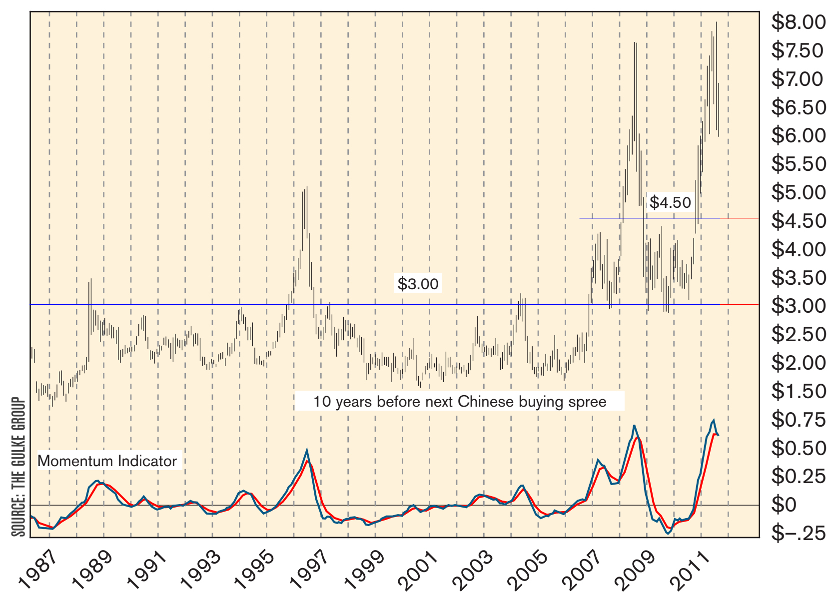
Price Discovery Process

When USDA released its July 12 report, it incorporated the National Agricultural Statistics Service's June 30 report for corn. However, it elected to increase ending stocks by only 150 million bushels, thereby suggesting demand will absorb 200 million bushels of the total increase in stocks (357 million bushel) found on June 30. That good news means the uncomfortably tight stocks situation has been transferred to the 2011/12 marketing year giving the market another 12 months to solve the problem.

The market action on June 30 helped to post a negative monthly key reversal. Price exceeded the 2008 highs, but failed miserably. The failure to sustain new highs told me the corn bull market had reached maturity and we were destined for a retreat.

Continuous Monthly Corn Chart



I don't think the bull market was ever about demand. Demand for grains in general has remained constant the past year except for soybean demand to China, which has been increasing. Corn, however, suffered from supply problems, primarily due to a reduction in the U.S. this past year and poor crops in Canada and then Russia, where lack of adequate feed wheat meant more feedgrain was needed. Corn rallied from $3.50 to $7.99 in the next 12 months in an effort to balance demand with supply.

I don't recall a time when the end user was so forewarned of the skyrocketing price for corn and impossible tight stocks in August and September. If the implied 150-million-bushel reduction in corn usage continues into the June, July and August usage, demand destruction could be an issue into 2012.

Concerns. In 1995/96, China had similar stocks problems and had to buy U.S. corn. Price rose to more than $5.25, a record back then (see chart above). It took more than 10 years before China was again in a situation where it had to use government stocks to try to subdue food inflation and cool its economy. I'm concerned about whether China has the ability to produce a soft landing. Do we believe that the market can start another yearlong rally in grains from current levels?

Technically, the "real" long-term support in corn is $4.50. Do I think corn will go back to that level? I'm not sure, but wheat lost 100% of its one-year rally before finding value as a feedgrain. Given that global economies are nonfriendly, at the very least I want price risk protection near 2008 levels. The monthly reversal adds to my concerns, prompting me to extend coverage to near 100% of 2011 corn and soybeans and to take a serious look at 2012 pending July and August weather.

We are at critical production levels—and a 500-million-bushel shortfall means a new ball game. Equally, if demand is curtailed, it likely won't be reversed to a demand-driven market until global economies shape up, which could be two or more crop years. ■

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