MARKETS

Grains look for big rebound year

BY DANIEL P. COLLINS

Post-drought years can be very interesting because prices still are elevated and supplies are tight, leaving markets more sensitive to weather problems, and the potential for a rebound in production leaves lots of downside risk. However, before there is a record crop, fields need to be planted.

While droughts are seasonal events, they really are not one-year events or, at least, their effects persist beyond the growing year in which they occur. And this goes beyond simply lower production numbers and inventory. It has to do with soil moisture, feed demand and the overall demand destruction caused by the higher prices — basically how those higher prices affected the entire supply/demand chain on a global basis.

Planting intentions
Old crop/new crop differentials

And as droughts go, last summer's drought was major, and you can see that while the prices of corn, wheat and soybeans have come down off of the summer 2012 highs, they still are elevated (see "Drought hangover," right) .

Veteran grain trader Tommy Kent Crouch called last year's drought the worst he experienced in 46 years of trading. Yet despite that, he was surprised that soybean yields ended up much better than forecast. And while we go into the 2013 growing year with tight supplies across the entire grain complex, surprises still happen, as with the first quarter U.S. Department of Agriculture (USDA) carryout number that came in better than expected, causing corn to move limit down in late March.

"A lot of traders didn't expect those numbers to be so bearish," says Peter Mooses, senior commodities broker at RJO Futures. "The stock just pushed down the market and changed the outlook for the short-term."

Corn stocks came in nearly 400 million bushels better than expected, leading to the sell-off. Soybean and wheat numbers also were better than expected, but corn was the driver.

While the supply situation was not as tight as the trade expected, it still is tight and prices still are historically high as the planting season gets into full swing.

Getting it in the ground

Adding to upside pressure because of tight supplies is an unusually cold, wet spring, which has some analysts concerned the planting could be delayed.

"Last year we had the heat that boosted the market up and now we are at these levels because of the colder temperatures. Farmers aren't able to be planting as early as they would like," Mooses says.

Rich Nelson, chief strategist at Allendale, notes that "As of [April 29] we

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are looking at the lowest planting pace since 1984. That is actually going to get worse. That is where the issue is. The trade is excited about planting delays."

However, Mooses points out that the wet spring could offer benefits as well. "We are hearing that even though they haven't gotten to their planting yet [because] of rain, cooler temperatures and even snow in some areas, [those factors] are able to give some good moisture to the ground," Mooses says. "So once they do plant, we might see some good crops coming. That may give us even more of a reason to stay around these prices or go lower."

Nelson adds, "Planting delays are short-term exciting, but [the added moisture is] helping to recharge some soil in the Western corn belt, which was dry. So I could see things from both angles."

However, Allendale's proprietary research questions the importance of soil moisture content.

"There actually is little evidence that soil moisture carries into corn yields," Nelson says (see "Quick and easy guide to summer grain trading," page 28). "It is each year's particular weather, both temperature and moisture, that determines corn yields, it is not [carryover] soil moisture, which is what most people believe."

The cool spring also could affect planting intentions because long delays in planting could force farmers to replace corn with beans.

"Most planting still will favor corn over beans through the end of May in prime growing regions," says Andy Waldock, founder of Commodity and Derivative Advisors. "Planting delays beyond this will encourage a bigger soybean crop at the expense of corn."

Mooses says, "We are behind schedule with the planting, but longer term, people think we are going to be able to plant. Farmers can catch up pretty quickly; we can see those weekly reports all of a sudden catch up to speed."

New crop

"For right now, planting will resume in early May. [That means] anything close to normal yield will cause [a] tremendous supply increase," Nelson says.

In fact, by the time you read this, most corn will be in the ground, and if it isn't you can disregard most analysis because prices will be much higher. A late planting may increase the amount of beans vs. corn, but good growing weather can make up for a late start and hot dry weather, like last year, can disrupt a crop that got off to a very good start.

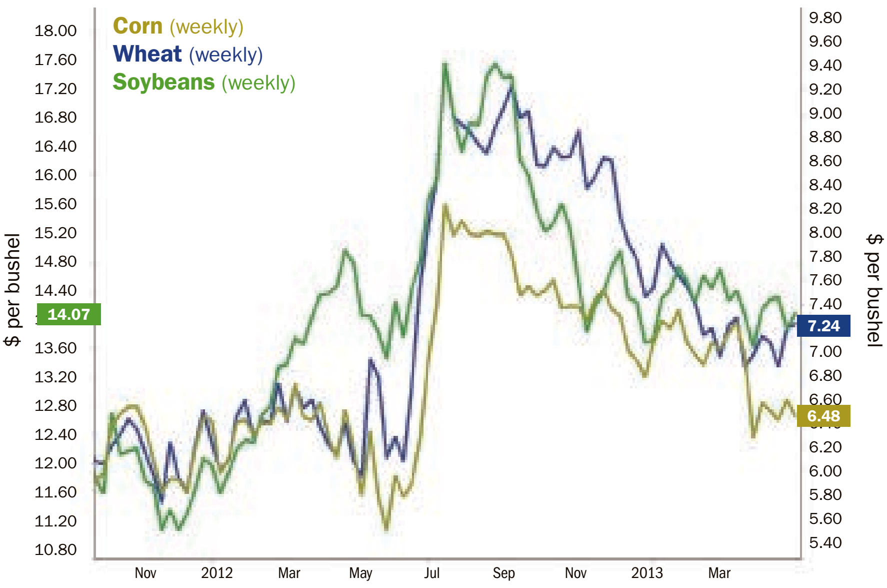
"The narrative of this year's grain complex is we are going to run off of an extremely tight supply and we are butting up against a dramatic increase in [new crop] supply," Nelson says. "The numbers you are talking about [are] a 3- to 4-billion bushel increase in production this year (see "Corn is in the driver's seat," page 22). The question right now is how much do we need to narrow off that production increase with these planting problems?"

Just look at the old crop/new crop spread to see this is a tale of two growing seasons; one drought stricken, the other with the potential to set production records.

Nelson adds that those estimates, an approximate 30% year-over-year increase for corn, put out by Allendale are based on more conservative yield estimates

DROUGHT HANGOVER

High prices last year because of drought could carry over into this year as traders size up the weather's impact on plantings, crop sizes and questionable demand.



Source: eSignal

than what the USDA is projecting. "You are looking at a record production for next fall," he says.

Nelson points out that last year's yield level was the lowest since 1995, but we have to assume a normal yield for 2013.

Once the crop is in the ground, Nelson anticipates old crop (July) corn to hit $5.72 per bushel and new crop (December) corn at $4.42. "These numbers are incredibly bearish from what you are hearing from other analysts," Nelson acknowledges, but adds, "You have to assume normal yields unless you hear otherwise; if we have anything close to normal we are talking record harvest. As we get into June and July, unless weather turns bad, then we see the market making that final step lower."

For soybeans, he sees July beans hitting a low of $12.38 per bushel and November at $11.10. He is neutral on wheat because the July and December contracts already have hit his downside targets of $6.81 and $7.14 respectively.

He doesn't cite upside targets because they are approximately 30¢ away as of May 1.

"Prices are high right now because we are dealing with last year's tight crop, but as we get into the yield determination time of the year, which is June/July unless there are problems showing, we have to assume a record crop and therefore much lower prices," Nelson adds.

Demand question

Ohio farmer and 40-year trading veteran Dave Proeschel also is bearish. Proeschel says a strong South American crop still being harvested could put pressure on price. He doesn't see a problem getting corn in the ground; his biggest concern is on the demand side. "There is less demand for feed [because of last year's drought]. We had a lot of ethanol plants close down and with crude oil down, I don't see them coming back online," Proeschel says. He expects soybeans to reach the $10 range and corn to drop below $5 by late summer.

Dan Cekander, director of grain market analysis for Newedge, also is concerned with demand. "Argentine corn remains competitive with U.S. corn, which will continue to limit U.S. corn export sales activity," Cekander reports. "Brazil's crop will [be] increased competition for U.S. corn during July-August, further limiting export interest for U.S. old crop corn and for new crop during the first quarter of the new marketing year."

CORN IS IN THE DRIVER'S SEAT

Last year's drought meant reduced carryover and tighter supplies. However, if weather remains good and plantings get done, it could be a banner year for corn.

Corn/Bushels	2007	2008	2009	2010	2011	USDA 2012	ALDL 5/10 Est. 2013
Planted	93.5	86.0	86.4	88.2	91.9	97.2	97.3
Harvested	86.5	78.6	79.5	81.4	84.0	87.4	89.5
Yield (BU/A)	150.7	153.9	164.7	152.8	147.2	123.4	159.4
Beginning stocks	1,305	1,624	1,673	1,708	1,128	989	757
Production	13,038	12,092	13,092	12,447	12,360	10,780	14,269
Imports	20	14	8	28	29	125	20
Total supply	14,363	13,729	14,774	14,182	13,516	11,894	15,045
Feed and residual	5,858	5,182	5,125	4,795	4,548	4,400	5,400
Food, seed and Ind.	4,442	5,025	5,961	6,426	6,437	5,937	6,110
Ethanol	3,049	3,709	4,591	5,019	5,011	4,550	4,675
Total domestic	10,300	10,207	11,086	11,221	10,985	10,337	11,510
Export	2,437	1,849	1,980	1,834	1,543	800	1,500
Total use	12,737	12,056	13,066	13,055	12,527	11,137	13,010
Ending stocks	1,625	1,673	1,708	1,128	989	757	2,035
Stocks/Use	12.8%	13.9%	13.1%	8.6%	7.9%	6.8%	15.6%

Source: eSignal

SOYBEANS AND WHEAT HANGERS ON

Soybeans and wheat have better carryover stocks than corn, but will not be as big a factor in the world of grains. However, weather and plantings are the wild cards.

Soybeans/Bushels	2007	2008	2009	2010	2011	USDA 2012	ALDL 5/10 Est. 2013
Planted	64.7	75.7	77.5	77.4	75.0	77.2	77.1
Yield (BU/A)	41.7	39.7	44.0	43.5	41.9	39.6	44.5
Production	2,677	2,967	3,359	3,329	3,094	3,015	3,392
Ending stocks	205	138	151	215	169	125	238
Stocks/Use	6.7%	4.5%	4.5%	6.6%	5.3%	4.0%	7.2%

Wheat/Bushels	2007	2008	2009	2010	2011	2012	2013
Planted	60.5	63.2	59.2	53.6	54.4	55.7	56.4
Yield (BU/A)	40.2	44.9	44.5	46.3	43.7	46.3	44.4
Production	2,051	2,499	2,218	2,207	1,999	2,269	2,120
Ending stocks	306	657	976	862	743	731	676
Stocks/Use	13%	29%	48%	36%	33%	30%	29%

Source: eSignal

Cekander also sees more concern over planting conditions. "July corn futures could find short-term support at $6.10 to $6.20 and resistance at $6.70 to $6.90 until the trade is assured there will not be a 3- to-4 million loss in U.S. corn acreage. If the majority of the corn crop is planted by the end of May and favorable U.S. weather persists, July corn futures eventually could erode to $5.50 to $5.75."

Waldock is not nearly as bullish as others, citing large commercial positions in the Commitment of Traders report released weekly by the Commodity Futures Trading Commission.

"Commercial traders are doing their best to put a floor under this market," Waldock says."Corn will replenish more quickly than wheat as long as it's the more profitable grain to plant. The December corn crop already has tested last summer's low of $5.11."

Waldock sees the sharp rally off that low as anecdotal evidence of the type of short covering situation that would be a buying opportunity. "I'd like to see the December contract test resistance at $6.30. Weather problems could trigger a technical rally above $7.50 in the December contract," he adds.

As for beans, Waldock says the large build in commercial positions, 93,000, leads him to believe there will be a secondary top in the bean market this year around $16.

"Our strategy will be to buy breaks of support looking for a speculative bear trap to fuel an initial run higher and limit the total risk on the trade," he says.

Most analysts see corn as the main driver of the entire grain complex this summer.

Wild cards

While it might seem dangerous to be counting on a strong crop that is only 12% planted as of the first week of May, there are signs of demand destruction from last year's drought. Analysts cite weak ethanol demand and the heavy livestock kill rate because of last year's drought pushing feed demand lower. This, along with a strong South American crop waiting to ship, could send grain prices back to more traditional levels.

First, however, farmers need to get this year's crop planted. F

Markets continued from page 19 ➤

MARKETS continued

Markets continued from page 18 ➤