Ditsch Trading

2016 Market Outlook

As the calendar turns to the New Year, I first must say how excited I am to be following my passion and returning to the CTA world. I believe that the current trading environment will require much more emphasis on detail and a more thorough understanding of cash markets, time spreads, and inter-commodity relationships. In other words, I don't think 2016 will be a year in which we see rapid flat price moves in one direction or the other, but I do expect there to be opportunities in calendar spreads, inter-commodity spreads, volatility, etc. These types of markets are what I specialize in, so I'm looking forward to the opportunity.

Here are some bigger-picture views on my expectations for 2016. Keep in mind, significant fundamental shifts (such as drought, Chinese policy changes, etc.) can alter these views at any given time:

1. Assuming normal weather, I'd expect ag markets to grind lower. World stocks of feed grains, food grains, and oilseeds have generally moved from 'tight' to 'adequate' to 'burdensome' over the past few years. Looking forward, it appears as if these burdensome stocks are set to grow even further. Lower flat price levels over the past several years have not yet turned the tide. It appears as if the function of the market is to continue to seek price levels that better balance supply and demand and ultimately force world stock levels to stabilize. I look for markets to slowly grind to lower levels in 2016, perhaps 10% lower over time with normal weather around the world.
2. While world stocks are burdensome and still increasing, the supply side has been impacted by reluctant farmer selling around the world. A historically large percentage is being hoarded by farmers, particularly in North and South America.
3. Additionally, large supplies are held by governments such as China. This creates another dynamic in the supply/demand (S&D) relationships. While supplies are heavy, available supplies in commercial hands have actually been tight. The past few years have shown us that flat price levels are driven primarily by overall S&D levels but spreads (particularly nearby spreads) are driven primarily by commercially owned S&Ds. Thus, I expect calendar spreads to stay relatively firm while flat price levels grind lower. In fact, I'd expect calendar spreads to trade much stronger than overall S&D levels would suggest, perhaps frustrating many traders who focus on historical fundamental relationships to trade spreads.
4. Farmer selling rates will be as important as ever in 2016. Current prices are at or near the farmer's perceived cost of production. While this is necessary to 'squeeze' farmers worldwide and reduce the growth in world stocks, most farmers (particularly in the US) still have a financial balance sheet that allows them to hold large supplies, waiting on a rally back above their perceived cost of production. This strategy has rewarded them many times over the past 5-7 years. While I think this will be the year that they do not get rewarded, they are not ready to let loose just yet. This slow farmer selling further highlights the probability that spreads remain firm. It can also push futures up from time to time in an effort to keep grain moving from the farmer to the commercial. However, my bias is that overall stock levels should limit the depth of these rallies.
5. Weather always plays a major role in our markets. However, burdensome world stocks will serve to better buffer markets from significant weather-scare rallies. This was evident last month. South American weather has been less than ideal, and it was looking quite dire at one point with rains looking quite limited

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for an extended time in northern Brazil during their growing season. Soybean futures rallied, but the rally was capped by the volume of farmer selling of existing supplies above the market. Futures then pressed quickly back towards the lows as weather outlooks improved somewhat. I look for this to continue. It will take a serious weather threat to spark a significant rally, and trade may be disappointed by the lack of traction weather scares are able to provide.

6. Volatility should remain cheap, perhaps pushing to historically low levels. As mentioned above, burdensome world stocks should limit rallies. At the same time, slow farmer selling can slow the rate of descent as the market presses lower. This is bearish for volatility. Assuming normal weather, vols should remain weak.
7. Daily ranges may exceed mid-term ranges. Despite low volatility, I'd expect daily ranges to be fairly volatile at times, driven mainly by market structure. However, these moves will frequently be nothing more than a change to 'trade the ranges'. Mid-term ranges should be relatively quiet with normal weather.
8. From a macro perspective, we are still in a deflationary environment. This should continue to provide downward pressure on ag commodity values. Ag commodities are tied, now more than ever, to energy markets. A major use for corn is ethanol and for soybean oil is biodiesel.
9. This deflationary environment should weigh further on input costs such as fertilizer, diesel, etc. As mentioned above, farmers do not want to sell below their perceived cost of production. Input costs have been somewhat sticky to the downside. However, if one assumes they do push lower in coming months, farmers will be more willing to sell their output at lower prices. Thus any decrease in input costs will prove bearish.

This is what I am looking for as we move into 2016. I am looking forward to building Ditsch Trading this year.

Best Regards,

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