SOFTS: Fast Facts—December 2017

WHAT'S AHEAD?

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ICE Notice: ***Softs Fast Facts Subscription Based Starting January:***

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Market Research, Analysis and Advisory Services

Softs Snapshot

Recap of What Has Changed; and What Has Not?

2018: Year of Commodities

A year ago, the leading concerns heading into 2017 by international forecasters was that there would be little chance of strong growth and instead geopolitical and economic instability would keep the world economy at a sluggish pace in a continuation of how activity was in 2016. Fears were that protectionist policies would derail the United States economy and keep growth in Europe also capped with the risk of the Euro being obliterated. This would make any economic recovery difficult and the world would continue to struggle. The October 2016 IMF report outlined that commodities would only see modest recoveries and there was a warning that turning back the clock on trade would deepen and prolong the world economy's then current doldrums. It was also felt that central banks reached their limit on expansionary monetary policy and 2017 may be the year where they face the day of reckoning about this. It was eight years of quantitative easing since the global financial crisis began and any sign of tapering in the European market was fret with worries. The spill over of economic concerns was also in Asia, particularly in Japan and then China. This led to the belief that 2017 would be a challenging year for commodities.

However, while the first half of the year did see prices continue to soften, since then the markets have tried to rally back in fits and starts. While drought was the major weather concern in 2016, too much rain became a common theme throughout 2017 and then especially so with a string of massive hurricanes and super typhoons that left island strewn in disaster and life changed for years overnight in several countries that are still without basics such as power and running water. Wild fires raged on an unprecedented scale while earthquakes rumbled and volcanoes erupted, all the while President Trump sent a hail storm of tweets that also rattled nerves.

Instead of the doomsday theories becoming reality, the stock market roared to new heights and crossed key threshold levels never before reached. The euro is stronger and the dollar weaker, while bitcoin far surpasses any currency for its astounding gains, which are only matched perhaps in shock value by the Venezuelan inflation rate and tumble in their currency. The Chinese economy didn't back slide as predicted and the rise of populism seemed to slow. While the threat of a nuclear war is frightening, the Fourth Industrial Revolution, which is led by technological advances, ushers in geopolitical instability, sharply reduces job security and has upended social and traditional business relationships. Technology is making longstanding industries obsolete. In fact, December 10th is Dewey Decimal System Day and there is probably a whole generation of kids that would not know how to find a book in a library with this numbering system that was widely used since 1876.

Heading into 2018, it may very well be that it becomes the Year of Commodities, with a chance of the unexpectedly steadier growth seen in 2017 continuing to pick up pace. Funds had been placing easy bets on the short side of the markets up until recently and may find that they collectively need to pull back or reverse from this as indications are that demand will thrive once again and that commodity prices are lifted even further. A deterioration in the dollar' value could occur. The World Bank has already targeted crude oil prices at $60 per barrel up from $55 this year. The Softs could find an ally in firming metal prices and the dollar dipping but also wider spread global demand from emerging markets. Brazil is still poised to bounce back fast from its prior deep recession. According to The Economist Big Mac Index, Brazil ranks 6th in purchasing power with Switzerland in the lead, then Sweden, Norway, the United States, and Finland. President Trump is reported to have a penchant for them and eats two as part of his favorite fast food meal. The average cost of a Big Mac in the United States is $5.30 compared to $4.47 in the Euro area, $3.24 in Colombia, $2.65 in the Philippines and Egypt second to last cheapest price $1.75. Swiss fork over $6.74 to chow down on this burger classic.

Despite the worries over global trade being crippled this year, international trade volumes are already rising. It was evidenced in a tightness of cargo capacity after cutbacks had been made in shipping vessels routes. Bulk carriers take the lead in the number of merchant ships and account for about 30% of total fleet.

While each individual market has its own particular fundamentals, commodity boom and bust cycles tend to move in tandem, driven by a period of hyper demand and high prices followed by a prolonged downswing as production kicks into high gear and demand growth cools. Heading into 2018, there are already some signs that the bulls will be kicking up their heels again. As noted, global demand seems to be on the rise again at a hastened clip after a rather protracted and beleaguered start from the financial crisis at the beginning of the decade. The murky waters last year and earlier this year of the eurozone splintering apart and China having a major meltdown have all passed without catastrophe. Even the Trump Administration has nearly made it through the first year and despite media reporting and anti-Trump sentiment, it is doubtful that he committed any impeachable acts. The stock market continues its upward trajectory and the United States economy has continued to move forward. La Niña could bring an abundance of rain to southeast Asia while keeping West African cocoa regions spared from harsh conditions.

Sugar and cotton have benefitted most from the pick-up in global use, as shown by their price recoveries and lack of stock build despite earlier reported surpluses.

Sugar:

Large Surplus Fails to Bulk Up Stocks: For more than a year, traders have been considering the size of the expected production surplus over demand this season with estimates varying between 5-6 million tonnes according to several published statisitcs including the USDA and International Sugar Organization and various trade reports. Yet sugar prices have ticked upward.

Outcome: It is not that the market is ignoring the strong likelihood that production will outstrip consumption by 5-6 million tonnes, it is that it won't create a similarly large in bulge in stocks. The difference between exports and imports, or unaccounted disappearance will keep the stock increase rather limited. According to the latest International Sugar Organization data, actual ending stocks are going to only climb 1.4 million tonnes this season despite production being five million tonnes above stated use. Furthermore, when stocks are measured against consumption, there is actually a decline in the ratio, which suggests that supplies this season are actually getting tighter despite the big production gain.

Brazil Focusing on Ethanol Over Sugar: Ethanol continues to take precedence over sugar as crushing of the 2017-18 crop continues. The season started with sugar in the lead and more than half of the crop moving towards sugar but that changed as ethanol prices rebounded and tax preferences favored pushing production towards fuel.

Outcome: While the Braziian sugarcane harvest will continue through end March, the weekly crush is winding down already with the majority of the crop already cut and processed. While for the season, sugar production is 2.3% better than year ago, this does not tell the full story. The percentage of sugarcane for ethanol is declining. The cumulative for the season is higher than last year at 47.4% VS 46.73% but the current figure is down to 42.5%, so a big drop from the prior volumes. At one point, sugar output was 6% better than it was last year, but that lead has been slashed to 2% better. In 2018-19 this trend should continue and that will reduce the volume of sugar to the market. The current sugar pricing is reflecting this likelihood.

MONTHLY OUTLOOK

Coffee

Brazil 2018-19 Uneasiness Continues Despite Rain: The market will need to wait a bit longer for confirmation on the outlook for the next Brazilian coffee crop as the development is not yet advanced enough to determine the production potential with any certainty. There has been an increase in rainfall of late and certainly any rain at this time of year is welcome news for the overall crop development but there are some areas that were previously too parched, too stressed that no matter the rainfall, the crop will not reach its fullest potential. It is only a matter of whether production in the other areas will be more than sufficient to offset this and keep the bumper crop from being achieved. The market needs a rather large Brazilian crop. A very good crop simply won't be enough.

Outcome: Still more time needs to pass before the next crop size is possible to consider with any seriousness. There is evidence already that what looks to be about 10% of the production on some farms may have been compromised. This does not consider that in other regions, production was not impacted nearly as much and in other regions, possibly more was hurt. What is clear is that it is not a uniform crop. Visuals of the trees show that there is a continued incidence of coffee borer and coffee berry disease. The borer presents with a black hole where the insect ate into the cherry. Coffee berry disease is evident by black fungus on the node and creeping onto the cherries themselves. If left untreated, it could spread and be a serious threat to production. Because of rather low stocks in Brazil, the crop needs to be near perfect to have sufficient supply next season and allow some stock buffering in advance of the 2019-20 season when again production could be set to decline.

Vietnamese Crop Outlook: Coffee areas received an abundance of rainfall. Through the growing season there was constant concerns that the rains were too good to be true, after two seasons of below average precipitation which drained water levels in reservoirs, which the farmer then relies on for irrigation.

Outcome: The size of the coffee cherries is larger this year due to plentiful moisture and this has aided crop prospects. The USDA attaché is now forecasting Vietnamese coffee output at 29.9 million bags or a gain of 1.3 million since the June initial crop view and an increase of production of 3.2 million bags from last season, owing to the improved rainfall this season. Due to rather low starting stocks, overall distribution will be 600,000 bags more than last season, but originally it was thought that exports would decline this year rather than increase. Rain during the harvest has spurred an untimely flowering, which could hurt prospects for 2018-19.

Colombia Suffers a Setback: Last month it was reported that October production, the first month of the new main crop, was considerably lower than last year. It was uncertain if this was an isolated event and production would rebound. The USDA attaché had pegged the total new marketing year output at 14.7 million bags, up 100,000 from 2016-17.

Outcome: The Colombian Coffee Federation believes that coffee production for October but also November and December suffered from very heavy rains at a critical time in flowering of the crop, which caused the losses. This is the most active period for the harvest and based on current estimates, there could be as much as 600,000 bags lost. This would be a temporary setback to Colombia's target of increasing production with ongoing rehabilitation of coffee farms to see ongoing growth in productivity. Colombia had a period of four years of rather low production starting at the end of last decade due to a combination of erratic weather, disease, and aging of the tree population. Colombia has made an impressive comeback and expects production to ultimately climb back to the prior record set in the early 1990s when more than 17 million bags was harvested.

MONTHLY OUTLOOK

Cocoa

Cocoa Surplus Forecast Trimmed: The International Cocoa Organization had previously estimated the 2016-17 production surplus at 371,000 tonnes. This was now reduced by a modest amount.

Outcome: The final tally for 2016-17 was not as overwhelming as previously anticipated with the surplus now reduced to 335,000 tonnes. Of course, this still quite large. However, the quality of the crop was not good and therefore, actual processed availability is not nearly as large as the surplus tonnage figure would suggest. This is partly the reason for the apparent tighter supply in in the cash market for cocoa by products and the surge in cocoa butter pricing relative to beans. A large percentage of the beans were rejected and the cocoa fat content on them was low.

Cotton

Demand Kicks In: Cotton prices were lifted on large export sales, which should force the USDA to raise the season target by as much as one million bales and lower United States ending stocks.

Outcome: Just as last year, the reality is starting to become clear that while production may be bigger than expected, so too is demand. The market is pushing higher as result and no longer feeling the weight of the large crop as a problem but instead as an opportunity to simply sell even more cotton. The market seems destined to repeat history in terms of the United States ability to sell what it grows. Much of the prior weight on the market was based on the expectation that ending stocks would be at least six million bales. With the sales to date, it would seem that ending stocks won't even top five million. The main sales period for booking USA cotton is still ahead. Foreign supplies are not going to be as bountiful as previously believed and that is also helping to benefit United States cotton sales this year.

FCOJ

USDA Lowers Florida Orange Crop Forecast: Last month it was believed that the initial crop assessment of Florida's orange production was too high. There was not enough time from when Hurricane Irma struck and the report to completely assess the damage.

Outcome: Florida orange production is now pinned at 50 million boxes, or four million less than initially forecast and probably 25 million less than what could have been if not for the devastating damage from the powerful hurricane. Standing water may have also caused root rot and more fruit could still drop prematurely from the trees, leading to a further reduction in the crop view. While prices have certainly rallied from levels prior to the hurricane, the gains have not come anywhere close to prior record levels despite the crop dropping to the smallest commercial crop in more than 60 years. The reason is because the reduced availability coupled with high prices is causing demand to be lost pretty much in lock step with the decline in output. While existing stocks in terms of the volume of processed orange juice on hand is rather low, with demand dropping as it is, higher stocks are not necessary. Brazil had a strong recovery in the 2017-18 harvest which is now finishing up and that too will help to keep the market adequately supplied. Certainly, a freeze this winter would be even more devastating for the industry.

Stats of the Month

The International Coffee Organization reported that exports slipped in October after posting a decline in September and August as well. October exports were only 8.799 million bags down from 9.928 million a year ago. The drop in volumes were from lowered Brazilian Naturals and Robustas. With more modest decline in exports of Colombian Milds and Other Mild Coffee. The drop in exports from Brazil and Vietnam the past 12-months was countered by greater exports from Indonesia and Honduras. Export volumes for the past 12-months are still significantly higher than the prior 12-month period (November to October). Since this is data for the first month of the new crop marketing year, there are no comparisons for 2017-18 on a cumulative basis with only the first month to observe. The prior 12-months exports topped 120 million bags VS 117.5 million a year ago.

The Green Coffee Association reported a decline in certified stocks in October but overall inventory levels in the United States remain at levels not seen since 1993. Total stocks of 7.035 million bags are well above year ago levels. This was the third month of falling inventories and represents a seasonal reduction. For the year, stocks, even with three months of declines, are still up substantially by 825,0000 cutting the overage from 934,000 bags the month prior. Stocks are likely to continue to drop in the coming months on slowed exports.

Ivory Coast cocoa port arrivals are starting to narrow the difference from this year to last year, giving improved expectations of production not declining all that much owing to favorable weather and good crop care. Last year production topped two million tonnes for the first time ever.

The combined ratio of cocoa butter and cocoa powder over the price of cocoa beans reached 3.83, a level not seen for nearly 12 years. This is an extremely attractive processing margin and should aid grinding.

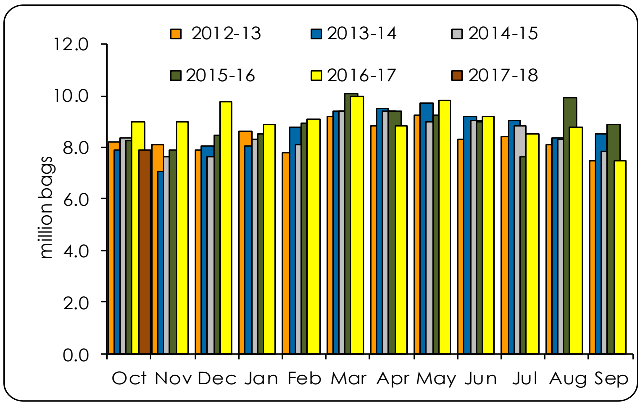
World sugar production is expected at a record 179.448 million tonnes compared to 168.373 last season as weather is expected to help boost production and so too did sharply higher planting of sugar beets in Europe. This marks the second year that production is climbing with last year a far more modest gain from the 164.253 million reaped in 2015-16. Production had reached a high of 174.145 million tonnes in 2013-14 but then El Nino linked cutbacks caused output to fall for back-to-back seasons.

China's cotton statistical balance is vastly improved from what it had been. End stocks are expected to fall to 39.669 million from 48.42 million last season and well off the peak of 66.92 million that had amassed by end of 2014-15. Chinese domestic mill use is beginning to recover with 2017-18 consumption pegged at 39 million or 1.5 million better than last season and up from the low of 2013-14 when mill demand fell to 34 million. Cotton use in China remains well below the peak of 51 million achieved back in 2007-08.

Demand for orange juice continues to fall. The season is getting off to a slow start and with prices rising, demand will struggle. Cumulative movement is down 25.1% on bulk product and 9.5% off on retail/institutional sizes for a combined drop of 22.1%. The declines are in keeping with retail sales data furnished by Nielsen that also show continued demand attrition.

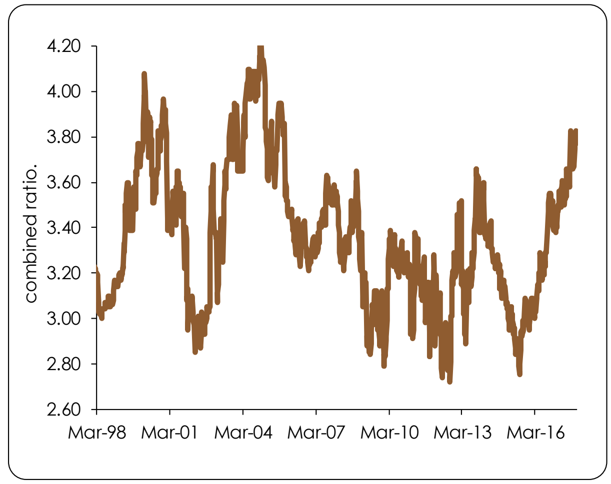
MONTHLY OUTLOOK

October Coffee Exports Fell from Year Ago levels—the Third Month of Lowered Volumes



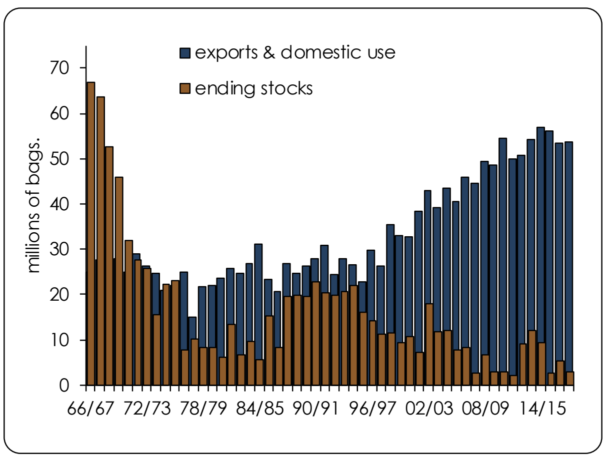
Source: ICO

Cocoa Combined Ratio of Butter and Powder at 12-Year Highs



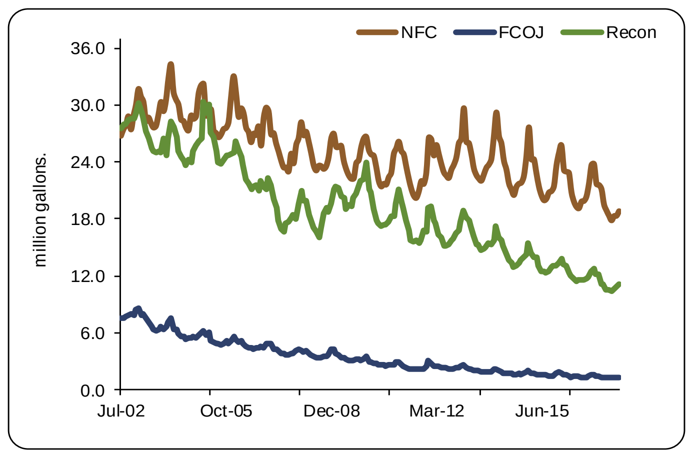
Source: Milling and Baking News

Brazilian Export Forecast Lowered on Tighter Supply While Demand Growth Steady



Source: USDA

USA Retail Orange Sales Barely Seeing Seasonal Gains



Source: Nielsen Scantrack

Watching the Weather

La Niña Impact Starting?

Meteorologists have remained fairly confident that the present La Niña condition, as characterized by equatorial sea surface temperatures (SSTs) are below average across the central and eastern Pacific Ocean, will continue through the Northern Hemisphere winter 2017-18 with 65%-75% chance). During La Niña, easterly winds gather speed, pushing warmer waters toward the coasts of Indonesia and Australia, bringing very high precipitation, including thunderstorms, in South Asia and drought like conditions in parts of South America. Comparison of production during the El Niño episode years suggests a typical fall of more than 5% in global cocoa production, but in La Niña episodes, on the other hand, there is an average 4% increase in global cocoa output. La Niña episodes appear to boost cocoa production in the Ivory Coast. For example, La Niña events between 1985-86 and 2005-06 marked a 13.2% increase in output above a six-year production average. In Ghana, La Niña episodes tend to increase production by 4.91% during the same period, The greater the intensity, the more favorable the crop outlook. The cocoa market has tumbled recently in expectation of improving conditions and production not declining as much as previously believed—in part due to the presence of La Niña conditions. The extent of the production benefit though does depend on the time of year and severity of the conditions.

For coffee, there is no statistical difference for Brazil when La Niña conditions are present. Vietnam sees increased precipitation but if too severe, output could be harmed. The same holds true for Colombia. There is already concern that prior heavy rains have caused losses for October-December output.

While some sugar producing countries may be negatively impacted by the present of La Niña conditions this tends to be offset by an improvement in other countries negating the impact of harsh weather. Sugar production is actually now becoming less concentrated and that too minimizes the chance of a severe weather risk.

It is getting close to the timeframe when Florida citrus becomes at risk in the event of a cold snap. There are differing views over whether the winter will be warmer than usual or colder. The Farmer's Almanac had forecast a chillier winter while NOAA sees a mild winter, but this does not mean there won't be any bouts of chilly weather. It simply reduces the chance of an artic air mass to push far enough south to harm the crop. The coldest weeks of the winter are still from Christmas extending into mid-January with the likelihood of a severe cold snap diminishing thereafter. The later in the season, the less damage possible with the fruit mature and the harvest advanced. With production already sharply reduced, any loss to the box count would register as a large percentage drop. Trees may be more vulnerable for lasting harm if roots are in a weakened state from Hurricane Irma flooding. As in any year, the chance of a freeze is limited but the market will start to become more sensitive to weather forecasts shortly.

For cotton, the weather is not a major factor until springtime when farmers will start to plant cotton once again. Prior, a cool winter is better as it helps trees to have a period of rest after a heavy load this year. Cocoa prices have stumbled this past week on improved weather forecasts for key countries. A moderately low Harmattan winds are expected, which should reduce crop stress.

Fundamental Favorite

Range Trading with Confidence

In my nearly 35 years of tracking the Softs, I have seen each of the markets at extremes, both highs and lows, overall multiple cycles. Sugar had plunged to 2.3 cents per pound and rocked to 37 cents during my career span, but spent many years nested between 8-10 cents then 12-14 cents and most recently between 14-16 cents. The sugar market finds a comfort zone within a 2-cent range and can sit in that level trading back and forth for months at time.

The cotton market I have seen towards 30 cents and above $2.00 but most years the market waffles back and forth between 60-70 cents or 65-75 cents and maybe extends the upside slightly or the downside, but then falls right back into it's comfort zone. Too low and planted acreage is reduced and demand is stimulated and too high, export sales slacken and planting prospects jump. Coffee prices also seem to gravitate back towards well known trading ranges with outlier years that are generally from a supply shock pushing the market to an extreme level and then this is followed by a surge in production that pushes the market sharply lower. Coffee has been as low as 32 cents and over $3.000 in the past three decades but most time is spent between $1.20 to $1.40 per pound. While some farm costs have gone up, there are other savings at the farm level and improved yields per hectare, which is why the market can still be trading in the same prices as it was 30 years ago.

The cocoa and FCOJ market have less defined trading ranges than sugar, cotton, and coffee. Cocoa tends to move in far greater swings with wild gyrations within a season and from one year to the next depending on production prospects in West Africa. The market seems to flip more easily from bullish to bearish and back again more frequently than the other softs. The FCOJ market also exhibits more price volatility owing to the market fundamentals vacillating between worries of supply shortages due to poor production but at the same time the recognition that demand will fall to match the availability.

ICE Update: Robust Rule Changes

Summary-Robusta Rule Changes

Effective from July 2018 expiry, there are three important rule changes that will go into effect.

1) Shortened Settlement Timeline
2) Load out charges (Free on Truck) included in the futures price
3) Rent
    a. Included up to the end of the delivery month in the futures price
    b. Global Average Rent Adjustmen

AFFECTS

Warehousekeepers—be clear on 2018 charging structures

Certified Stockholders—be aware of step-change from July 2018

Physical Market Participants—consider futures reference point in relation to differentials and local exporters to be aware of changes and beware spread moves when price-fixing.

IMPORTANT TO REMEMBER: Shortened settlement: 14 days become 4

Under the new rules first notice day is 26 June 2018

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