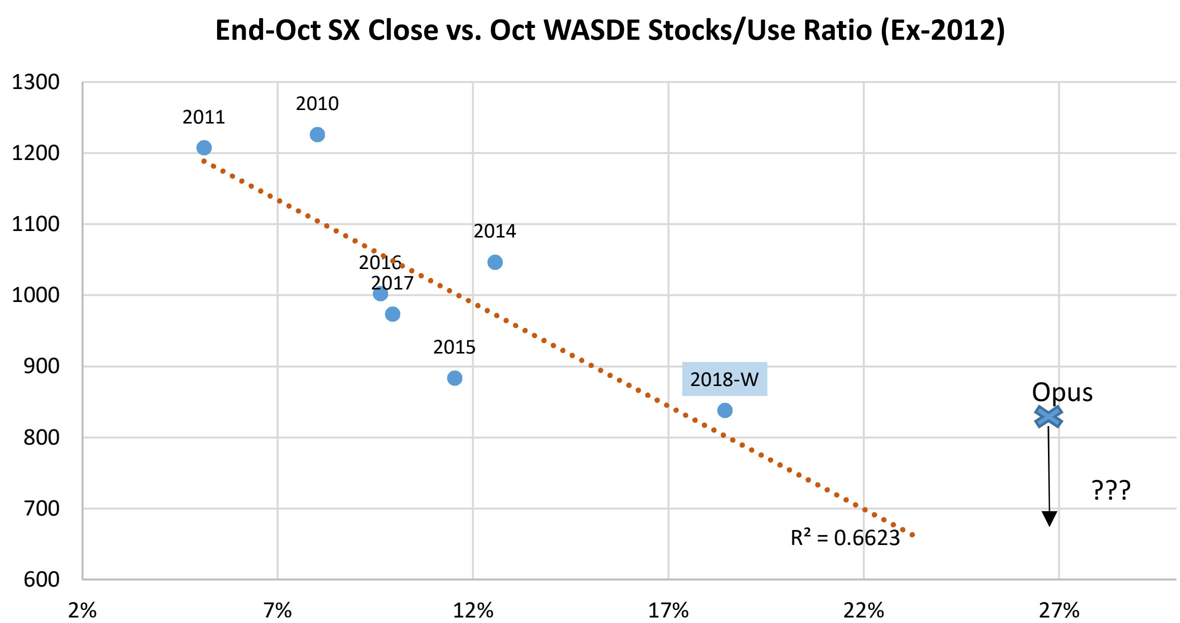
September 5, 2018

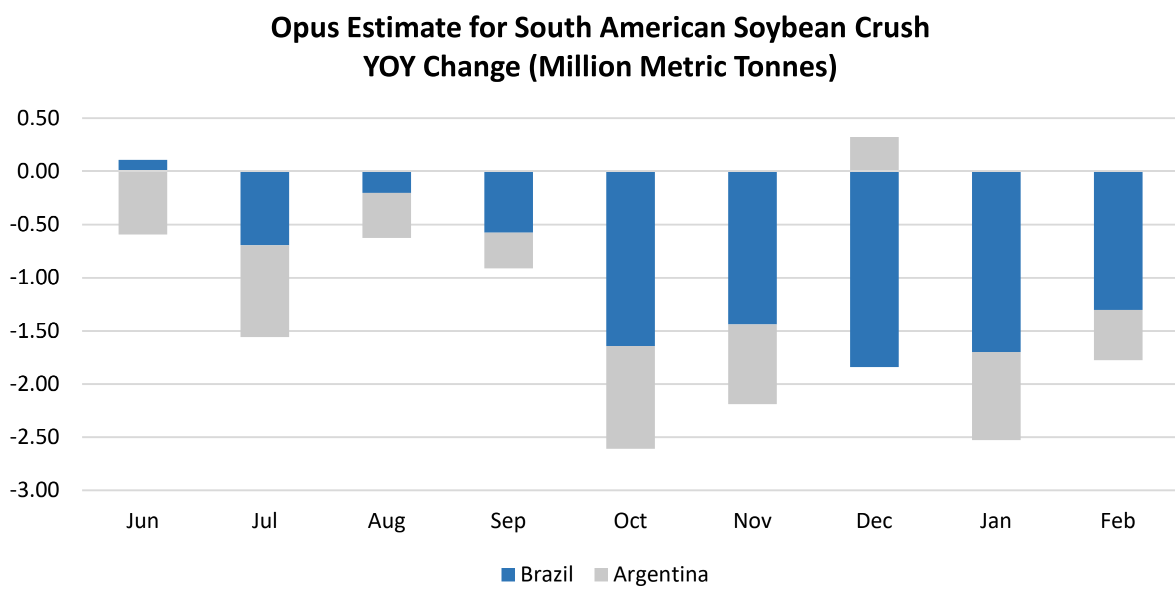
Advanced Ag Program Commentary

The month of August went largely as expected and for now there are no significant changes in my attitude towards markets. We remain bearish soybean prices, though admittedly determination of a "fundamental value" for soybean futures is growing more and more difficult by the day. There is no debating there is zero reason for optimism towards soybean prices. The US crop is looking very big. Our own crop trip through key production areas of the Corn Belt showed excellent yield potential and this viewpoint has been backed-up by other private analyst groups. Since we conducted our tour, excellent weather conditions have prevailed through the region giving ample opportunity for top-end yield potential. In contrast to strong production potential, demand prospects are abysmal. Yes, old crop US exports are proving to be stronger than expected as the world takes advantage of high crush margins and big US supplies. That relative strength will soon turn to disappointment with the absence of China as a key market for US exports during our peak supplies immediately following harvest. Early 18/19 export commitments are likely to be among the lowest we've seen in several years, and with no improvement in US-China relations there is little reason to hope for improvement. Finally, looking ahead to South American production prospects, it is highly likely that Argentina sees a notable boost in production in their 2019 crop vs. this year which should weigh on US demand prospects further. All of this adds up to a negative backdrop for soybean prices. As shown below, one could perhaps make an argument that based on WASDE's latest demand projections the market is approaching "fair value" for SX. However, WASDE's demand projections continue to look highly optimistic to me. Using my preferred demand projections, the chart below would imply sharply lower prices.



Unfortunately, I don't think it's quite as simple as just staying short soybeans and looking for prices into the low-$7 area. For starters, WASDE is unlikely to be as aggressive with demand cuts as I am, even after Sep-Oct-Nov export totals are likely to disappoint vs. their expectations. Additionally, we also have the issue of sharply lower meal and oil production in South America. As shown below, Brazilian and Argentine crush totals are expected to drop dramatically vs. last year in the months ahead. This will lead to sharply lower meal and oil production and exports from these two big exporters of both. Other parts of the world are attempting to offset some of this production. US soybean exports to Mexico, Pakistan, Egypt, Bangladesh, and Europe are up and these destinations are taking advantage of historic crush margins to produce more meal and oil. Still, I don't think there is enough capacity in these areas to completely offset the losses we're expecting to see in

South America. Production losses from South America *might* put a floor under meal and oil prices, and this could allow soybeans to find their floor at a higher level than we might otherwise expect.



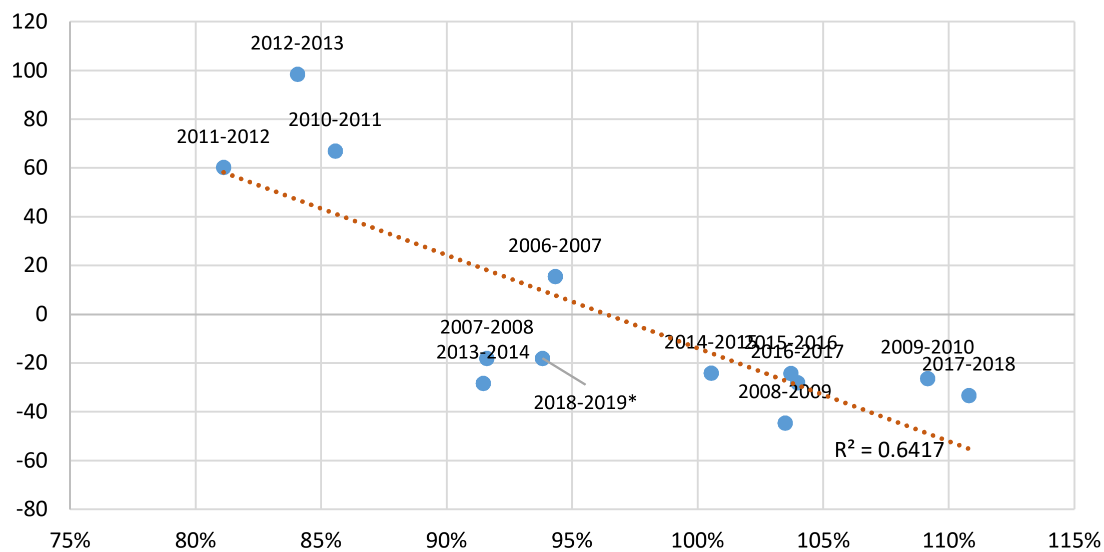
My bottom line on soybeans is that I remain bearish and short, but my inclination is the seasonal bottom in soybeans might come a bit sooner than most are expecting. I will admit, however, that with harvest just starting we still don't know what production will prove to be. If bean yields perform above expectations, that will open the door to greater downside than I'm currently expecting. The point is we simply have to maintain flexibility with our bias right now. Anyone that says they have a fundamental analysis suggesting a specific price target is not being honest. We are in the midst of an "outlier" year with tariffs combining with potential record production to create a situation where we simply don't have a historical precedent.

Turning attention to corn, I continue to believe that corn demand will be very big in the coming months. We've seen crop losses in Europe and the FSU that should lead to added export demand and US ethanol demand remains very strong (and ethanol exports continue to increase as well). Our crop trip found that NASS's new record corn yield projection is likely a bit optimistic and we favor downside revisions to their projection in the coming months. The combination of likely increases to WASDE demand projections and possible reductions in supply should produce an environment where corn should score a seasonal bottom in the very near future.

But yet again, it unfortunately is not so easy as to expect a significant rally in corn prices. On paper US corn values appear to have solid room for upside, but we have to debate whether soybean prices might act as an anchor on corn. We have to consider that US soybean area for 2019 is likely to be reduced dramatically, and a good portion of that reduction could very likely move towards corn. That added area and presumed added production will make long-term balance sheets look amply supplied again, creating only a brief period of possible market tightness. The soybean "drag" could mean the corn price upside is somewhat uninspiring.

For that reason, I find myself a bit more attracted to calendar spreads in corn right now. The combination of very strong upfront demand combined with thoughts for increased 2019 acreage could create a situation where calendar spreads narrow dramatically from current levels. The chart below shows the March-December corn spread vs. Sep-Feb estimated stocks/use levels. This would imply the spread should narrow to near even money vs. the -18 level it is trading at the time of writing. So, I am friendly to corn prices and calendar spreads, but again the theme here is mental flexibility.

End Dec Mar-Dec Corn Spread vs. First Half Stocks/Use



There is nothing to report on wheat this month. The late-July rally has almost been completely reversed at this point, justifying our lack of interest in the rally in the first place. I still find myself having an "agnostic" view towards wheat prices at this point in time, though I will admit I'm intrigued by the possibility of a weather problem developing in Russia for this upcoming season. Winter wheat areas in southern Russia have been dry all summer, and the forecast continues to call for mostly below normal precipitation over the next few weeks. While there is no reason to sound any alarms today, further production losses in wheat on top of what we've seen already this year would certainly create an interesting situation. It is not something that requires action today, but something we will be watching.

In cattle, I've taken a very small bullish position in the December contract. March, April, May placement levels imply YOY reductions in cattle supplies later this year. Placement totals since the spring have been bigger, however, and this has created some weakness in current cattle prices. I believe the market mistakenly believes these bigger spring placements could be felt late in 2018, but considering the light-weight nature of the placements it is more likely these cattle will not be ready until late winter or spring of 2019.

Thank you,
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