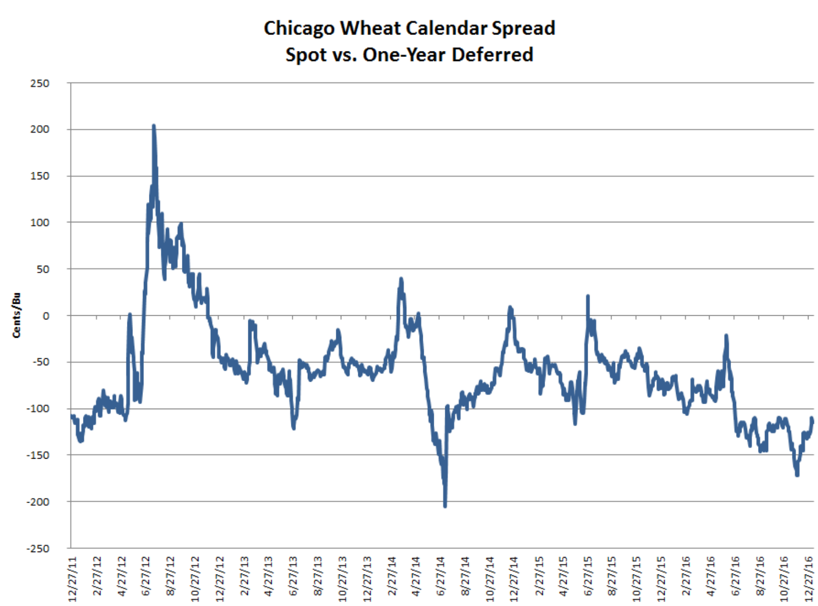
January 9, 2017

Agriculture Market Highlights:

The initial days of January are always an exciting time. The New Year is as good a time as any other to click the restart button of life, both personally and professionally. After a challenging year of trading in 2016, I am very excited about a fresh start. It helps that I see the marketplace having loads of potential for calendar year 2017. There are a lot of moving pieces in the market right now and many unknowns. Still, I think we're walking into 2017 looking at excellent *potential* opportunities in agricultural markets and I am aiming to be in position to take advantage should these present themselves. In no particular order here is a breakdown of the key items I'm watching for each major crop. Things might not develop exactly as planned, they rarely do, but having a good feel for the baseline scenario in each case will allow us to make moves on the fly to take advantage of any development going forward.

Wheat

If you've been with me for any length of time you know wheat is not typically a primary focus of mine. The market has had very little "life" to it over the past few years. From the start of 2015, spot Chicago wheat prices were down roughly 30% to end 2016. They would have been down more if not for a late-year push higher. This poor performance over the past few years has earned wheat the "privilege" of being a short leg vs. longs against other markets. This short leg in wheat has proven to be especially fruitful for the managed money segment of the market. In addition to flat price weakness, wheat spreads have been in a wide carry now over the past year. A chart showing a recent history of the wheat spreads is shown below, and as you can see spreads earlier this year had reached almost the record wide levels seen in 2014. This means any wheat short held by a managed money trader would make money on the flat price move lower *and* would benefit from the roll out the calendar.



This "easy" trade has worked for so long now that the managed money short is now complacent and bloated. However, they have had no reason to sweat this position as the fundamentals of the wheat market have remained on their side. Last year saw record wheat yields scored in several parts of the world and world wheat production set a new record by a wide margin. World wheat ending stocks also sit at a record level. The entrenched wheat short sits here today happy and content that nothing is changing.

Instead, as I view the wheat market today I see lots of *potential* for change and this could have major ramifications on wheat prices in 2017. For starters, let's look at that record

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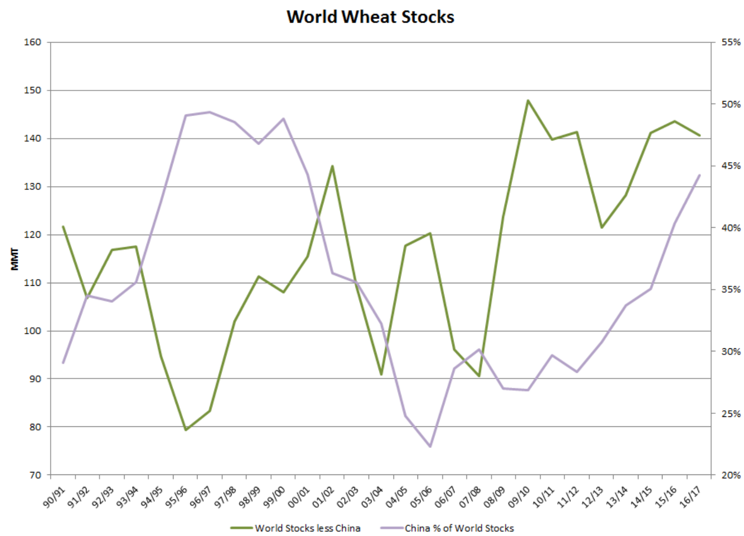
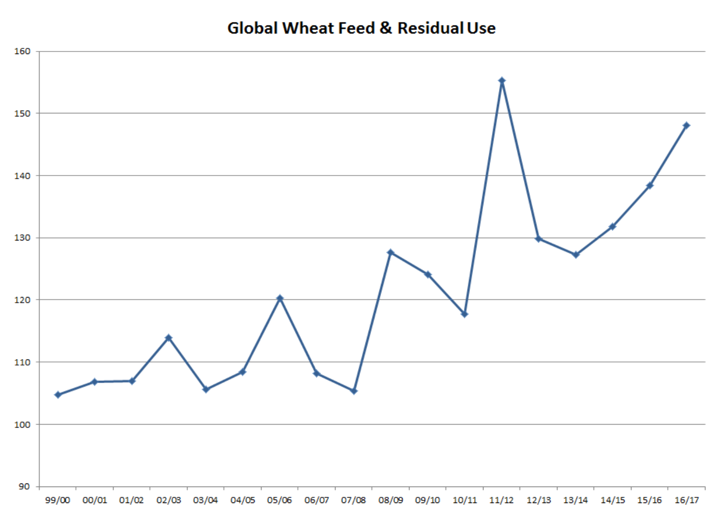
level of world wheat stocks. It is easy to look at the headline world wheat figure and conclude the world is swimming in wheat. However, note the chart to the right. Global wheat stocks outside of China are actually projected to post a decline in 16/17. So-called “major exporters” are expected to see inventories decline YOY. This does not paint a picture of increasing wheat supplies globally in my opinion. Additionally, it is also worth pointing out that these wheat supplies in China are thought to be of very poor quality and might actually encourage imports of higher quality supplies for blending purposes.

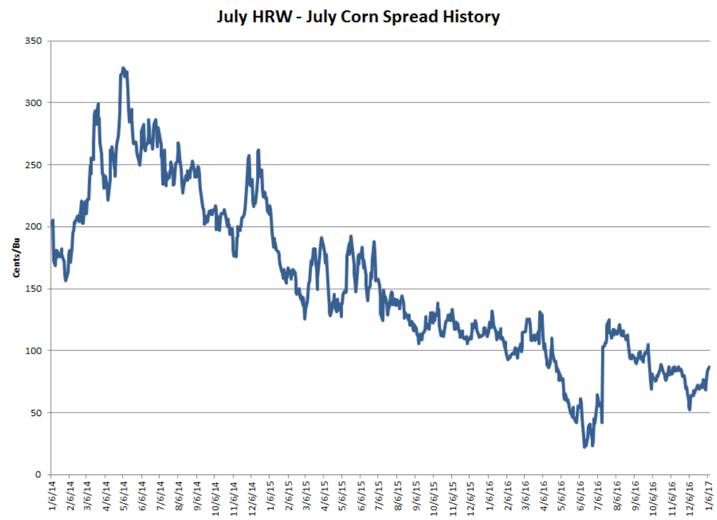


Then let’s look ahead at total 17/18 production. It seems very likely that US wheat area is going to decline vs. last year. HRW area is expected to be down in the Southern Plains as farmers look to plant more corn this year following successful recent efforts and better potential for profits this year. SRW area in the Delta and eastern Corn Belt is expected to be steady at best but probably slightly lower as well. Yields this year are unlikely to even come close to reaching last year’s massive records and that is even before we consider the negative effects of cold temps earlier this year and a lingering drought in the Southern Plains. Spring weather always has the final word on winter wheat production, but it is safe to say this year’s crop has already faced a lot more adversity than seen last year. US wheat production will be down.

World wheat production is likely to be down as well. I don’t get the sense that wheat area will decline globally like we’re expecting in the US, but it is just highly unlikely that yields can even come close to duplicating last year’s success. Keeping total global wheat area unchanged YOY and reducing global wheat yields to simply a “trendline” level would result in YOY decline in global production of 20-25 mmt. In the context of *already shrinking* global stocks ex-China I think this creates an interesting *potential* situation in wheat prices ahead. For starters, it does not leave much wiggle room for crop adversity in the US and/or FSU this winter, so markets should maintain at least a limited form of “risk premium” in prices through the spring meaning near term downside should be limited. Secondly, it calls into question how much wheat feeding will be seen going forward. As the attached chart shows, global wheat feed use has reached near record levels as wheat prices have moved to depressed levels vs. other feedgrains due to the strong supplies. However, keep in mind the spike record high on the chart on the prior page was due in part to sharp reductions in corn production globally and sharply higher corn prices. Instead today we have low corn prices and ample supplies of competing feedgrains. I believe that wheat prices will need to work to reduce feed consumption in the 17/18 marketing year. This means



wheat-corn spreads should widen, and as you can see from the chart to the right we have perhaps started to see the early innings of this trade develop.



It is worth noting that this spread can work even if wheat prices themselves don't experience great upside. We're simply looking for wheat to gain vs. corn. That said, there will be considerable *potential* upside to wheat prices if there is any crop adversity at all in the upcoming calendar year.

Soybeans

The soybean market is always good for some wild price swings during the course of a year and this presents lots of opportunities. The trick is being on the right side of the market and timing it right. It was our primary failure in 2016...one that I have no intention of repeating. Luckily I feel there are several *potential* opportunities setting up in the soy complex right now. At this point in time, however, we don't have a ton of clarity on the market, so these opportunities might take some time before presenting themselves. We won't have a good handle on South American production levels until mid/late February at the earliest and probably later than that.

Right now it appears nearby soybean futures have some downside potential as South American crops are at least being treated decently by weather and as Chinese demand starts to slow down a bit. Chinese meal prices are finally starting to back off after an impressive run lately, and while that might prove to be temporary it will likely affect flat price and spreads in the soy complex.

However, over the long term I think there are significant reasons to look for upside potential in soybean prices in 2017. Overall world demand for soybeans remains robust and grows virtually every year as livestock herds around the world continue to expand. Due to the abundance of wheat and strong feeding rates noted above, soymeal demand has been a bit soft in some parts of the world this year but I would expect that to increase going forward as wheat feeding becomes less economic. This should keep global demand growth moving higher in the upcoming year.

Additionally, consensus thoughts for US soybean acreage in 2017 seem to be getting a bit optimistic. Many analysts and observers are making the case for record soybean area in 2017, and I agree that is likely to be the case. In my baseline scenario I am projecting soybean area to increase to 88.6 million acres, up roughly 4 million from 2016 and a new record high. However even with that aggressive area estimate if yields move back towards a "trendline" level (I'm assuming 48.5 bpa at this point) global soybean inventories are still likely to decline next year as shown in the attached chart. That does not account for the potential for sub-optimal weather this summer or for area to be smaller than currently anticipated. Due to heavy snow-cover in the Northern Plains at the time of writing I'm already a bit concerned about the planting pace potential for this spring.

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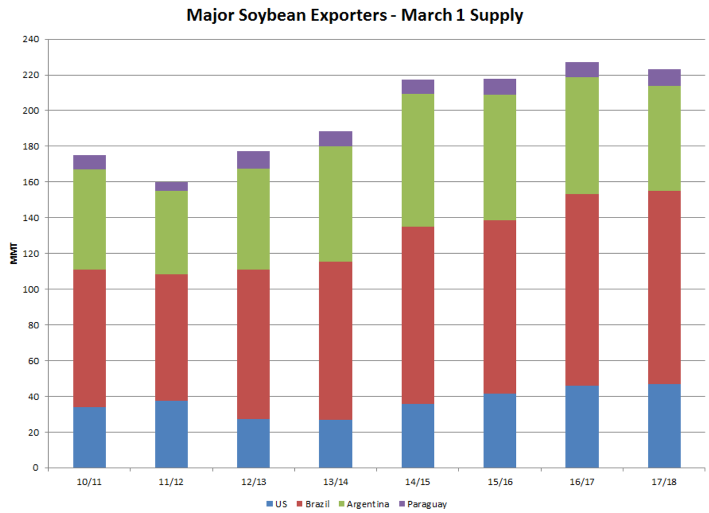
The bottom line here is I do not believe soybeans will experience significant downside potential when faced with the prospects for smaller global soybean supplies at this point next year. Obviously weather developments both now and this summer will affect that baseline scenario but as of right now I'd lean towards the risk/reward being skewed towards the upside in soybean prices right now.



The other area of interest in the soy complex is oilshare, or the relationship between soy-meal and soy-oil. Oil gained sharply vs. meal in 2016 for a variety of reasons. Initially the gains were supported as palm oil prices exploded higher due to poor weather conditions in Malaysia and Indonesia. Palm oil production has yet to recover, but it should gradually trend higher in 2017 and slowly take away one supportive element for soy-oil. The other supportive factor for soy-oil has been the Obama EPA's strong support of advanced biofuels. Recent EPA requirements have sharply increased mandates for advanced biofuel blending, and right now the only commercially viable way to meet this requirement is biodiesel. Soy-oil typically accounts for roughly 50% of the inputs into producing biodiesel, so this has promoted big projected increases in soy-oil demand.

The change in administrations bring changes at the top of the EPA, while messing with the RFS has proven to be political suicide there are several minor tweaks the new EPA could use to lower biodiesel demand from current projections. One simple change would be to simply follow the RFS as currently written. This is not what the Obama EPA has done. The Obama EPA would retroactively increase RFS mandates to match total production for the calendar year in question. This served the purpose of eliminating "rollover" RINs that could be used to satisfy the following year's RFS requirements. The new EPA administration is more likely to allow these rollovers as specified in the original law, and this will serve to reduce the YOY increase needed in biodiesel production as the chart on the prior page breaks down. Additionally the new EPA is less likely to push the "undifferentiated" advanced biofuels so strongly. This is simply just "added" biodiesel demand as there is no other commercially viable advanced biofuel on the marketplace today. Finally, biodiesel imports have grown to record levels and this isn't likely to back off considerably. The bottom line here is consensus thoughts towards growing biofuel demand for soy-oil have likely become a bit stretched.

`	Current RIN Production*	Likely-Final RINs**	2016 RFS Requirement	"Rollover" RINs	2017 RFS Requirement	2017 Needed Production
Cellulosic Biofuel (D3)	161,190,407	175,844,080	230,000,000	(54,155,920)	311,000,000	311,000,000
Biomass-Based Diesel (D4)	3,469,794,009	3,785,229,828	2,850,000,000	935,229,828	3,000,000,000	2,400,000,000
Undifferentiated Advanced Biofuels (D5)	90,992,504	99,264,550	530,000,000	(430,735,450)	969,000,000	969,000,000
Total D4+D5 RINs	3,560,786,513	3,884,494,378	3,380,000,000	504,494,378	3,969,000,000	3,464,505,622
Renewable Fuels- Ethanol (D6)	13,865,027,864	15,125,484,943	14,500,000,000	625,484,943	15,000,000,000	14,374,515,057

*RIN production thru November

**Current RIN plus estimate for December

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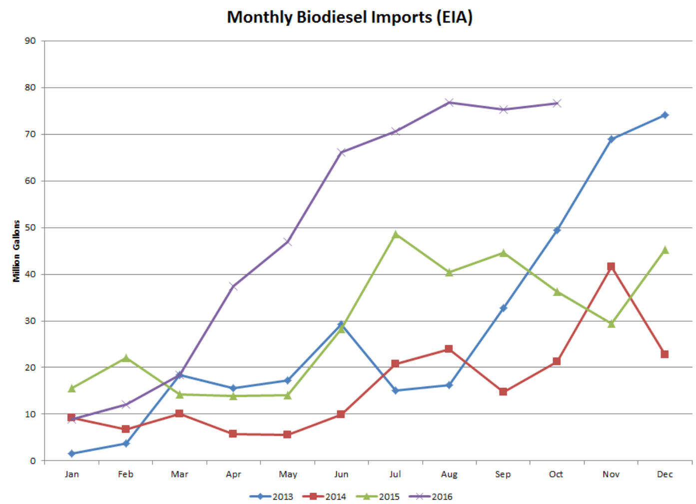
The combination of likely higher soy-meal demand (following less wheat feeding) and overzealous projections for soy-oil demand have me believing soy-oil product share is a bit stretched here. This could become especially lucrative if we were to run into any potential soy crop difficulties at any point this year.



Corn

Of all the crops covered here, corn has the least compelling story right now. Corn supplies are ample, but demand is also very strong. I believe corn will be stuck in a relatively range-bound pattern over the weeks and potentially months ahead as the market grapples with this situation. On the price rallies producer selling is likely to cap gains, while on price declines the lack of producer selling and active end user pricing will support prices. I believe corn will work well as a short leg vs. wheat as noted previously but also against soybean longs when appropriate.

That being said, we don't have much clarity on South American production yet. Brazil's main safrinha crop is still waiting to be planted and if we have any adversity on that crop the corn market could certainly become more interesting. And with prospects for lower planted area in the US in 2017 things could certainly become a bit more interesting later in the year or as we approach 2018. Still, right now corn needs an outside development in weather or something else to become independently interesting.

I am looking very forward to the challenges and opportunities ahead in 2017.

Respectfully,

David Zelinski
Opus Futures, LLC