The Long & Short of It

April 23, 2021

Corn

Net change for the week:

May corn: 6.55 1/2 up 70
Dec '21: 5.50 3/4 up 38 1/2

Quite the week. And it's only April. What will July be like?

There was some chatter this week about cold weather delaying corn planting, but that's not what this rally is about. There are two primary forces behind the move. The first is Brazilian weather, and the fate of the second-season, "safrina" corn crop there. Safrina corn is planted after soybeans, and needs to go into the ground quickly in order for the corn to get past pollination before the dry season gets underway. But the soybean harvest was delayed by wet weather, which means that safrina corn planting was delayed by wet weather, and a large percentage was planted late.

The entire crop is not in peril. The single biggest producing state is Mato Grosso, which harvested an average of 43% of the total safrina corn crop from 2017-2019. That one state is getting sufficient precipitation. The other major producing states are in dire need of rain, and the dry season hasn't even started yet. A few scattered showers and storms are expected through month-end, but this will be nowhere near enough to improve crop conditions ahead of the dry season. Monsoonal moisture is currently expected to exit in early May, and crop conditions are already deteriorating rapidly.

So are the production estimates. South American crop consultant Dr. Michael Cordonnier cut his Brazilian corn production estimate by 2 million tonnes this week, to 103 million, citing the dry weather. Rabobank cut its projection by 2 million tonnes, to 105 million, and IHS Markit dropped its estimate by 4.55 million tonnes, to 104 million. And these production totals are only possible if crop conditions do not deteriorate any further, but the odds of that happening appear low. Assuming the dry season is as dry as usual, production totals are more likely to be closer to 95 million tonnes. For reference, the USDA last estimated 109 million.

Brazil tends to use its first-season corn for domestic use, and safrina corn for export. They have commitments to meet, and the crop is going to be much smaller than hoped for, so the Brazilian ag ministry has announced that import duties on corn from outside South America's Mercosur trade bloc have been suspended for the rest of the year. Brazil has already started importing corn from Argentina and Paraguay, and this was already exempt from import taxes since all three countries are in the trade bloc. Removing import duties for non-Mercosur countries increases the possibility of US and Ukrainian corn imports. We stand to gain more export business down the road when Brazil's exportable surplus runs out, and now there is speculation that some of that extra export business could be to the Brazilians themselves. This isn't a slam dunk, however. Many of the genetically modified corn varieties used in the US have not been approved in Brazil.

Brazilian weather is not the only force propelling the corn rally. We are months away from the next harvest, and old crop corn is getting difficult for end users to find. A commentary I read on DTN yesterday mentioned a $7.00 bid in the Texas panhandle. There is also talk of a possible squeeze in the May contract, which goes into delivery next Friday. Commercials may buy May futures and stand for delivery as a way of obtaining ownership, forcing shorts without deliverable corn to bid up prices in order to get out. The spreads are already hinting at this possibility. May corn closed today at a 23 cent premium to July, which is up 11 1/4 cents over the past five days.

One wildcard going forward is the potential for hostilities between Ukraine and Russia. Both sides have been lobbing artillery at each other for days, and an emergency meeting of Russia's Federation Council was scheduled for today. The operational powers of the Federation Council are few, but they include approving the introduction of martial law, approving a declaration of a state of emergency, or approving the use of Russian military power outside Russian territory. If war breaks out between these countries as it did in 2014, there could be damage to ports, railroads, and highways. Or, the insurance rates for ships in the area could get so high that the supply of Ukrainian corn flowing into the world market comes to a halt.

My upside objectives have been reached and exceeded. The safrina corn crop will be pollinating soon, so there could still be weeks left in this weather market. That said, weather markets are tough to trade because weather forecasts can sometimes suddenly flip from hot and dry to cool and wet. But if Brazil sustains the losses that many think are possible, and then the US has unfavorable weather this summer too, the record high of 8.43 3/4 made in 2012 would likely be in play. That probably won't happen without a weather threat here in the US, so I am not saying that is where this rally is necessarily going. It's just something that is entirely in the realm of possibility.

Soybeans

Net change for the week:

May: 15.39 3/4 up 106 1/2
July: 15.16 up 93 1/2
Nov: 13.41 1/2 up 67 1/2

There is no "safrina" soybean crop, so this rally isn't being fueled by weather. The strength stems from the vegetable oil market and scarce supplies.

Soybean oil futures are trading at the highest level since 2008. Biodiesel plants are cropping up all over the country and California pays incentives for biodiesel production, so more and more of the value of the crush is in the oil, rather than in the meal as is usually the case. It's not just soybean oil that is in tight supply. Palm oil is also used for biodiesel, and it too is at multi-year highs, prompting palm plantations to further deforest Indonesia to satisfy a world trying to be more "green." Brazil will keep doing the same thing, burning and clearing the Amazon jungle to plant soybeans to be crushed for oil. That may seem stupid to you and I, but to politicians trying to publicly demonstrate their willingness to fight climate change, I guess it makes perfect sense to cut down a rainforest to make biofuels. Even Canada, which is a major exporter of canola oil, is importing Ukrainian rapeseed oil due to tight supplies of vegetable oil. For what it's worth, my interpretation of the monthly soybean oil chart suggests that if May soybean oil, currently at 62.71 cents per pound, finishes the month over 60.41, the record high of 71.26 will not only be exceeded, but perhaps exceeded by as much as 20%.

It's worth noting that the Brazilian ag ministry announced this week that duties on imported soybeans, meal, and oil were being removed until the end of the year. Think about that. The world's largest soybean producer is removing import duties to make soybean imports more economical, and this announcement is being made before they have even finished harvesting a record soybean crop. The USDA is currently assuming that the US will import 35 million bushels of soybeans this marketing year so we can make it to the next harvest, while the country we are presumably going to import from is removing import duties in case they need to import. It's quite possible that the US and Brazil will have to take turns exporting to each other to fill in supply deficits between harvests. It is utterly astonishing how much things have changed in the last nine months.

Soybeans are getting harder for end users to find, and we could see a squeeze in the May contract if commercials try to force delivery. The premium that May holds to July has grown by 13 cents this week. The next upside objective for July is in the 15.50 area.

Wheat

Net change for the week:

May KC: 6.73 1/4 up 64
July: 6.80 1/2 up 64 1/4
May SRW: 7.10 1/4 up 57 3/4
July: 7.12 1/4 up 57 1/4
May Minneapolis: 7.18 1/2 up 54 1/4
July: 7.25 1/2 up 54 1/4

Some have credited this week's gains in wheat to cold temperatures a few nights ago, but there is much more going on than that. Regarding those temperatures, it did get colder than anticipated in parts of western Oklahoma and the Texas panhandle, and that is the area where some damage is the most likely. Here in Kansas, the northwest corner is where it was the coldest, but that is also the area where the wheat is the least developed. According to KSU, wheat in the joint state is unlikely to suffer damage unless the temperature drops to 24 degrees or lower for at least two hours. As of Sunday, about half of the Kansas crop wasn't even in the joint stage yet.

The larger weather threat has been in the Northern Plains and Canadian Prairies, where severe drought is putting the spring wheat crop at risk. Drew Lerner of World Weather Incorporated thinks that the precipitation chances will improve in these areas next month, so perhaps that concern will go away. I'm also hearing more talk about dry weather in France and Germany, which are the two largest wheat exporters in the European Union. Russia has some issues too. Russian consultancy IKAR lowered their Russian wheat production estimate this week by 1.5 million tonnes, to 79.5 million, citing winterkill and poor crop conditions in some areas.

Besides these supply issues, it appears that demand may be better than anticipated due to the tight supply of corn, which will ultimately result in more wheat in livestock rations as corn gets increasingly difficult to source. And this isn't limited to the US. Reuters reported this week that China bought "at least" 500,000 tonnes of French soft wheat, and there are rumors that the total could be as high as 1 million tonnes. This is milling quality wheat, not feed wheat, yet the Chinese are expected to use most of this for feed. They do not tend to import soft wheat for food. The same thing is going on in Brazil. Brazilian packers JBS and BRF feed

their own cattle, and have started buying wheat, as well as triticale and barley, because there is no longer enough corn to go around.

Last week I wrote that July KC wheat could retest the contract high of 6.67. That target was over 50 cents away at the time I wrote that, but four trading days later the market blew through that target like it was of no consequence at all, and then kept going. The monthly continuation chart suggests that prices may be headed somewhere north of $8.00. That doesn't mean that it will necessarily get there soon; there isn't a time element to that projection. And of course, it may not get there at all; I'll insert here my usual disclaimer about technical analysis working except for when it doesn't. But it at least gives us some clue about what the long-term potential might be.

Cattle

Net change for the week:

April live cattle: 117.85 down 3.00
June: 115.72 down 3.45
May feeders: 137.67 down 6.05
August: 149.90 down 4.65

Fed cattle sold mostly for $119-$120 in the South, compared to $120-$121 last week. Choice beef saw substantial gains, while the advance in select was more modest.   The average steer carcass weight for the week ended April 10 was 900 pounds, up 6 pounds from the previous week and 14 pounds more than a year ago.

The April Cattle on Feed Report was out this afternoon, and it came in friendly relative to expectations. The number of cattle on feed as of April 1 was reported to be 105% of year-ago levels, compared to the trade guess of 106%. Placements in March were 128% of a year ago, which was well under the average trade guess of 134%. Marketings in March were 101% of a year ago, which was in line with trade expectations.

That placements number is nowhere near as horrendous as it appears on the surface, because a year ago we were in the midst of a Covid crisis that was sharply reducing packing capacity. With packers unable to process the usual number of cattle, feedlots got backed up, which left little pen space for new placements. Also, some placements in February were delayed due to winter storms, and that bunched up March placements to some degree. Compared to 2019, placements were actually down one percentage point, and marketings were 15 percentage points higher.

Looking at what has happened to the cattle market this month, it is obvious that I underestimated how difficult it would be for feedlots to regain some leverage from the packers. Cutout values are soaring, fueled by outstanding beef demand from retail, food service and exports. With beef prices rising nearly everyday and cattle prices under pressure, the packers are making enough money to finance a small country.

Several things are contributing to the problem. One is capacity restraints in the packing industry. When Covid came along and sickened the labor force, the plants were reconfigured to keep people farther apart, which reduced the daily slaughter. This has been largely made up by increasing the Saturday kill, but there isn't much more than can do to increase kills further unless they start running seven days a week or open new plants. Meanwhile, packers have been buying cattle with time this month, accumulating inventory. Combined

with contract and formula cattle, they seem to have enough captive supply to keep letting the market come to them. Although this year should be different due to a smaller-than-usual rise in fed cattle supplies from the first quarter to the second, feeders appear to have been anticipating the usual April high and have not really fought to obtain better bids. That's especially true of the "basis traders;" those with hedged cattle that will gladly accept a lower packer bid as long as futures have fallen enough to provide them a strong basis.

I'm at the point where I'm about to defer my hopes for greater feedlot leverage out to the third or maybe even fourth quarter. This week's action has damaged the charts, and unless we see a decent recovery next week (perhaps the COF report will help), a week from now we'll have a key reversal down on the monthly chart. That's usually a fairly potent indicator of a high that is going to hold for a while.

Have a great weekend!

Jeff

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