

## Market Report – February 7, 2006

Grain commodity trading benefited last week from activity of large funds. These funds are such a market force now they are being called the “commercials” by some. It is interesting to note the surge in open interest in grain futures in recent years as the commercials diversify portfolios. Open interest is a contract that has not closed the position with the offsetting trade thus completing the “round turn.” On the Chicago Board of Trade (CBOT) during the 70’s, open interest for Wheat ranged from 10,000 to 20,000 contracts and between 50,000 and 100,000 contracts for both Corn and Soybeans respectively. Wheat open interest on the CBOT is now past 300,000 contracts and is a little over 150,000 at the Kansas City (KCBT) and Minneapolis (MGE) grain exchanges. CBOT corn has been setting open interest records for several days. On Friday, it went above 1 million contracts for the first time ever with soybeans nearing 750,000 contracts. What does all this mean? Total contracts is a generic way to “play” wheat. The near-year supply/demand markets show bearish and are likely to go more that way. Traders don’t seem to mind this as more and more move into the Chicago market instead of the KCBT or the MGE which more often than not represent the true wheat fundamentals. Total open interest now exceeds the size of the U.S. wheat crop. This sets a new standard. It is believed by several analysts that this expanding open interest is what is supporting crop prices above fundamental levels as large commercial firms trade. The tendency for these firms is to be long in the market continually propping up values with spreads reaching into back months. A concern is what will happen if the money stops coming in or the market were to retreat? This would most likely be a bearish development but not a major market threat. Funds hold money for the long-term based on coinciding indexes as they diversify. This would indicate some level of activity level over the long run. However, there are no guarantees. These markets can not be expected to keep up current levels without U.S. crop problems for the 2006 crop. Markets are expecting more volatility in the coming months as no one knows how the funds will influence the market.

**CORN** futures on the CBOT were lower early Monday on chart setbacks after last week’s rallies to near five-month highs driven by the funds. The MAR’06 corn contract closed down 2.4¢/bu at \$2.226/bu with the DEC’06 futures down 1.4¢/bu at \$2.584/bu. The CFTC report on Friday showed large speculators growing their net long position by 45,823 lots from the previous week to 194,225 lots in CBOT corn futures. The net short positions were down 44,244 lots to 120,071 lots. The 14 day Relative Strength Index (RSI) for the DEC’06 corn futures finished at 66.84. An RSI of 70 is considered overbought. Last Friday dogged buying of corn futures by the funds boosted prices and drove the market into overbought levels on the 9 day RSI closing at or above 70. Some support was noted from brisk export sales of U.S. corn but price still contended with an anchor of very large global supplies. The USDA said on Monday that 38.5 million bushels of corn were inspected for export last week. This was higher than trade estimates of 32 to 38 million. Weather also held up price as the Argentine corn crop is seen to be suffering. Basis bids for corn were weak early on Monday following speedy farmer sales. Farmer sales were enormous last week in the U.S. Midwest after the CBOT rallied to price levels above \$2.00/bu. Cash sellers should hold with last week’s considerations of forward pricing the ’06 cash crop at 35%. Hedgers should think about being short on 50% of the ’06 crop.

**SOYBEAN** futures on the MAR’06 futures at the CBOT closed down 7.6¢/bu to \$5.870/bu on Monday. The NOV’06 soybean futures gave back all of last Monday’s gains plus another 0.4¢/bu finishing the day at \$6.216/bu. This was down 8.6¢/bu from last Friday’s close. Technical selling on the MAR’06 contract gathered momentum when price broke through the 100-day moving average at \$5.913/bu and the 50-day moving average at \$5.90/bu. Reports that South America remains on track for another soybean record production year in 2005/06, even though there was some concern of drier weather, kept the damper on price. Argentina’s crop region returned to dry weather after crop relieving rains late last week. Lagging exports from a year ago cast a bearish pall over the market. Exporters hoping to sell more beans to China were worried that the price rise of last week would slow sales. Additionally, hot weekend weather in

Brazil caused stress to the corn and soybean crops but rain was in the forecast within the next few days. The South American private crop analyst, Agroconsult, said in its February report that Brazil's soybean crop forecast was down 0.9% at 55.34 million tones. Even at that level, the crop will still set a new record at 8.3% above the 04/05 crop of 51.12 million tones. U.S. cash spot bids were soft early Monday following last week's surge in beans from the farm to the elevator. CFTC data showed large commercials cutting their net short positions in futures and options as of January 31. Cash sellers should think about having 20-25% of the '06 crop forward contracted. Hedgers should consider staying with 45% of the crop in short hedges. You could also consider buying an out of the money call on the NOV'06 contract in case prices rise.

**WHEAT** futures on the MAR'06 in Chicago closed down 1.4¢/bu at \$3.550/bu and the JULY'06 was down 2.4¢/bu at \$3.754/bu. As with corn and beans, the market was set back after last week's fund-led rally. New contract highs at the KCBT amid concerns about dry weather in the U.S. Plains HRW belt supported CBOT wheat prices. Meteorlogix weather said no precipitation was expected for the next 5 to 7 days in that region. The market is also waiting to see if Iraq and India will tender offers for U.S. wheat of 1 million and 500,000 tonnes respectively. Long Commercials were even to net short of up to 1,000 lots showing futures and options combined down 6,163 contracts. Export data supported price somewhat with shipments up 7.2 million over the high-end of the 18 million bushel estimate. The JULY'06 CBOT wheat contract is featured this week as several interesting things are going on. There was a double bottom established on December 12, 05 at \$3.256/bu. The minimum measuring objective of \$3.602/bu was met on December 28, 2005. The next double bottom formation was established on January 19, 05 at \$3.415/bu. The minimum measuring objective was met on January 27, 05 at \$3.673. The primary resistance point is the life of contract high currently at \$3.83/bu. Also, using the life of contract high, an up trending triangle formation can now be drawn. Here are the questions: 1) In light of fundamentals shaping up, will the contract go higher in an upside breakout? and if so, 2) How high will it go? The rule that fundamentals drive market direction and technicals signal when to pull the trigger is still in play. In light of dry weather forecasts and increasing export demand, it is quite possible that an up-side breakout can occur as the KCBT and the MGE fuel price in HRW and demand for SRW at the CBOT is driven by impending short supplies amid increasing U.S. wheat exports. Even though the 9 day RSI on the JULY'06 is showing at 67.19 and the 14 day RSI is at 63.95 this market could go higher supported by the "long tendencies" exhibited by the commercials. Keeping in mind that volume and open interest are the "fuel" for the market, it is noted that Friday's volume spiked while Monday's volume has not been reported as of this writing. If Monday's volume is also up near Friday's 59,000+ then an upside breakout is a very real possibility. If Monday's reported volume tends lower to average, the possibility of a price pullback is enhanced. This pullback sometimes returns back to the last measuring objective (\$3.673/bu). If a dynamic breakout is pending, a gap in price usually precedes the action after the pullback. If volume is extremely high on the breakout day, chances are diminished that the gap will be filled by bearish price moves back toward the Triangle. This is because the small traders are driven out of the market with margin calls as the commercials hang in. The next signal is a high volume day preceded by a low volume day possibly signaling a steeply bearish move as longs take profits and more small traders exit the market nursing their bruises. Put these pricing opportunities together in this volatile situation and price just may shoot right back up establishing a new contract high for the JULY'06 contract month. With these thoughts in mind and the '05 crop long gone, cash sellers should have 30% of the '06 crop forward contracted on last week's advice while watching to forward price another 20% in the next few days. Short hedgers should be vigilant for opportunities in JULY'06 futures at the \$3.78 - \$380/bu price level if Monday or Tuesday's volume is reported lower to average. A \$3.70/bu price floor buying a JULY'06 put option on the CBOT cost 22.4¢/bu on Monday. This should be considered if volume is low for the next 2 to 3 days and a price floor is desired.

**LIVE CATTLE** on the FEB'06 contract closed lower \$0.0.125/cwt at \$92/15.cwt in moderate to steady trading. Grains dragged the nearby contract lower while the APR'06 and the JUNE'06 live cattle (LC) were up \$0.025/cwt and \$0.125 at \$89.65/cwt and \$83.85/cwt respectively. The 14 day RSI on the FEB'06LC at the CME closed at 32.33 while the APR'06LC RSI finished in the oversold range of 30.93. An RSI of 30 or below is considered oversold. Even though grains dominated the news of the day weighing on price, news of cheaper inputs provided some support, floor sources said. The market has confirmed a major top in live cattle estimated last week. Live cattle feeders should consider maintaining short hedges in the FEB'06LC on 1<sup>st</sup> quarter marketings and the APR'06LC for 2<sup>nd</sup> quarter marketings. No long positions are currently in place for live cattle feeders expecting feeder supply price to decline. Watch for grain booking opportunities in the coming days and keep marketings current.

**FEEDER CATTLE** on the CME MAR'06FC closed up \$0.225/cwt at \$108.05/cwt on Monday. The APR'06 and MAY'06 both closed up \$0.40/cwt and \$0.225/cwt at \$109.20/cwt and \$109.10/cwt respectively. Feeder cattle futures finished up as commercials turned long raising the 14 day RSI to 32.94. USDA's recent Cattle Inventory report showed the market has factored in cattle numbers and expect feeder cattle to sell better in the coming days. Feeders resisted following live cattle lower with recent declines in corn prices adding to buying interest in a bearish market. Feeder sellers should remain short in the MAR'06FC on a significant portion of 1<sup>st</sup> quarter sales and short in the APR'06 and MAY'06 protecting 2<sup>nd</sup> quarter marketings. It would be a good time to price some, but not too overly much, grain inputs at this time. No long positions should be in place for feeder cattle feeders.

**LEAN HOG FEB'06(LH) and APR'06LH** both closed up \$0.60/cwt on the CME amid bullish moves by the commercials and news of lower grain prices. Last week's report showed the APR'06LH looked oversold with a 14 day RSI at 29.50. Today, the 14 day RSI finished up 2.9 at 31.99 leaving plenty of room for the bulls. Floor sources said last week's hoped for packer interest buoyed hopes as the market showed steadier and margins remained in the black. After looking like the market has confirmed a major top on the weekly chart there is hope of sideways trending trading channel. As grain price sank, the market looks to have factored in the hog/corn ratios calculated by Dow Jones. Dow Jones calculates ratios using the industry-accepted fob cash hog prices from USDA and cash corn prices from private sources. Ratios showed no new news but were encouraging. Historically ratios at or above 20-1 for hogs (live basis) have resulted in expansion of production, while a ratio of 15-1 or less has resulted in contraction. The

Live Basis Hog/corn	Daily Ratio	Average Hog Price	Corn Price
Iowa/S. Minn.	20.87	\$39.59/cwt	\$1.898/bu
Week ago	23.12	\$42.95/cwt	\$1.858/bu
Month ago	29.25	\$52.88/cwt	\$1.808/bu
Year ago	16.94	\$48.90/cwt	\$2.888/bu

Advice is the same as last week. Hedgers in the FEB'06LH have taken profits on 1<sup>st</sup> quarter sales and should now seriously consider protecting a significant portion of 2<sup>nd</sup> quarter sales in the JUNE'06LH contract. Cash sellers should be pushing the weight limit on marketings to the edge to take advantage of market support before this oversold market declines.

## JULY 2006 Chicago Wheat, 2/6/06



Data furnished by DTN on the Web

*Remember, when working with futures, risk is involved. Past performance does not indicate a promise of future results.* For comments or questions you may contact Mike Roberts at [mrob@vt.edu](mailto:mrob@vt.edu) or 804-733-2686.