The Grain Service Newsletter

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MAKING SENSE OF THE CORN STOCKS

Jaws dropped when USDA's 3.7 billion bushels June 1 corn stocks number hit the wires; the *highest* pre-report estimate was 3.5 B and the average was around 3.3 billion. This June 1 stocks number is as out of proportion and unbelievable as last year's unexplainable June 1 stocks number which came in exceptionally *low (the 'missing' stocks)*, setting off the long rally to \$8.00. USDA's July Outlook report on July 13 will detail third quarter disappearance by exports, industrial use, and the 'catch-all' category of feed/residual. The July 12 Supply & Demand report will adjust the crop year balance sheet.

Starting from the March 1 stocks, USDA's June 1 corn stocks number infers 3rd quarter disappearance of only 2.85 billion bushels, a drop of 5.1% from 2nd quarter usage. Exports and industrial use of corn are easily quantified, *which infers the remainder - March/April/May feed/residual - was under 700 million bushels, the lowest for the 3rd quarter in 40 years, and a drop of 55% from the prior quarter.* With Cattle on Feed and hog numbers higher than a year ago, a 55% drop in corn consumption for feed defies logic. The only other answer is that USDA is plugging close to 400M bushels of unexplained 'supply' into residual which would make feed usage look artificially low.

Staying with USDA's projected 2010 crop year corn disappearance (13.45B bu) along with the June 1 stocks infers then that June/July/Aug disappearance will set a new record high of 2.95 billion bushels (prior record was 2.6 B) to reach the crop year forecast. This 4th quarter total disappearance would also top 3rd quarter use – something not seen in 40 years.

2010 Crop year total	13,450
Minus inferred usage Qtrs 1-3	10,498 ?
= Qtr 4 use	2,952M bu.?

The more logical answer is that USDA has 'found' bushels that are included in the feed/residual balance, and total usage will remain around 13.45 billion bushels – with ending stocks now likely to be 1 billion to even 1.1 billion bushels. Another result of the corn stocks is that wheat and soybean stocks drew little attention, mainly because they were as expected. Wheat stocks do reveal however, that Mar/Apr/May wheat disappearance shows no spike in wheat-feeding.

There's plenty of room for criticism of the numbers but arguing about USDA's numbers is like revisiting the Bush-Gore vote counting in Florida. These *are* the numbers and we have to accept them.

BLAME THE FUNDS AGAIN!

Traders have been blaming funds for 40+ years, but the futures slide across grains and soybeans tracks the recent activity of managed funds. *Large managed funds (excluding index funds) cut their net long corn holdings 31% since the end of May*, and 48% since last October. But managed funds are still long 226,000 corn contracts (futures and options combined) as Chart 1 shows. Chart 2 shows monthly continuation price charts for corn, soybeans and CBT wheat, reflecting the heavy selling throughout June. Corn now shows a monthly downside reversal after a spike following the early June bullishly-construed USDA report. Typically, market tops during this time frame are negative and

Table 1: June 30, 2011 Planted Acres & Quarterly Grain Stocks

	Planted Acreage		June 1 Grain Stocks					
	3/1/11	6/1/11	6/1/10			6/1/11		
Crop	Intentions	Planted	On-Farm	Off-Farm	Total	On-Farm	Off-Farm	Total
Corn	92,178	92,282	2131	2179	**4310**	1682	1989	**3670**
Soybeans	76,609	75,208	233	339	**571**	218	401	**619**
All Wheat	58,021	56,433	210	766	**976**	131	730	**861**
Sorghum	5,645	5,345	11	77	**88**	3	77	**80**
Oats	2,839	2,587	18	63	**80**	15	53	**68**
Cotton	12,566	13,725						
Rice	3,018	2,676						

Acreage numbers are in thousands. Stocks numbers are millions of bushels.

Chart 1: CFTC Commitment of Traders recap CORN

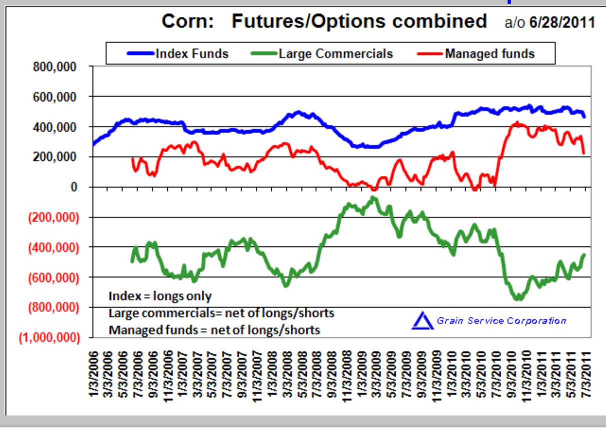
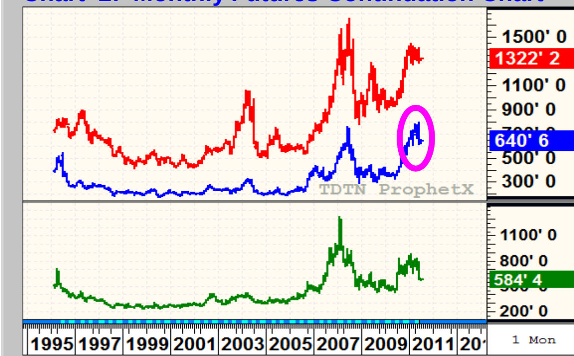


Chart 2: Monthly Futures Continuation Chart



Red=soybeans, Blue=corn; Green= CBT wheat

from a technical view don't bode well for flat price over the next 4 to 5 months. Some will also argue corn may have put in a front-month double-top in the weekly charts that dates back to 2008—also negative.

Managed funds have cut their soybean net longs by 48% since early April, and accelerated their selling in June. This category remains net long over 60,000 contracts as of June 28, but that's their lowest since July 2010. Soybeans lost $1.30 in June but have held above $12.75, the low on weekly charts since last December.

Managed funds have liquidated 43K contracts since late April and shifted their net CBT wheat position to their present small net short. CBT wheat broke $2.25 in thirty days, to 55¢ below corn on July futures, a 60+ year record discount. This along with harvest winding down, rising world demand, and problems with global production should soon halt the slide – outright and relative to corn. Even Australia, which had hopes for their largest crop in many years, now has turned dry, and the woes in Canada and the Northern Plains remain. Interestingly, Index funds – long blamed for the price run-ups of recent years – reduced their (long) holdings across the grains by only a small amount during this washout.

Corn and soybeans may now struggle awhile with a speculative 'sell the rally' attitude more than a 'buy the break' approach. But 2011 corn and soybean crops are far from assured and production threats can change things quickly: End users should have substantial coverage into fall. Add short-term options for protection through crop reports.

BIG PICTURE

USDA's planted acreage numbers clearly do not reflect all flood losses or prevented plantings. FSA in North Dakota talks about 25% or potentially 2.2M of the wheat acres lost or not planted there, against 8.7M intended acres. USDA reduced North Dakota by 1.4M wheat acres so further cuts seem probable.

USDA *raised* corn acres slightly, adding around 600K in the W. Corn Belt & N. Plains (versus March intentions), and cutting the ECB by 350K. USDA shows a cut of 950K soybean acres (versus March) in the WCB/Plains, and another 140K in the Midsouth with a minor increase in Ohio.

The acres may be high but the impact on the global balance sheet is insignificant. The US will barely raise enough corn and soybeans to cover demand, and falls short by 10% in wheat. Globally, the last USDA forecast put production and consumption neck and neck – with no room for loss. *Any* cuts in US acres *or* in yield this year would tip the world balance sheets to red again. The USDA reports on June 30 weren't bearish – they continue to reflect a tight balance sheet and the need to keep prices high enough to encourage global acreage –particularly next in S. America, and to moderate the demand growth curve. But the price momentum's slowed.

	Corn	Sbns	Wheat
Pltd A	92,282	75,208	56,433
Hvstd A	84,888	74,258	47,174
Yield ("what if?)	157	44	44
= Produc.	13,327B	3,267B	2,076B
'11 crop usage	13,255B	3,290B	2,290B

GAME PLAN – REVISED?

Stocks numbers aside, it's still tough to buy corn. Basis remains especially strong in the E. Corn Belt where published bids of +60 Sept are common at ethanol plants. What seems to be lost in the drama of the June 30 reports is that even a corn carryout of 1 billion bushels this summer (instead of 730M bushels) *would still be the tightest stocks/use ratio since 1996, at around 7.5%.* Assuming futures don't rally much, basis has to pry 73% of all the June 1 US corn stocks out of bins just to get us through August. The farm-stored bushels are in strong hands already, and these stocks actually have to carry us well into September.

One point to note in the state breakdown of corn stocks is that Iowa and Illinois showed a steep *drop* in disappearance for the 3rd quarter compared to the Dec/Jan/Feb period. In Iowa, corn disappearance apparently fell a highly atypical 25%, almost 150M bushels, especially unusual given that ethanol production is up this year and Iowa is the center of that sector. Maybe Iowa is where USDA 'found' a lot of the extra corn bushels?

Overall, we expect corn basis to remain generally strong and we stay with our earlier recommendations: Continue liquidating ownership as local basis opportunities arise. For end users, be sure your physical inventory needs are covered. Stocks are still tight; the cushion is only slightly bigger than we thought last week. September and FH October bids in the Midwest reflect this with buyers getting quite aggressive in those slots.

The game plan on soybeans is straightforward: Continue selling old-crop basis, but we're not ready to recommend shorting DP quite yet.

Hard red wheat basis has firmed and interest has also climbed in old-crop lower protein wheat for blending. Some areas show values strong enough to justify moving HRW ownership now, which also frees up cash flow and space for corn or soybeans.

"WHEN MARKETS GET ROUGH, THE TOUGH CAN STILL TRADE."

Last week's dramatic collapse in corn futures showed both strengths and weaknesses in the argument about price limits. Daily limits *are* an effective 'circuit breaker', providing time for additional order flow to bring balance, and providing additional time to prepare for additional margin calls. Prices will still find their 'right' value, and the world is surely not harmed if it takes two or three days to do so.

The weakness was clear on June 30, coinciding with month & quarter-end for speculative funds. The 'real' price of deferred corn futures was lower than posted settlements, but statements are based on settlement prices. Fund results for June were out of sync as a result.

Market purists were enraged that corn could not be traded in futures, but could be priced synthetically via options or using the spot July contract. A mini-refresher may clarify how that can occur.

- Effective the 2nd business day prior to the 1st business day of the front-month futures, the daily price limit is removed *for that contract month*. Starting on June 29 and until expiration on July 14, July '11 grain/soy futures have no daily price limit, for ex.
- Options have a daily price limit that matches the daily price limit on futures. Corn options typically have a 30¢ limit, wheat 60¢.
- A newly listed option strike price has *no* limit as it has no prior settlement price.
- Futures spreads have a daily price limit that is double the outright futures; typically 60¢ up *or* down on corn, 120¢ on wheat, etc.

When futures are limit-bid or limit-offered, with unfilled orders, trade can continue synthetically – at a value *beyond the limit price.*

--Using spreads and the "no limit" spot month to 'bypass' the limits on deferred futures. On June 30, July corn futures were off 75¢ or more. But most people wanting to sell September futures on June 30 at 30¢ lower were unable to fill their orders; there were far more offers than bids at limit down. But you *could* sell July '11 futures. The next step (immediately or later) was to enter a spread order and buy back the July and sell September futures. Interestingly, the July/Sept spread on June 30 was only minimally changed from the prior day.

Ex. Sept futures were limit down at $6.48
6/30 Order: Sell July futures at $6.25 (down 73¢)
6/30 Buy July/sell Sept at 22¢ inverse
6/30 Outcome = a sale in Sept equivalent to $6.03
(45¢ below the 'official' limit down Sept futures price)

The key is that spreads can continue to trade even when all futures are locked limit up or down, and they can trade at values not reflected by simply subtracting one price from another. (Ex. On 6/30, $6.25 July minus $6.48 (Sept) made it look like the spread was a carry of 23¢ when in reality the spread was still trading at a 22¢ inverse.

--On limit days, a previously unlisted option strike price will be posted for each futures month by the CBOT, for immediate trading. This will be a deep in the money strike price, which will move essentially as a futures contract would. ($1 September corn call, for ex.) Buyers can buy the call at whatever price they're willing to pay and immediately exercise the option. Buying a $1 call for $6/bushel is the same as buying futures at $7, even if futures are limit-down at $7.20. Selling a $1 call for $6/bushel would yield a short futures equivalent of $7.00 after the call is exercised.

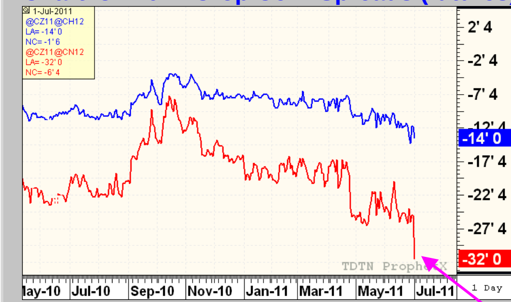
WHEAT VARIABLE STORAGE RATE

The VSR for CBT wheat will remain at $.00665/day, or 20¢/bu./month, at least until September 18. This may be a result of SRW basis values in the East of +$1 or higher (still cheaper than corn). And buyers from the Midsouth to the E. Coast are bidding up to buy wheat before harvest is over to fill bins and capture the current carry. Put short hedges at least to Dec11 at 75+¢ (July/Dec) to protect that strategy! (See June 1 GSC Newsletter)

CORN SPREADS

July11/Dec11 is still the star of the corn spread show, but don't forget the new-crop carries, which have widened to attractive levels: Dec11/March12 closed on July 1 at 14¢, 76% of Full Carry. Dec11/July12 was settled at 32 cents, 74% of FC. We recommend starting to set Dec/March at least by 15¢ (81% of FC), or lower if you are more conservative. Our initial Dec11/July12 goal is around 33¢. Dec11/July12 had been trading a little under 28¢ prior to the close on July 1; the 32¢ closing price may be a result of the way the CME sets settlements. But it's also a reminder of the value of having even "wish list" orders working in volatile markets.

Chart 3: 2011 Crop Corn Spreads (futures)



Full carry Dec/March = -18.4¢ (negative = carry)
Full carry Dec11/July12 = -43.3¢ (a/o July 1)
?

Sept11/Dec11 is a key new-crop spread for Midsouth and Southern elevators. We expect this spread to remain inverted and choppy through August but to weaken in time. Index fund rollovers in August should weigh on the inverse as they did with the July/Sept spread and, ultimately, owning Sept futures isn't a good source of cash grain for September needs. We suggest southern elevators hold new-crop short hedges in September for now.

CBOT

The CBOT will hold an industry meeting on July 19 to discuss the proposed 45¢ daily price limit on corn. The meeting is open to all via webcast. See details/registration at: CBT online registration .

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IN THIS ISSUE

"We hold these truths to be self-evident, that all men are created equal; that they are endowed by their Creator with certain unalienable rights; that among these are life, liberty, and the pursuit of happiness." Thomas Jefferson