Ditsch Trading

April 2016 Monthly Commentary

It has been a long time since I have seen fundamentals swing so dramatically over the course of a month. Entering April, we had just found out that US farmers intended to plant a record amount of corn and nearly a record amount of soybeans in 2016, South America was in the early stages of record corn and soybean harvests, and there were signs that China may slow soy purchases.

Well, our world changed significantly in April. Fortunately, we capitalized on the changes early enough to catch the rally. What happened?

1. South American weather took a dramatic turn for the worse. At one point, we thought Argentine soybean production could approach 62 MMT and Brazil 103 MMT. However, historically heavy rainfall across Argentina as well as neighboring areas in southern Brazil and Uruguay have caused dramatic quantity and quality damage to their crops. Argentine production is now estimated near 55 MMT with declines in southern Brazil bringing the Brazilian mid-point near 98 MMT. Uruguay, a minor producer, has also likely lost 0.5 MMT of production. Add this up, and South American soybean production has likely dropped by about 12-13 MMT from the highs. This is nearly 450 million bushels.
2. Chinese soybean imports have exceeded all expectations with no sign of slowing down. They have been pulling from Brazil at a record pace. It now looks like Chinese imports could reach 85 MMT, 2-3 MMT above estimates from a couple months ago. Their annual crush rate should expand by an impressive 11-12% this year.
3. World soybean and meal demand growth has been equally as impressive, well above all estimates.
4. While Argentina and surrounding areas have been far too wet, it has turned very dry in the northern Brazilian areas that grow the late corn crop. That is likely going to cost Brazil an unknown but significant amount of corn production. The world has grown accustomed to cheap and readily available corn from Brazil from late summer through fall and winter and that just won't be nearly as readily available this year.

The reduction in South American soybean and corn production puts much more pressure on the US to produce record crops. The 16/17 soybean balance sheet now looks incredibly tight. Why? Well, the lower South American production combined with record world imports should bring Sept 1 world stocks down by about 7 MMT versus last year as opposed to the latest USDA estimate that they would be up by 1 MMT. More specifically, I project South American stocks to be down by about 10 MMT. The lower South American stocks should result in much stronger US soybean and meal exports in the first and second quarters of 16/17. Finally, tax changes in Argentina are likely to cut soybean acreage there for next year. With all of this, I project a dramatic tightening of US soybean stocks next year even if acreage reaches 84 million (record) and yield is near trend, most likely down to rationing levels by the end of the next marketing year. I project world soybean stocks could fall by as much as 15 MMT next year, to one of the tightest on record. This is a huge fundamental change taking place, driven by the factors listed above. The decrease in Brazilian corn exports should also push US corn exports higher in 16/17.

Despite this, many analysts are still pointing at burdensome 2016/17 ending supplies. It's almost as if many don't even look at world numbers. We believe these changes suggest higher prices in coming months, perhaps significantly higher for soybeans should we run into any weather issues during the US growing season. Soybeans have rallied $1-2 from the lows, but this is not enough in our view to achieve the function of the market – which is to increase world production AND slow the rate of world demand growth. In fact, it appears as if other than buying maybe an extra 1-1.5 million soybean acres in the US (not enough), the price move from the upper $8s to the lower $10s has achieved very little (especially with corn prices also rallying, offsetting the push to plant soybeans instead of corn). Current prices are still cheap based on the past 8-10 years of history ($8s to upper $17s). It looks like soybean prices could move back up towards the mid-point of that range over the next 12-18 months. If there are significant weather problems, much higher levels cannot be ruled out. Corn prices are likely to follow, somewhat reluctantly. Wheat is flailing in the wind. US and world wheat fundamentals look more bearish than before due to favorable weather, but I doubt wheat will sit still if soybeans and corn push higher.

Regards,

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