May 29, 2013

MERCHANDISING MEETING NOTES

TURN UNCERTAINTY INTO OPPORTUNITY

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ADVANCE TRADING

We are planning an Origination and Merchandising class on June 11th at the Holiday Inn and Suites @ Ameristar in Council Bluffs. The Morning class will be focused on origination tools and customer support/service. The afternoon will be an Intermediate Merchandising class on basis/spreads/DVE/Carries/Inverses with some case study time. Please contact your broker to register for either or both.

CORN

- We are thinking we might not get to USAD's 750 mbu export number. LW inspections of 12.4, vs. 15.8 is not too alarming, but US price, compared to world price is. E.g. June CIF bid at +94 CN, June Brazil offered FOB at -75 CN and the freight is around 68c. The bigger issue is South American vessel loading capacity.

- Ethanol production is up on decent margins, so we are taking corn for ethanol usage up 25 mbu for the current year.

- Gov. says US is 86% planted vs. 5 year average of 90%. Of bigger concern is that it is some higher yielding states that are lagging. WI is 64% vs. 85 average. IA is 85% vs. 98 average. MN is 82 vs. 95 average. ND is 72 vs. 82 average. And 7 day forecast is not conducive to corn planting.

- Crop insurance benefits will affect farmer's final planting decisions. Insurance "prevented planting" dates vary, but start on June 1. One field report for one farm, in northern part of Corn Belt, is that to him the prevented planting benefit is $660A and that that farm's economics will mean that the farm does not get planted. The higher coverage that the producer purchased, the more motivated he is to fallow the land. It is very difficult to project the effect of the prevented planting provisions, as the economics change. E.g. the insurance benefit drops 1% per day, starting at the prevented planting date, and it is difficult to project the date that planting is possible. Also, some areas have a higher need for forage, so they will be less inclined to fallow the land. Also the economics of planting beans as an alternative are changing. E.g. SX was up 40 cents today.

- After all that "hedging", as of today, we think we will lose 1 million corn acres to soybeans and 1 million abandoned. See our Fundamental review as we now have 13/14 carry out estimated at 1.584 BBU.

- Livestock profits: Corn fed cattle coming to market today showing about a $275/hd lose. Feeder cattle placed today, projected to lose $137/hd. Milk margins were -$0.24 cwt in April. Projected to be +$0.42 in May and +$1.68 in November. Hogs, feed bought over the growing period, showing $9.88 hd profit. Feeder pigs going in today are projected to lose $4.70 hd. Broiler producers are netting around $1.10 bird, best in a long time. Egg producers netting around 14.8c doz. and production is expanding. (See WFR for detail)

- Brazilian ethanol is finding its way to the US. Our count is 1 unloaded, 2 unloading, and 2 loading in Brazil.

- Nearby basis unchanged to 5 weaker across the Belt. Decatur is bidding +57, down from 59. Cedar Rapids went up and Clinton went down, so they are both bidding +66. However, still too high to own; and high enough to short. More "shot" below. Nearby Hereford, sellers reported at +135 CN, but by this writing looks like 128B/134Offered. OND Hereford, sellers, traded +85 CZ. (+85CZ Hereford OND is 'good' by traditional standards, see spread thoughts below). Nearby Garden City bid openly at +120, but traded this week at +136, June ship. Eastern Belt crossings bid +55 for Jun/Jly, flat to down 2 on the week.

- LHJuly, CIF = +52, brg fgt = 280, equals +6.5 FOB IL R barge, or right at 'delivery value'. Some say that this means it 'safe' to own the CN, as CN futures could be stopped and loaded out at about even money. Some would say that with CN:CU at 80 cent inverse, stopping CN means you will own the corn at +86.5 CU, which represents 80c of spread risk, plus storage and interest cost.

- Our view: If you are short the basis, longs should be in CN. You should not be long the basis thus hedge placement is academic. (However, for those that long the basis anyway, you should sell out, and if you can't or won't your short needs to be in CN)

- Index funds have started rolling their longs forward. They are selling CN and buying CZ. Rogers started on May 28. Deutsche Bank is next. Goldman starts on June 7. It appears the "locals" have been front running the CN:CZ in anticipation of fund rolls.

- New Crop: Funds are rolling longs to CZ, thus buying CZ. Best analysis is that delayed plantings are going to cost us 250 mbu of production. Cash OND bids are at or above a soft DVE.

- Note above, we reported OND, Hereford, sellers traded +85CZ. Track IL this comes back to something between -2 and +8, depending on final freight rates, COBO spread, car cost and the ship by date on the Oct portion of the trade. For NE, it is around -12 (doing some rounding and averaging here). For NE it is easier to look at UP Group 3, where the OND bid is -5CZ on -1 offered. Per the merchandising 101 handbook, these numbers mean that in a 1.6 BBU carry-out year, CZ is lower than cash for OND)

- These 3 factors lead us to the same conclusion: Make sure we have enough new crop carry locked in. The fact that the funds will be buying CZ for the next 10 days causes us to want to get this done with some urgency. Buying the CZ:CH is an easy decision. Buying CZ:CK makes sense too, especially if one is long space. Suggest staying away from CZ:CN for the time being. We don't encourage "chasing" at this time!

SOYBEANS

- Export inspections were 3.4 mbu, vs. expectation of 2-10 and 6.2 needed. YTD sales are 1.348 BBU, or 99.9% of USDA forecast. Mixed into the 12/13 export picture is South American logistics. SA ports are at capacity. This has caused importers heart burn, e.g. Chinese, as they not getting the beans as needed, not to mention the demurrage bills. For June, SA beans are about 130 cheaper out of SA than US, before demurrage and other logistics costs. Thus the US's ability to perform on a contract is garnering at 130 cent bushel premium. Importers won't pay this premium any longer than they have to. From this point, our bias is the USDA is 10-15 mbu too high on their 12/13 export forecast.

- SN:SQ spread is a 72 cent inverse and was 100 last week, which is what is keeping SA loading beans. And the US, for that matter.

- Since SA is loading at capacity and since they have plenty of beans, we can expect them to compete (at least price wise) for longer than normal.

- Our carry-out projection for 12/13 is 131 mbu, and 251 for 13/14, after adding 1 mln acres at expense of corn.

- Spot crush margins are holding well. Decatur at 82c. Fostoria at 139. Lincoln at 98.

- The inverted meal market is a challenge to the processors, in that carrying spot beans into an inverted meal market is a loser.

- US old basis has dropped at a record setting pace for May. Mainly this speaks to just how high the basis was and how big the inverses were/are. As we get closer to July, the users have SN deliveries to protect them. For the period from SK ceasing trading and SN deliveries, they have no basis protection. Feels like the processors are pretty well covered through June.

- LH July CIF is +50/+60, so use +55. Barge freight at 280% = +6 FOB barge, or about 6c less than DVE. However, in the spot, FOB IL River is +40 SN.

- In old crop, doing back to back is safest. Maintaining a basis short has good risk/reward. If short the basis, longs should be in SN. Some have rolled a small portion of their long forward. If one is 100% short, probably should keep long in SN. If less than 50% short, rolling some longs forward, with the backstop of being able to short more beans can be justified.

- With SX:SF at -6 ¼ and interest cost at around 8c, one must think about selling new crop beans if and when you see a DVE number. Just a reminder to not sell "tight" shipment times unless you get paid for it. The current inverse will likely carry into harvest, thus if one can't make an early harvest shipment, for any reason, it will be painful.

WHEAT

- An ATI crew made a tour of the HRW crop last week, and a synopsis of their trip is in this week's WFR. If you would like the whole report, let your broker know.

- Of significance, they judge the HRW crop to be 3 weeks late!

- Export picture looks routine.

- Our Australian friends that were on the above mention HRW tour, comment that they think their old crop production is 20 MMT, compared the USDA's 22 MMT estimate. Further that new crop planting conditions have improved of late and they think this year's crop has 23 – 24 MMT potential.

- As of our meeting time the WN – CN was +27. As of this writing, it is +46, thus taking some of the thunder out of the message. …here goes anyway!

- Southwest KS and OK July corn is worth around +125 CN. At the current WN – CN spread, on a per pound equivalent to SRW is +137 WN. BNSF shuttle rate is 65, thus if IL SRW can be bought for less than +72 WN track IL BNSF shuttle loader, wheat competes if we use 100% the value of corn. If we adjust to 90% the value of corn, we get -12 WN FOB IL BNSF shuttle loader. Offers on new crop SRW are tough to come by for many traditional reasons, but we do know the cost to stop WN. If we stop WN, odds are very high that the stopper will get the SRW in Toledo and that the cost is +6 WN. We know (think) at 100% the value of corn, SRW is worth +137 WN KS/OK. We know the rate from Chicago to KS/OK is 65. 137 – 65 = 72. Thus we have 72c left to cover the cost of handling and freight from Toledo to Chicago and the discount to corn as a feed.

- The point of the above math is simply to point out the gross values of stopping WN for cattle feed in the Southwest can be visualized. It might also help explain the WN – CN spread moving 19c overnight. We all already know that SRW is pricing well into feed rations.

- The merchandising take-away is to have your short hedges beyond the July. We make the same suggestion on HRW also

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