

MERCHANDISERS' CORNER

By Diana Klemme

About Face?

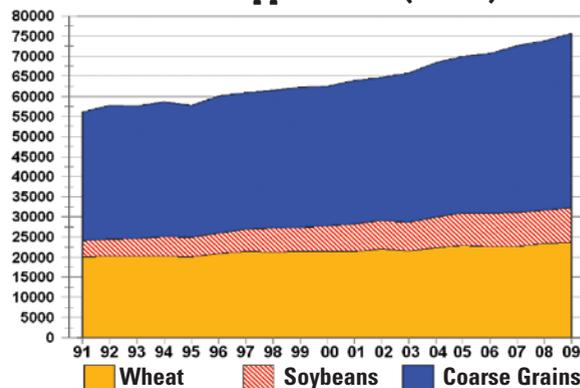
Must all good things come to an end? Corn futures moved above \$3 in the fall of 2006 and have held there. Soybeans moved above \$7 in early 2007 and have only rarely traded below \$8 since then on front-month futures. Even CBT wheat has remained above \$4.25 since 2006. This three-year run has turned into a mind-set about value that may cause buyers and sellers to be complacent, even when conditions change.

This commodities roller coaster ride since 2006 was powered by various factors.

- The concept of commodities as an investment class attracted nearly \$300 billion following one index or another.
- Low interest rates and hard sell-offs in equities and real estate since early 2008 also made commodities attractive.
- Talk of dwindling oil supplies and concern over dependence on foreign oil boosted global demand for biofuels.
- China and India's rising living standards and economic growth brought rising demand, trimming global grain stocks and triggering a 'wake-up' call in 2006. The world's cookie jar was running low, leaving little room for error; one major production shortfall could be devastating. Fears of food shortages accelerated foreign buying interest.
- China soybean imports rose 39% since 2006 to 43

million tonnes, 1.58 billion bushels — almost half of U.S. production!

World Disappearance (M. bu)



USDA statistics January 2010

The slide down the coaster...

The resulting explosive rallies in food and feed prices brought a 6% increase in global crop acreage by 2008, along with increased inputs to boost yields. Brazil and Argentina increased soybean acreage 13% by 2009, some 12 million acres. Fears of food shortages subsided.

Then the recession of 2008/09 hit. Many investors moved to the sideline, and global demand for many real commodities declined as industrial production slowed. The Reuters/Jefferies CRB (commodity) Index which had doubled from 2006 to 2008, retreated to the '06 lows.

Up we go!

Then inflation fears surfaced in '09 as 'green shoots' of economic recovery appeared and budget deficits soared. Owning commodities was increasingly viewed as an inflation-hedge as well as a portfolio-diversification strategy. Major index funds were reallocating their portfolios in early 2010 to increase holdings in ag commodities and reduce energy ownership, briefly supporting ag prices.

The Big One hits

The drumbeats in Washington grew louder, however, about the role of speculators in rising commodity prices and may actually turn into tougher regulations and restrictions — and President Obama appears intent on reining in bank trading units.

Shock waves were felt around the grain industry on Jan. 12 when USDA released the 2010 Winter Wheat Seedings report, along with final 2009 Crop Production.

- U.S. corn production increased 230 million bushels to a record 13.15 billion bushels, at the top of all estimates.
- 2010 winter wheat acreage came in at 37.1 million acres, far below the average estimate and 6.2 million acres lower than last year. The wet fall of 2009 that delayed corn harvest also prevented wheat planting.
- USDA raised the estimate for Brazil's soybean crop 2 million tonnes to a record 65M.
- Global total grains ending stocks were increased 10 million tonnes to 21 million above '08 crop carryouts.
- Over 2 million acres exited the Conservation Reserve before Dec. 31, 2009, adding uncertainty over what crops producers would plant.

Suddenly ideas of adding 6 to 8 million acres to corn and soybean plantings in 2010 began circulating. Analysts quickly calculated how much this could add to the United States and global stockpiles. Then analysts remembered '09 acres had declined 3+ million from 2008; what if *those* acres returned? After such bear-

ish numbers, combined with the 'get tough' stance in Washington, how could prices move higher? Forecasts of \$7 soybeans surfaced, and corn below \$3 seemed less remote. Clearly the roller-coaster was destined for a steep plunge to levels not seen since 2006.

The fear fed on itself. Corn plunged 60%; in a week, soybeans fell \$1.40 in two weeks; and wheat dropped by 90%. Price charts turned negative, fueling further selling by speculators. Producers slammed the bin doors shut, and end-users stepped in to buy at the cheapest levels they had seen in many months.

Corn: weekly futures chart



(red line = 40 day moving average)

Up or down next?

Differentiating a price break fueled by fear from a genuine reversal of market fundamentals will take time but by then market opportunities may be long past.

U.S. producers do have more acres available for spring crops in 2010. A lot will go into corn and soybeans, all but eliminating the need for \$5 corn or \$10+ soybeans. This will hang over the markets until the March 31 Planting Intentions are released, perhaps longer if large acreage increases are confirmed.

U.S. crop acreage, millions of acres

| | Corn | Sbns | Wht | Sorgh. | Cotton | Hay/Pasture | Sum |
|----------|------|-------|-------|--------|--------|-------------|-------|
| 2009 | 86.5 | 77.5 | 59.1 | 6.6 | 9.1 | 59.8 | 298.6 |
| 2010 ? | 90.0 | 80.2 | 54.0 | 6.9 | 9.6 | 61.5 | 302.2 |
| Change | +3.5 | +2.7 | -5.1 | +3 | +5 | +1.7 | +3.6 |
| % change | +4% | +3.5% | -8.6% | +4.5% | +5.5% | +2.8% | +1.2% |

2009 acres are USDA final statistics, January 2010

2010 acres are Grain Service Corp. projections

Analyzing where the shortfall in winter wheat acres occurred, and what states had maturing CRP acres, shows diverse acreage gains, including hay/pasture. Rough farm surveys support the idea that farmers will add acres to a number of crops rather than all the gains going to corn and soybeans.

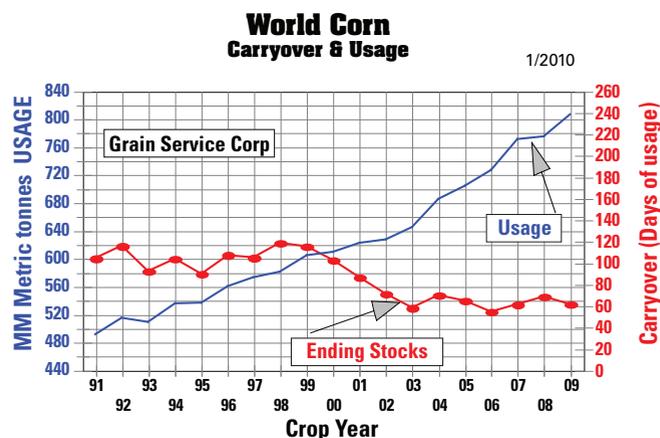
The table, U.S. Crop Acreage on pg. 24, shows a potential acreage scenario. Adding 3.5 million corn acres in the United States could increase production around 500 million bushels; and 2.7 million additional soybean acres would raise around 120 million bushels. Both of these assume a repeat of '09 high yields. It's too early to assume record yields, and it's too early to know that these acres will even be planted. An early S&D estimate for 2010 crop tells us to expect bigger U.S. ending stocks in 2011, and perhaps higher global stocks, but global demand is rising annually and bigger crops are needed — overseas and here in the United States.

The South American soybean crop being harvested this winter is huge, up 1.1 billion bushels over '08 crop. The United States will lose a lot of export business to their massive crop. But USDA forecasts South American soybean exports to decline not increase, for their '09 crop. The United States has already captured the lion's share of China's imports, and Brazil and Argentina need to rebuild their pipeline and carryover stocks, which were sharply reduced after their 2008 crop production shortfalls.

In aggregate, global consumption of coarse grains, wheat and soybeans is rising approximately 30 million tonnes/year. It takes about 23 to 24 million acres added each year at a global weighted yield, or the equivalent in higher yields per acre, to grow that much.

The roller coaster of grain and soy prices may plummet further, but attitudes could change quickly. Acreage changes, planting delays or yield problems could suddenly drain global stockpiles to uncomfortably tight levels again.

Merchandisers and end users can benefit from this downhill slide, whether temporary or long-term. The perception of an improved stocks/use ratio may keep



futures carries wide and basis weak and allow elevators to earn carries. U.S. corn quality is not great this year which is setting up a two-tier basis; one value for #2 yc and another cheaper value for 'other' corn.

End users have opportunities to reduce corn, wheat and soymeal costs to the lowest levels in several years just as livestock, poultry and ethanol prices have climbed. End users may be able to cut costs even more if they can utilize lower-quality corn, or some of the growing surplus of corn screenings which are now trading down to 60% of corn.

The roller coaster may plunge further but end users should set up a buying schedule for the ride down rather than waiting for some unknown bottom. Buying corn scale-down every 10 cents or soymeal every \$10 lower on a sizable percentage of ingredient needs for spring and summer could result in attractive average costs. This is also a year made for using put and call options to fine-tune pricing strategies in markets that may not be sure where they're going. ■



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