



Why Agriculture & Softs should be in your Commodity portfolio

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From sugar to cotton, cocoa to soybeans it's all about global supply and demand. Whether you are a trader that relies on fundamentals or technicals do not over complicate your trading philosophy. Step one - identify what the supply and demand dynamic is for the underlying commodity you are looking to trade. If there is a deficit or diminishing supply in the underlying commodity and demand is growing, guess what, prices are probably heading higher and that's the case with a number of agricultural and soft commodities. Here we will discuss our outlook on what we view to be some standouts within these sectors and some potential ideas on how to capitalize on the coming moves into 08'.

In a research note to clients Morgan Stanley said "agriculture is likely the most recession-proof of all asset classes in commodities." Although it is evident that the global growth engine may be stalling we feel this is just a pause in a secular bull market that has many more years in the making. Just days ago with the rising cost of milk, eggs, meat and produce we experienced the biggest jump in food prices in 17 years; with insatiable demand worldwide, we expect this to be the unrelenting trend. Remember it boils down to supply and demand. Whether it is a smaller crop, weather issues, or just a growing population, demand is outstripping supply for a variety of commodities across the board.

The global battle for acreage is causing a kind of cyclonic effect, as needed changes in acreage rotate from crop to crop. Three commodities that we believe will continue to trade higher fighting for acreage are cotton, corn, and soybeans.

Cotton – Cotton prices pushed higher in late 2007 as planted acreage fell to an 18 year low caused by the fact that corn and soybean returns were much better for producers than cotton. As a result ending stocks are expected to drop; once again supply and demand cannot be ignored to recognize potential trading opportunities. If the production and usage of 07' is repeated in 08' ending stocks could slip to the lowest level since 95/96 which is also the year of all time highs of 117.20 for the nearby futures. The current price of cotton is approximately 70 cents, which based on the perceived supply is cheap. The wildcard here will be demand out of China and India, which now represent 58% of world cotton usage. We will be recommending both option and future strategies looking for December 08' cotton to trade at 85 plus cents.

Corn – The need to avoid losing too many acres to wheat and soybeans will be a key factor for the corn market this year. The market has reacted to this need by enticing US producers to plant the highest number of acres in corn since 1944. This is the supply side but the underlying issue here is that the demand is growing at a feverish pace globally and even with all these acres corn has still managed to trade up and does not look like its high is in yet. The world ending stocks/usage ratio for the 07/08 season is estimated at just 14.5%, a record low since at least 1960. For the first time since 1996 when corn hit the highest price in history, China could become a net importer of corn in 08'. The trend remains up and we would recommend buying breaks in December 08' corn ultimately looking for 5.50 and potentially 6.00 per bushel.

Soybeans – Beans in the teens is no longer a far fetched dream but a reality as soybeans traded above \$13 this past week. The recent rally was not based on near term supply and demand issues given that ending stocks are relatively high. Rather, the 2007 rally was based on projections of a record one year drop of 60% in stocks that would be

available in September 2008. The reason for the expected decline is the steady rise in consumption. Prices needed to rally to attract increased acreage in S. America for the 07/08 season and will need to stay high to attract further acreage in the US for 08/09. Additionally the world needs higher acreage because of the increased crush demand that will be needed to support the higher bio-diesel consumption projections. With growing open interest and increased fund activity the move higher in beans is far from over in our opinion and a further 7-15% rise in prices on the board is reasonable. Buy significant breaks as there are many gaps in the daily chart that could get filled on pullbacks before a further acceleration in prices. For a position trade in the futures we would recommend trading November 08' and for options we would trade a back spread in May.

Although agriculture commodities have been getting all the buzz, much like Rodney Dangerfield we do not think the softs get the RESPECT they deserve. Find below a few notable soft commodities worth taking a look at.

Sugar – After a range of over 10 cents in 2006, sugar prices consolidated and stayed in a relatively tight range of just 3.30 cents in 2007 but volatility is back. Just over one week into 2008 and we have already established a range greater than 1 cent, with sugar appreciating nearly 20% in the front month futures just from early December 07'. As the sugar market continues the transition from a food commodity to a food & energy commodity the impact of changes in energy prices on sugar supply and demand should make things interesting. With sugar as one of the cheapest feedstocks for ethanol production and with the growing possibility of increased Brazilian exports to China, Japan, and others, the world may rapidly see the projected surplus shift to a deficit. With a great deal of volatility expected, we anticipate to see sugar #11 make its way back to 15.50 in 08' and 20 cents into 09' if not sooner, but be careful picking your points.

Cocoa – While a number of critical supply side uncertainties face the cocoa market in 2008, prices begin the year having been range bound for the better part of 5 years trading between 1300-2400. Cocoa prices have moved up just under 600 from 07' lows and may still have some upward momentum left. World cocoa consumption is growing year over year, supplies are suspect, cocoa workers are at all times either on or talking about strike, and political uncertainty inside the largest production country, a potential bullish case can be made for cocoa. Furthermore with many commodities near or recently making all-time highs, cocoa is far from its all-time high of 5379 reached in 1977. As a side note cocoa in the past has seemed to have an inverse relationship to the US dollar so depending on how you feel on the almighty buck that could affect your outlook on cocoa.

Coffee – In October 07' nearby futures in coffee hit an 8 year high trading above 140 but since prices have backed off. The current price although off the recent highs is far from the lows seen just in 01/02 of nearly 40 cents per lb. The gradual grind higher in prices looks to continue into 2008 with the world stocks to usage again looking to move lower. Brazilian CONAB's most recent estimate has the crop size between 41.3 M and 44.2 M which is on the lower end of estimates. With solid demand and extremely tight stocks in producing countries and an "off" production season ahead it would not take much to see the makings of a supply driven bull trend to lead to another leg higher in coffee prices. We will be playing coffee by trading call spreads, depending on the premiums anywhere from 10-20 cent bull call spreads.

Closing we have discussed just a small amount of the many opportunities that will present themselves to the informed trader in agriculture and softs in 08'. For a more detailed explanation on these or perhaps other commodity trading ideas do not hesitate to contact us. If you are not receiving MB Wealth's Weekly Commodity Commentary yet you should be. Contact us today to open your trading account! Call Matthew Bradbard at 1-888-920-9997 or email me at <http://www.mbwealth.com/contact.html>

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