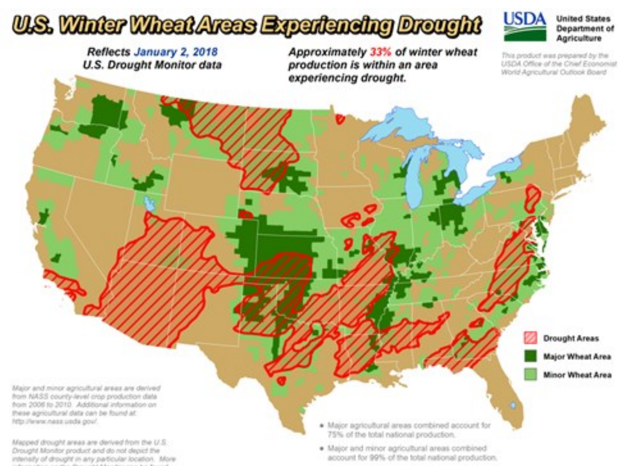
January 5, 2018

Advanced Ag Program Commentary

While I'm overall very pleased with trading performance over 2017, I have to admit we somewhat ended the year on a whimper. The past three months have seen our positions move mostly flat to slightly lower. Market action during this period, from soybeans to corn to cattle, has been a random walk of choppy and at times nonsensical price moves. It's been a fairly frustrating period, and I'm very much looking forward to being out of "holiday mode" markets.



Despite my relative frustration with the past few months, I have a hard time containing my optimism towards 2018. Our overall market bias has not changed much in the past few months. We remain mildly friendly towards the wheat market. As shown in the attached graphic, a significant portion of the Southern Plains HRW region is experiencing drought conditions with very little recorded precipitation thus far this winter and this comes after winter wheat conditions entered dormancy at their lowest levels in years. While I still understand winter wheat yields are made by spring weather, in this environment the market will be highly sensitive and the massive spec short position makes it vulnerable to a significant upside move. Add in the fact that the FSU winter wheat crop has seen very warm weather so far this winter, potentially reducing its defenses against later cold winter, and I think there is a good chance wheat prices stabilize at a minimum. World wheat inventories outside of China have been in contraction for two years now. While the Australian production shortfall seen in 2017 is unlikely to be repeated in 2018, any other potential production shortfall (in the US or elsewhere) has the potential to produce a meaningful rally, even if it proves to be short-lived.

Our bias towards the cattle market also remains unchanged. Simply put, cattle placements into feedlots appear on pace to exceed slaughter capacity this summer. Technically speaking, packer capacity (on paper) would be more than enough to slaughter the cattle it appears we'll have, however the industry is dealing with significant labor headaches that makes it very unlikely the slaughter rate can exceed levels reached last summer. Keep in mind packer margins last summer were in excess of $200/head, giving them every incentive in the world to push their slaughter as hard as they could. Assuming this implies their "max" capacity given current labor shortages, it seems highly likely that cattle supplies will exceed slaughter capacity and result is a significant drop in cattle prices by late spring or early summer.

And quite frankly, that is still a relatively best-case scenario. That assumes that the US consumer is going to consume a record amount of meat (per capita) in 2018 *and* that export demand for beef, pork, and chicken will all also continue to grow and post new records. What if exports are not as strong as expected, resulting in greater supplies of meat competing against each other in the domestic market? As of the latest FAS export sales data available, current outstanding sales for beef are down about 5% from the same time last year and current outstanding sales of pork are down about 3%. Clearly that can change quickly, but the point remains current demand projections are requiring a lot of the consumer, both here domestically and around the world.

A newer position that has come about recently is the desire to be short soybeans. My weather data shows that the Brazilian crop thus far has been treated very favorably and I could potentially make the argument for yield that equals or potentially exceeds last year's record. However, as you can see here WASDE is currently assuming a *below-trend* yield, which clearly looks mistaken at this point. If WASDE were to raise their yield projection to just the trend level indicated on the chart, it would raise their production estimate 4 mmt to 112 mmt. If yields were to equal last year's record level it would raise the crop roughly 10 mmt to 118 mmt. The market is completely asleep on this potential in my opinion.

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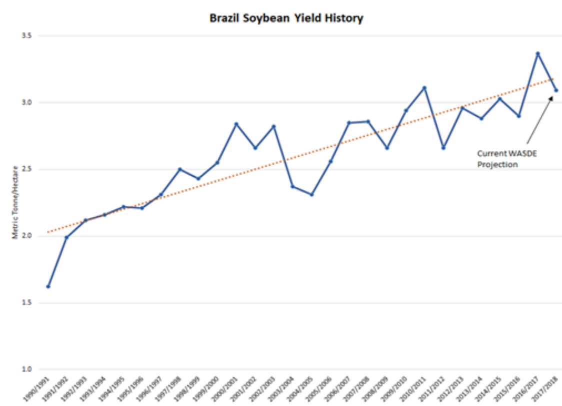
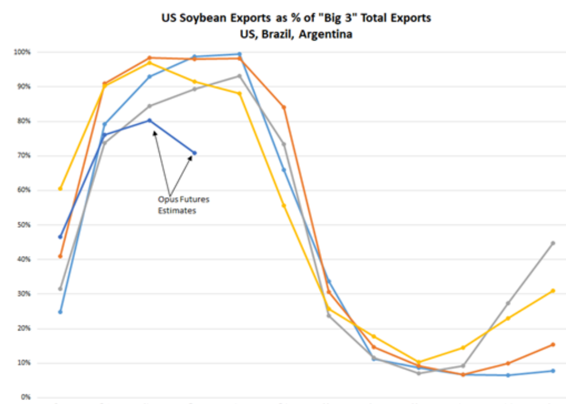
F U T U R E S

Further fueling my bearishness is the fact that the current WASDE projection for US exports already looks implausibly too large even if they're right on Brazil's crop today (108 mmt). US exports have been disappointingly low so far this year, and it isn't because global soybean demand is down. Total "Big 3" soybean exports are actually higher so far this marketing year, however as shown to the right the US has lost a considerable amount of market share to Brazil following their record large crop last year. New regulations requiring US exporters to ship soybeans with only 1% foreign-material ("FM") while the rest of the world continues to be allowed to ship 2% FM beans won't help the US's case. For WASDE's export projection to be matched we'd need to see a major YOY increase in US shipments from Jan-Aug, and without a problem in terms of South American production I just don't think that is probable.



Another factor supporting my bearish sentiment in soybeans is the fact that it appears the US farmer will be inclined to plant more soybeans in 2018 at current price levels. In the scenarios mentioned above, both US and world ending stocks projections for 17/18 will reach much higher than current projections and I believe the market will start to figure this out in the coming months. The market will then be forced to try and discourage further gains in soybean area, and for this reason I have spread short new crop soybean futures against long positions in new crop corn futures. Global and US corn supplies area clearly ample, so this isn't necessarily a bullish call on corn prices. Instead, I simply feel the market will try to discourage soybean area as the realization of higher Brazilian production and larger US ending stocks sinks in. I do, however, believe there are interesting potentials for corn later in 2018 and into 2019 as the massive Chinese domestic stocks are drawn down and as the ethanol mandate in China comes into effect. This will be something we can discuss in more detail later.



The bottom line is there should be no shortage of opportunity in 2018.

Best Regards,

David Zelinski

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