

Three hours and fifty nine minutes

"To lose one parent may be regarded as misfortune; to lose both looks like carelessness." Oscar Wilde, *The Importance of Being Ernest*.

I would like to paraphrase the above; "To run out of corn may be regarded as a misfortune, to run out of both corn and soybeans looks like carelessness". Last September I accused the USDA of deliberately misleading the market when they emphatically stated that there was no comingling of old crop corn in the September stocks. By doing so they managed to offset their overstatement of the 2009 crop. I have also been insistent that they are still overestimating the 2010 crop as well. It is well known that the 2010 crop is of excellent quality and of higher feed value than normal, so the bullish surprise in the March 1 stocks report strongly suggests a sharply lower carryin than the official number.

In Friday's supply and demand report the USDA provided some heavy ammunition to those who wished to shut the government down. Incredulously, they left the old crop corn carryout unchanged. Why bother to have a March stocks report at all if the USDA is simply going to disregard its input? The implied domestic feeding for the next five months is projected to be at a twenty-five year low, this despite good to great profitability through all animal sectors and unusually heavy animal weights. According to the USDA this rationing will occur at prices much lower than those which prevail today. Ironically, having ignored last year's comingling of new stocks, the USDA is now trumpeting that early new crop corn will save the day. Their increased feeding of soft wheat is also overly optimistic. Thanks to the variable storage rates in Chicago, soft wheat is now grown primarily to be stored and locked up as an annuity, not consumed. Where else can you earn a 25 percent annual return with no risk? Elevators have become giant Roach Motels. Wheat checks in but never checks out. The USDA continues to grossly overstate the world corn carryout. I can understand that if you have a budget of \$3 billion per week, and live in one of the biggest buildings on the planet, you would naturally think big, but the USDA's estimate of Chinese corn ending stocks at 58 million tons is a miss worthy of the Guinness Book of Records. Anyone watching the Chinese corn market over the last year would conclude that those stocks would be under 10 million tons.

It should be obvious to all that a monumental rationing of corn lies ahead. Had the USDA not pursued their gradualistic approach to dropping yields and had they not messed up the September stocks, the market would have had a signal many

months ago to force rationing. By now the domestic feed and ethanol industries have, on average, excellent forward coverage of at least two and a half months, so the rationing of circa 500 million bushels of corn will have to take place during a very short time span. Every time the market gets close to rationing it backs off and falls out of bed. Whatever the catalyst; earthquakes, tsunamis, Mubarak, Libya, or just Goldman cracking the whip, invariably the market responds like a lemming and seeks the nearest cliff, and the rationing process is postponed, once more.

The market can only respond to the signals that it is given and if those signals are bad, bad things will happen. Try turning on your left turn signal on the expressway at 70 mph and turning right. So, what other signals have we had from the USDA, apart from the bogus supply and demand report? Tom Vilsack, Secretary of Agriculture, recently expressed a desire to increase CRP acres. He also wrote, two weeks ago, a letter to the Financial Times praising the glories of ethanol. Then John Block, former Secretary of Agriculture, wrote in the Chicago Tribune on April 5th: "Far from biofuels stealing food from hungry humanity, the world food crisis would be much worse were it not for the innovations that the ethanol industry has encouraged in American agriculture". This quote clearly belongs in the Monty Python skit "The argument clinic." Mr. Block continued: "Ethanol uses feed grains, largely corn for livestock. The food grains people actually eat, mostly rice and wheat, aren't affected by biofuels products." One would have perhaps thought that being able to connect the dots between corn, livestock and meat would have been a prerequisite for the job of Secretary of Agriculture. Apparently as corrosive as ethanol is to your car's engine, the lucre of ethanol is more corrosive to the political brain in Washinton D.C. I would say this to the present and past Secretaries of Agriculture, and/or ethanol lobbyists: Ethanol will shortly enable you to drive up to the McDonald window and place your order for a quarter ounce and cheese. In a few months, when the waiter in a restaurant asks you "how did you find your steak?", you can reply "I lifted up a french fry and there it was!". Hurry, you better load up at the supermarket with boneless and skinless chicken before it becomes meatless as well.

For those of you who think that we cannot run out of a commodity, take a look at the old crop/new crop cotton spreads. The spreads have recently traded at a price which is higher than the highest price that cotton traded at for the previous fifteen years. The equivalent spread in corn would be July-Dec at \$7.50, and July-Nov beans at \$17.00. That my friends, is what I call running out. In commodity trading inverses are the true barometer of tightness.

Notwithstanding the USDA, the apparent corn carryout today is headed towards 500 million bushels. History says of that about 200 will still be left on the farm, leaving us with about 10 days supply on September 1st, scattered across the country. We better have a record amount of early southern corn available on that date, and an early Midwest harvest. With a dying la Nina, the odds are for a wet, cool summer which is not conducive to pushing crops to early maturity, and without a la Nina to shear the hurricanes, the record warm North Atlantic waters should spawn plenty of hurricanes. God forbid that a tropical depression forms in the center Gulf in early September or that the Chinese buy more old crop corn. By constantly fooling around with the numbers since last August the USDA is risking a blow-up of unprecedented proportions. The margin of error is razor thin. Of course they will not be held accountable. There is a simplicity and beauty hidden in the USDA acronym, U Screwup Dey Accountable. Congress, the CFTC and the public will have a field day gunning for the speculators and the food companies that are gouging them.

The more I think about the old crop corn situation, the more it reminds me of the warning that accompanies the erectile dysfunction commercial "if you have an erection lasting more than four hours, IMMEDIATELY seek medical attention". So, picture this, after two and a half hours you continue reading "War and Peace". After three hours no worries. After three hours and forty minutes you brew yourself a cup of tea. After three hours and fifty eight minutes you casually look at the clock and yawn. Then, after four hours and one second you jump up, totally stunned and bewildered by the sudden and unexpected turn of events. You start hurling furniture around in a frenzied panic looking for the phone to call the paramedics. The longer we wait to ration corn, the more dysfunctional and violent things will become. You can only go to the tipping point. You cannot rewrite history and deconsume corn. "Archduke Ferdinand found alive. First World War a mistake."

With all the attention given to corn, the old crop soybean situation has been utterly neglected, despite the fact that the USDA's projected carryout is one of the tightest on record. The large soybean crop and weak premiums in South America have caused the trade to assume that export sales will be cancelled and that the carryout will be comfortably larger than the USDA's estimate of 140 million bushels. Throughout last fall the trade overestimated the soybean crop. Exclusively focusing on the good yields in the core belt, the trade paid scant attention to the very poor peripheral yields. Kansas with 4.3 million soybean acres dropped 11.5 bushels per acre from the previous year. I bet that is the first time that

you have ever seen the words Kansas and soybeans in the same sentence. The neglected periphery lowered the national yield by 1.5 bushels per acre. On top of this, with a record early crop, the USDA was up to its usual tricks of comingling old crop and new crop, thereby overstating the September stocks. Both the December and March stocks were well below expectations but the trade still expects to find stocks back through the magic of negative residuals. In my opinion the large South American crops and market action have dulled the collective mind.

Virtually every day for the last several weeks, there have been rumours of US cancellations to China. If all the rumours were correct, US exports would be zero. The perennial rumour of Argentine soybean meal sold to the US was trotted out once again. That really got the lemmings going. Acapulco or Jonestown? I have seen nothing to suggest that the US carryout should end up much above 160 million bushels. At that level I believe the transition from old crop to new crop will be as tight as any we have seen in the last ten years. The crop year begins on Sep 1 but the main Midwest harvest is not until October. Year in year out, what typically bridges the gap is the single crop southern harvest. From the March 1 planting intentions, one can calculate that around 2.8 million single crop southern acres have gone to other crops, while doublecrop soybean acres, which are harvested mid-October, have increased by 2.4 million. Since March 1 the signal to the farmer could not have been stronger to plant even more corn and cotton acres. Not only did the signal come from the outright price but also from the steepness of the inverse in cotton and corn, whilst the soybean inverse collapsed. I believe that the southern farmer will respond with an additional 500 thousand to 700 thousand acre switch away from single crop beans. If this is correct then some 120 to 140 million bushels of southern beans, which normally get harvested end August to late September, will be missing.

Rather than just look at the Sep 1 supplies, I think it is more correct to combine those with Sep 15 new crop availability. Last year the crop was exceptionally early everywhere and the snug Sep 1 carryout of 151 million bushels was boosted by 157 million new crop on Sep 15 for a total of 308. In 2004 a very tight carryout of 112 was boosted by 121 new crop for a combined supply of 233 million, the second lowest in ten years. The lowest combined was in 2009 at 183. If the carryout this year is around 160, then total supplies will be similar to 2009 as I expect no more than 25 million Sep 15 new crop harvested. In 2004 the August/Sep soybean spread traded between 24 and 97 over in the month of August suggesting extreme tightness. In 2009 the same spread traded between 75 and 150 over. That same year the August/Sep meal

hit a late season high of \$67, Sep/Oct \$81, and Oct/Dec \$31 for a combined whopping \$179 inverse. Today's cotton market would be proud of those inverses. We all know that soybeanmeal consumption has been heavily impacted by DDG's and will continue to be impacted for the medium term. Unlike soybeanoil, soymeal is poorly storable and must seek a market clearing price; in other words, soybeanmeal is a flow. However, if my calculations are correct, lack of available soybeans will apply a sudden tourniquet late summer to that flow. If, as I suspect at the same time, corn supplies are running low, or running out, the competition from DDG's will become far less intense.

The corn market is probably the most dynamic I have ever seen, but it is high stakes poker all the way. The potential tightness between old crop and new crop soybeans is not on anybody's radar screen. The same combination of meal spreads that went parabolic in 09, are available today at a discount to even money. Being a Scotsman I have always thought that lotto tickets were too expensive, but this is a risk/reward opportunity that I simply cannot resist. The truth is, as Oscar Wilde said: "I can resist everything except temptation."

John Macintosh  
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