in South America this winter. Right now I would call conditions mostly favorable. There has been some concern over wet conditions in Argentina and that is something we'll certainly need to monitor but right now it appears the forecast is drying out in most regions of the country and I suspect planting efforts will not be severely hampered. A small portion of southern Brazil could also be described as a little wet, but again I do not view this as a lasting issue. Overall the initial stages of the South American growing season appear to be off to a good start, and it is worth noting that planting progress is running well ahead of year-ago levels right now. Just this morning, Brazil's largest state, Mato Grosso's, ag agency (IMEA) reported soybean planting is 80% complete compared to roughly 60% at this time last year.   An early soybean harvest, if realized, would mean an early end to US export dominance and likely could weigh on total US soybean demand.

I also still have a modest long position in cattle. I still view recent cattle market weakness as likely overdone in part by poor hedging management in some major feeding operations. Additionally, it appears we might have over-marketed supplies heading into winter months and export demand is picking up while imports have slowed down considerably. I do think there is upside potential here, but I also do concede the market has acted in an irrational manner for a while so I will not consider myself "married" to this position.

I do feel we have brighter days ahead and I am confident in current positions. Thank you for your confidence and patience, I do not take it for granted.

Respectfully,

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