

Corn: It's Too Early to Count on a Bumper Crop

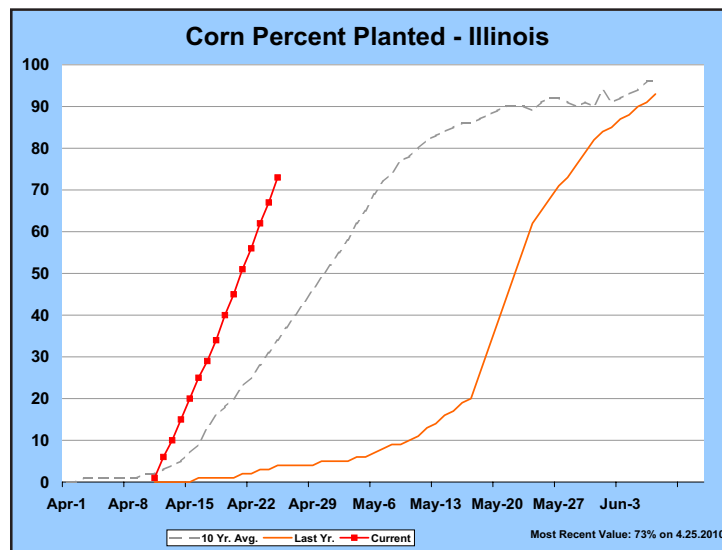
April 30, 2010

Signs of better demand ahead due to the expanding global economy and ideas that China will eventually import feed grain are factors which could quickly bring about a need for the corn market to build a weather premium. The market may be in the process of bottoming out this spring and about to begin a demand-led rally into the early summer. Traders seem to have already priced in a conservative demand outlook for the rest of this year and next year and a relatively large crop for this summer.

While many other commodity markets have moved well away from the depression-type pricing that was seen in the wake of the sub-prime crisis, December corn was up only 15 cents from the 2009 lows as of April 27th. The fast start to this year's planting pace has allowed the market to become complacent about the possibility of a tight supply situation developing if we were to see less than perfect weather for the coming growing season.

Corn Planting Ahead of Pace

The corn planting percentage reached 50% as of April 25th, the fastest in at least 28 years. (The previous record was 37% in 2004.) Given the strong start, traders appear to be counting on a huge yield (and a bumper crop) this summer. However, historical data does not show much of a correlation between early plantings and yield. Precipitation during June and July and the temperatures that occur during pollination are the dominant factors.



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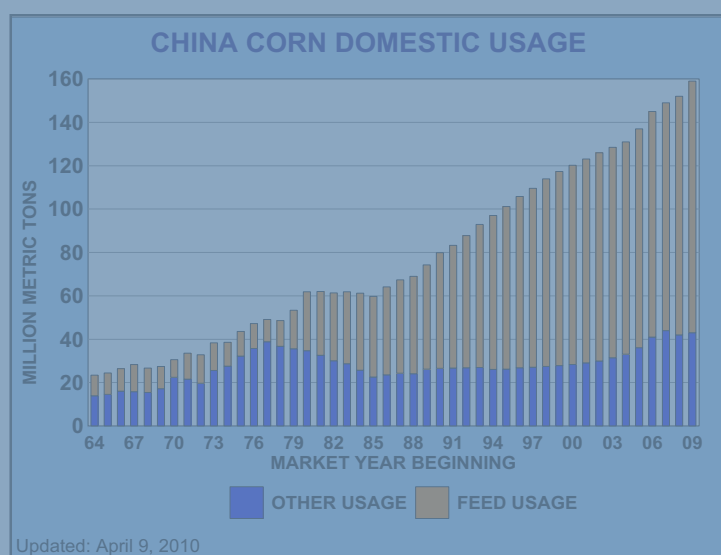
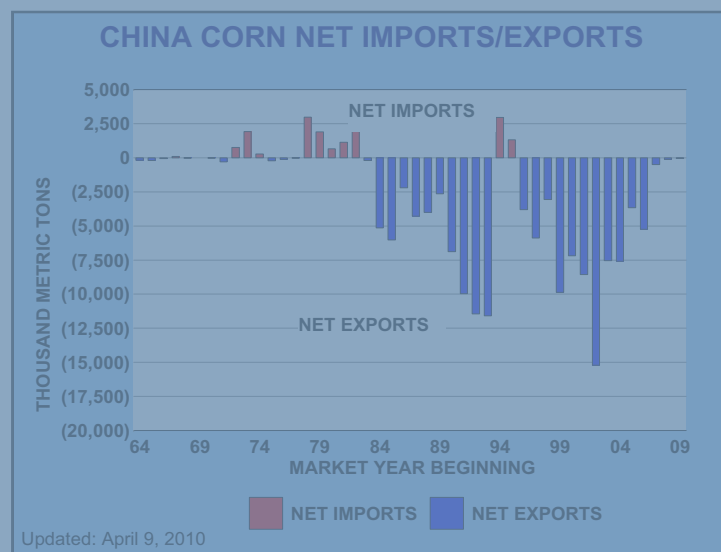
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Basing a yield prediction on how early the crop is planted could be a dangerous game. In 2004 the crop was planted early but weather was excellent for the entire season. Yield reached 160.3 bushels per acre and production totaled 11.806 billion bushels, both new record highs for that time. December 2004 corn contract posted a contract high on April 8th at 341 ½, but by December 2nd it had fallen to 191, the contract low. In contrast, the 2006 crop was also planted early (70% by early May), but yield ended up below trend that year at 149.1 bushels per acre, due to dryness from in late July and August.

Will China be a Corn Importer This Year?

The corn market saw a spike higher on April 7th on rumors of China buying corn, but it quickly retreated when the buying could not be confirmed. However, just the thought of China shifting from being an exporter to an importer may have been enough to turn the psychology of the market from bearish to bullish. We believe China will be an importer of corn sooner or later and that the odds of it happening this season are improving significantly. On April 28th China bought 115,000 tonnes of corn for delivery in the 2009/10 season. In the April USDA World Supply/Demand report, China's total imports for the 2009/10 season were pegged at 100,000 tonnes and its exports were revised lower to 150,000 tonnes from 500,000 tonnes in the March report. Traders believe China has already bought another 300,000 tonnes and there is talk that China will import close to 2 million tonnes this year.

In each of the last 13 years, China has been a net exporter of corn with amounts mostly ranging from 5 to 15 million tonnes (197-591 million bushels). The last time China was a significant importer was in 1994 and 1995, when China brought in net amounts of 2.95 and 1.32 million tonnes, respectively. December 1995 corn moved from spring planting season prices of around \$2.50/bushel to a contract high of \$3.44 1/2 by December 2005. The May 1996 contract eventually reached an all-time high of \$5.36 per bushel by expiration. China and Asia growth situations were similar in the mid-1990's to what they are right now, as expanding incomes and increased food consumption were common themes. The USDA believes China production was 155 million tonnes last year, but there are still traders who believe the crop was even less than 140 million tonnes. We would not be surprised if China imports as much as 4-5 million tonnes this year, especially if there are any weather concerns for the new crop season.



With China seeing poor planting weather so far this spring, an ongoing drought in the southwest part of the country and the possibility of expanding corn usage in the coming season for high fructose corn syrup, starches and livestock, it becomes more and more likely that China will be a net importer for the coming season. China's pork production is soaring and is now 5 times that of the US (see chart).

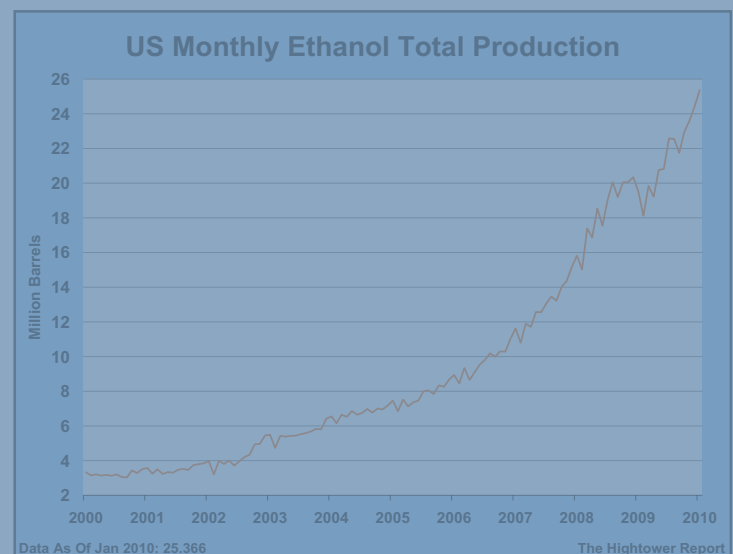
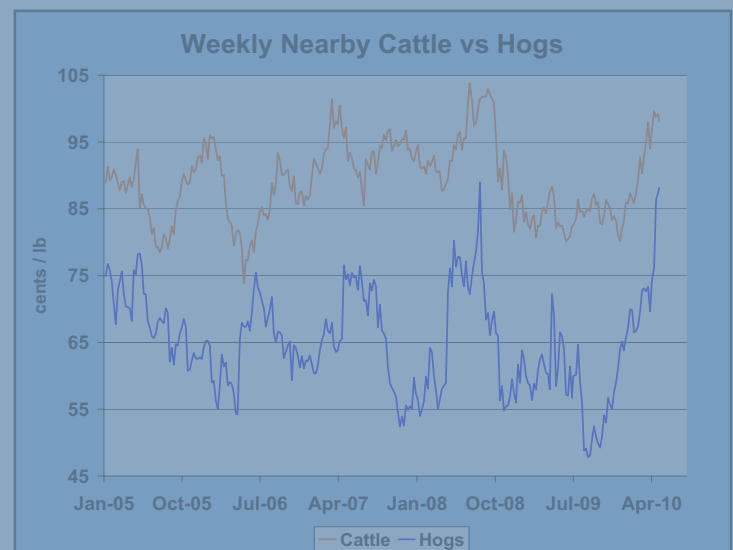
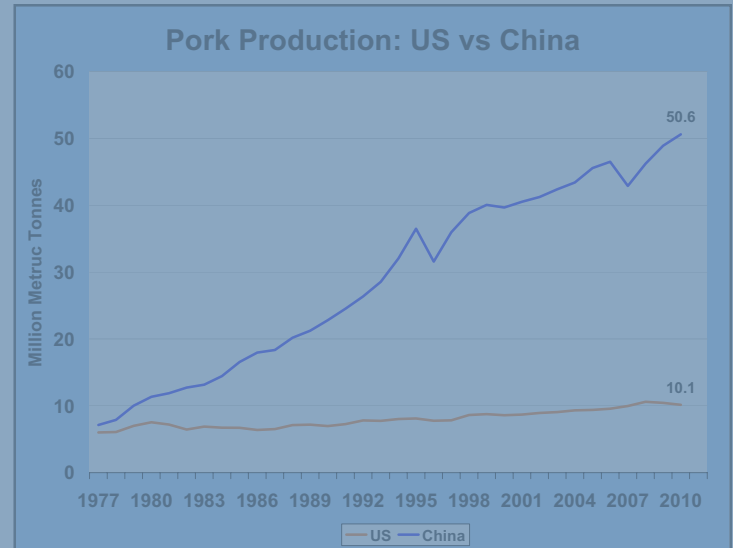
Given the outlook for their economy, we see no reason to expect that China would need *less* corn in the future. On top of the domestic meat production, industrial usage in China is expanding rapidly, and a significant sugar production deficit for China the past two years has helped boost HFCS usage of corn over the past year.

Demand Growth Potential

In the meantime, demand for corn appears to be improving. Estimates are likely to be revised higher for US corn exports, corn used to produce ethanol and even for livestock feed. Weekly export sales have run well above the average needed to reach the USDA's current export projection for the past 5 weeks. For the week ending April 22nd, corn sales came in at 1.228 million tonnes compared with 459,800 tonnes necessary each week to reach the USDA projection. The average of the past four weeks is 1.268 million tonnes. The enclosed livestock price charts speak for themselves. We expect demand for feed grain to improve as livestock producers expand herds and increase feed rations as their profitability levels improve.

The enclosed chart showing ethanol production suggests industrial demand for corn is also increasing. For the most recent reporting period (January 2010), an estimated 389.7 million bushels of corn were used for ethanol production. This is above the estimated 355.1 million bushels that need to be consumed each month to reach the USDA's current corn *Ethanol for Fuel* usage estimate for the 2009/10 season. Given the recent trend, we would think that the USDA may raise the ethanol usage number (and lower the 2009/10 ending stocks estimate) in future monthly USDA reports. In addition to that, the EPA is considering shifting the gasoline blend rate from the current maximum of 10% ethanol to gasoline to 12% or 15%. An announcement is expected in June.

If exports, domestic feed usage or ethanol usage is revised higher, beginning stocks for the 2010/11 crop could be revised down from the current estimate of 1.899 billion bushels. We



could easily see a drop of 300 million bushels with just export and ethanol usage along.

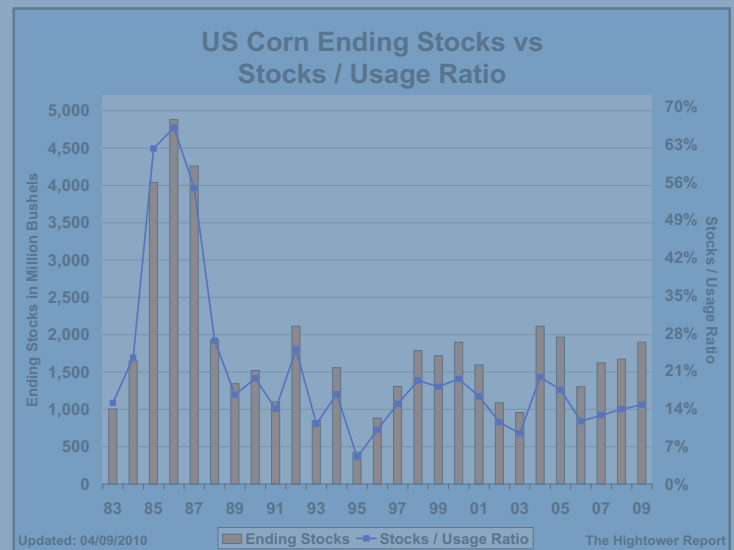
Yield Expectations Overly Optimistic?

On top of demand issues, we feel that the market may be basing its yield expectations on the successful growing seasons of the past two years under what have been “ideal” conditions. A return to a more normal weather pattern might lower yield expectations and result in a tighter than expected supply.

If there are any weather or demand issues that surface to suggest that prices are just too cheap or that supply will tighten, the technical set-up for the market is such that corn prices could quickly turn around to a more bullish posture.

A review of the new crop supply/demand situation may be in order. The enclosed table shows the current outlook for ending stocks given various yield scenarios for the 2010/11 season. Many traders see “trendline” yield this year around 160.5 bushels per acre. If we plug in the USDA Prospective Plantings report estimates and some conservative usage estimates, we start the season with 1.899 billion bushels and end the season with 1.693 billion.

However, the University of Illinois makes a very strong argument that recent years have seen “better than normal” weather (with a lack of heat in July and above normal precipitation in June and July) and that if we see “normal” weather for the Midwest this year, the average yield would be closer to 157 bushels per acre. At this level, ending stocks



USDA SUPPLY/DEMAND US CORN					Apr	Apr	Apr	2010-11 Crop Outlook		
	03-04	04-05	05-06	06-07	USDA 07-08	USDA 08-09	USDA 09-10	Trend Line	U of I Trend	5-Year Average
	Planted Area (M Acres)	78.6	80.9	81.8	78.3	93.5	86.0	86.5	88.8	88.8
Harvested Area	70.9	73.6	75.1	70.6	86.5	78.6	79.6	81.3	81.3	81.3
Yield (Bu/Acre)	142.2	160.3	147.9	149.1	150.7	153.9	164.9	160.5	157.0	153.3
Beginning Stocks (M Bu)	1,087	958	2,114	1,967	1,304	1,624	1,673	1,899	1,899	1,899
Production	10,087	11,806	11,112	10,531	13,038	12,092	13,131	13,054	12,769	12,468
Imports	14	11	9	12	20	14	10	10	10	10
Supply, Total	11,188	12,775	13,235	12,510	14,362	13,729	14,814	14,963	14,678	14,377
Feed & Residual	5,793	6,155	6,152	5,591	5,913	5,246	5,450	5,500	5,500	5,500
Food, Seed & Industry	2,537	2,687	2,982	3,490	4,387	4,953	5,565	5,770	5,770	5,770
Ethanol for Fuel	1,168	1,323	1,603	2,119	3,049	3,677	4,300	4,500	4,500	4,500
Domestic Total	8,330	8,843	9,134	9,081	10,300	10,198	11,015	11,270	11,270	11,270
Total Exports	1,900	1,818	2,134	2,125	2,437	1,858	1,900	2,000	2,000	2,000
Use, Total	10,230	10,661	11,268	11,207	12,737	12,056	12,915	13,270	13,270	13,270
Ending Stocks	958	2,114	1,967	1,304	1,624	1,673	1,899	1,693	1,408	1,107
Stocks/Use Ratio	9.4%	19.8%	17.5%	11.6%	12.8%	13.9%	14.7%	12.8%	10.6%	8.3%

would slip to just 1.4 billion bushels with a stocks/usage ratio of just 10.6%, the second lowest in the last 14 years.

If were to see a yield of 153.3 bushels per acre (the average of the past five years), it would leave ending stocks at just 1.1 billion bushels and a stocks/usage ratio of just 8.3%, the second lowest since 1973. If usage is 300 million bushels more than expected for the 2009/10 season, you can see how quickly the market can see tightness.

Bear in mind that we are not predicting lower yields. We are just trying to point out that a high yield will be necessary this year to avoid a tight situation. None of the estimates above call for exceptionally poor weather, just at or slightly below trend.

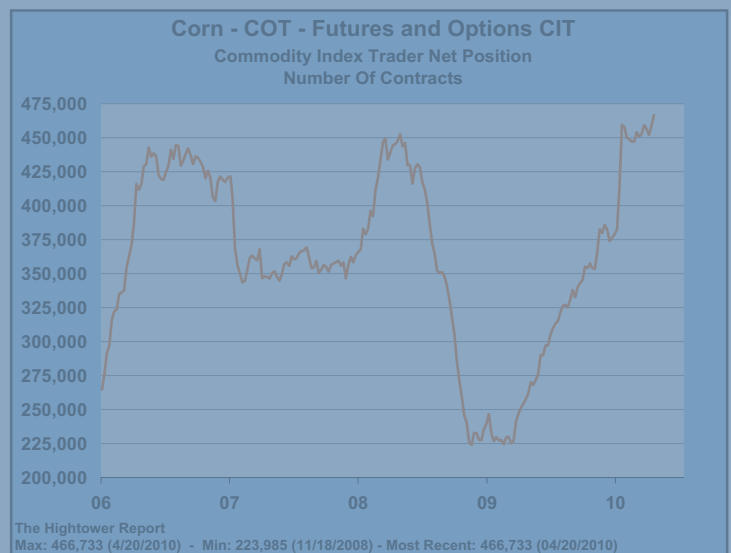
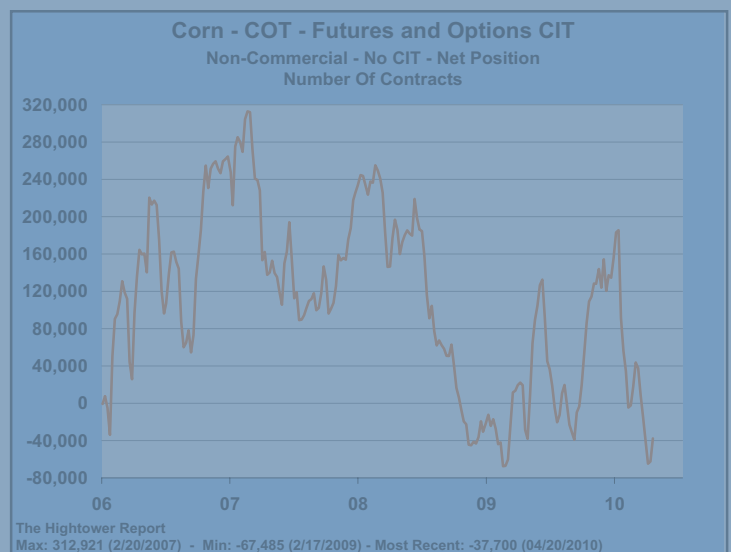
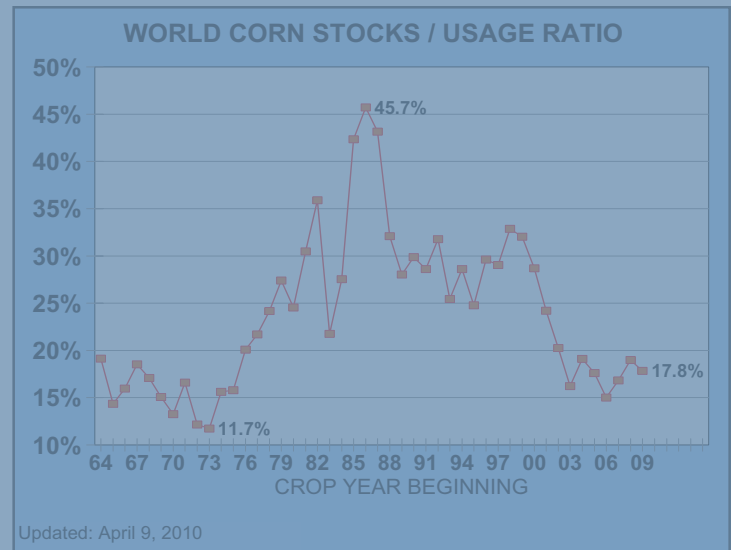
From a global perspective, corn supplies could be considered tight as well. While the world stocks/usage ratios for wheat and soybeans are still at burdensome levels, the world ratio for corn is pegged at 17.8% for the 2009/10 season, down from last year and the low end of the historical range.

Other Positive Developments

While there is still no strong *technical* signal of a near-term low, other indicators are beginning to show some more positive signals. For example, the cash market is starting to get tight, and commercial traders are canceling deliverable warehouse receipts. This can be seen in the way the May contract is gaining on the July as we go into the delivery period.

Traditional technical indicators are exhibiting an oversold condition. Recent Commitment of Traders reports showed a near-record net short position of nearly 62,000 contracts held by trend-following funds (Non-Commercial, Non-CIT traders). Any turn higher in the minor trend will be enough to spark short-covering from this group.

On the other hand, index fund traders have exhibited a steady buying trend, moving from a net long position of around 225,000 contracts as of early 2009 (which was the depth of the recession) to a record high of 466,733 contracts recently. There are many types of index funds, and corn seems to be included in most of them. It is a food, fuel, feed and industrial commodity. Index fund participants tend to be long term investors and are unlikely to exit their positions until there is



a general perception that inflation has peaked. If anything, corn is likely to attract increased buying from fund traders in the future with the proposed corn-only ETFs likely to attract new investment money ahead. If the trend turns up into the spring, trend-followers are likely to exit the short position and other fund and speculative traders will be buyers.

The lack of a weather premium for this year's growing season and the relative tightness of supply "if" weather is not close to "perfect" leave the corn market as a prime candidate to attract aggressive investor buying interest on any sign of supply disruption or on any turn up in demand that is not currently expected. China weather, US weather, China demand or even outside forces such as inflation, currency movements or energy price inflation are all seen as forces which could turn the trend from down to up.

Suggested Trading Strategies:

- 1) Buy a December Corn at 369 1/2 with an objective of 422 and don't rule out an eventual run to 481. Risk to 352.**
- 2) Buy a December Corn 370 call and sell the December 470 call and the December 340 put for a net premium paid of 7 cents on the entire position. Risk a total of 16 cents on the spread and hold until December corn hits 481.**
- 3) Buy a September Corn 370 call at 26 with an objective of 52. Risk to 17.**

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