April 4, 2019
Advanced Ag Program Commentary

It would appear my optimistic comments last month towards a market with less trade negotiation influence were mistimed. Prices continue to bounce haphazardly around from headline to headline as US and Chinese officials continue to hammer out a deal. My thought process on the deal remains unchanged -- While the initial realization of a deal will likely support prices further, the reality is US export demand for key agricultural products remains in retreat. As an example, let's look at corn exports for a moment.

(I want to ignore soybeans for now because determining what "true" demand for soybeans right now is virtually impossible. The politically-inspired, counter-seasonal Chinese soybean purchases out of the US have made a mess of "normal" soybean trade flows. I suspect China is forward-covered beyond normal levels at this point in time, as ASF continues to limit feed demand. If I'm right, shipments will lag a normal pace vs. sales, but that will unfortunately only be realized over time).

Focusing instead on corn, consider all the following scenarios are unfolding at the same time:

- EU wheat production is likely to increase dramatically YOY. Last year's crop was damaged due to unfavorable weather, but conditions are much better this year and this could increase production anywhere between 10-15 mmt. As roughly 40% of the EU's wheat production is used in animal feed, the increase in wheat production will lessen import requirements for other feed grains. At a minimum, this should reduce EU corn imports by ~5 mmt next year…possibly more.
- Argentina is experiencing much better growing conditions this season. Corn production is expected to improve dramatically vs. last year's drought-reduced harvest. Conservatively, Argentine corn production could be near 47 mmt this year compared to just 32 mmt. That 15 mmt increase in production will certainly compete against US supplies in the global export market. I am currently projecting that Mar '19 – Feb '20 Argentine corn export potential could be up 11 mmt from the same time period in this past year.
- Likewise, production potential from Brazil is looking up vs. last year. It is still relatively early in the Brazil's safrinha corn production season, but weather has been nothing short of phenomenal and commercial contacts are implying *potential* for near record production. Brazilian corn production could be up anywhere between 12-15 mmt or more YOY. Conservatively, I am projecting Mar '19 – Feb'20 Brazilian corn export potential increases roughly 8 mmt YOY vs. the same period this past year.

Summarizing, we are looking at potential for 5 mmt less world demand and almost 20 mmt more world competition. That is easy math…implying the potential for a loss of 25 mmt in US corn export demand. And certainly it would appear that the US market is not keenly interested in competing for what demand is available. US FOB corn prices are the most expensive among the major suppliers as markets instead focus on the "hope" for Chinese purchases. Those Chinese purchases may or may not come, but even the most ardent believer in Trump's negotiation team wouldn't believe that China is capable of offsetting all of that other (potential) lost demand. Simply put, I do not believe politically-motivated (and not to mention, over-priced) Chinese purchases can save the US from the coming "evaporation" in global demand for its corn supplies.

While that would normally be bearish enough, there is plenty more to be concerned about in regards to corn demand. Last month NASS reported March 1 corn stocks were significantly higher than expected. There are several possible theories as to why inventories did not line up more closely with expectations, but the bottom line is that on-farm supplies of corn in the US stand at a record level. The WAOB will be forced to cut their feed and residual demand estimates until/unless future inventory data implies this month's release was in error.

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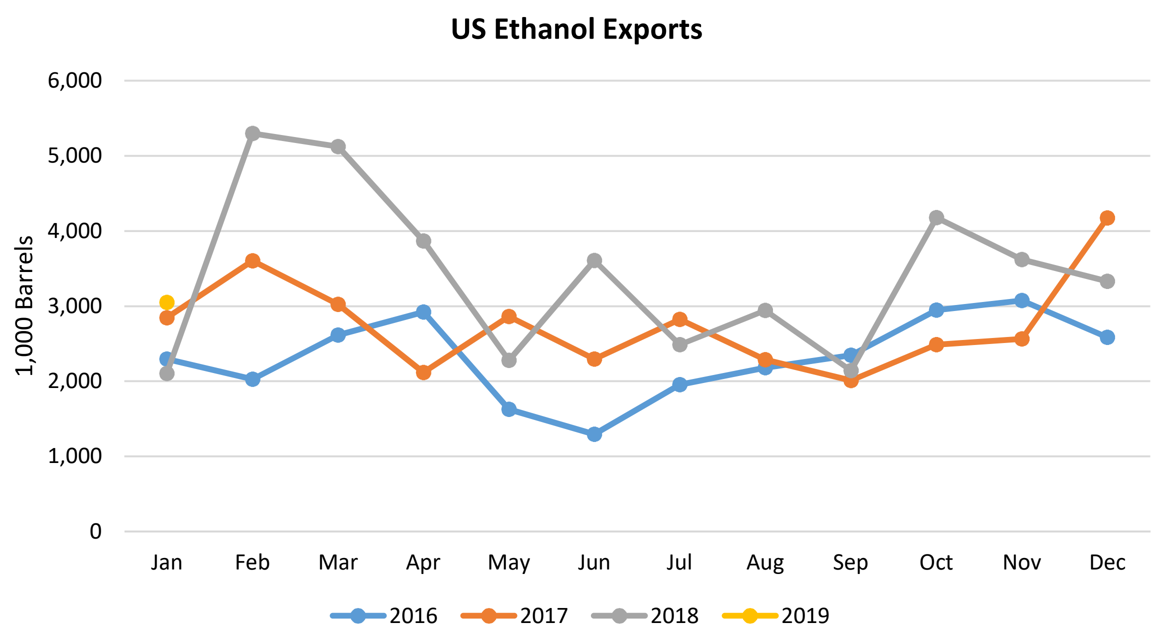
Additionally, the US ethanol industry continues to struggle. The commonplace rationale is that Chinese tariffs on US imports have decimated US exports, but the data simply doesn't support that argument. The chart below plots monthly US ethanol exports over the past several years. Calendar year 2018 exports were actually record large despite the lack of Chinese demand, up almost 25% from the prior year.



Yet despite the YOY strength in exports, the ethanol grind has faltered significantly. So far during the 18/19 corn marketing year, the ethanol grind is running 5% lower than last year. While that may not sound like a big number, it equates to roughly 130 mil bu less demand YOY. Also note that despite the significantly slower production rates, ethanol inventories have remained stubbornly high, implying a saturated market. Certainly a removal of Chinese tariffs on US ethanol would boost demand prospects, but that is not all that ails the ethanol inventory in my opinion. Current USDA projections on corn grind for ethanol will need to come down sharply in the months ahead.

When you add it all up, the current consensus (USDA) 18/19 demand projections for all three major demand categories in corn must be revised significantly lower. Starting point consensus projections for 19/20 are all starting too high. Now consider that US corn planted area is expected to increase almost 4 million acres in 2019 due to the negative implications of the trade war on soybean exports. Even with a trend yield, US corn production would be expected to increase at the same time we're looking at potentially major reductions in demand. Additionally, all major weather forecasting organizations are in agreement that El Nino conditions will continue into the summer months. As shown in the breakdown at the right, there is a general tendency for corn yields to perform well when there is an El Nino present during the summer as that typically leads to cooler than normal conditions through much of the Corn Belt.

Some National Corn Yields
In Years with El Niño during the summer

2015	**1.6% above trend**	
2009	**7.1% above trend**	**(record)**
2004	**1.8% above trend**	**(record)**
1994	**12.8% above trend**	**(record)**
1992	**10.7% above trend**	**(record)**
1987	**-**	**(record)**
1982	**-**	**(record)**
1972	**-**	**(record)**

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Add it all together, and we might be looking at one of the most bearish balance sheet scenarios in corn that I've ever seen. Considering I'm someone who has made a decent living trading agricultural commodity markets in a seemingly relentless bear market that is truly saying something. That does not mean this is an "easy" trade to short corn here. The euphoric attitudes toward the eventual trade deal with China will be tough to crack. We also are looking at a wet spring forecast, which might cause some market concern over early crop conditions and final planted area. That said, if we can navigate cleanly through the next month or two I think we're looking at a historical short opportunity in the corn market here. Unfortunately, navigating this nonsensical market has become increasingly difficult during the Trump administration… but I feel confident we will eventually be rewarded. I expect new crop corn futures to slowly gravitate towards $3…though this will require a great deal of patience.

I do still remain negative to soybean prices, but compared to the corn dynamics listed above I must admit the soybean complex looks far less exciting at this point. We were never rewarded with the downside in soybean prices that we expected this past year and 2018 will definitely make for an interesting case study for future reference.

I have no significant bias towards wheat prices at the moment. While there might be some opportunities in inter-market spreads, I simply see wheat values choppy around aimlessly in the weeks/months ahead.

Thank you,
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