DAVIS COMMODITIES LLC

January 2025 Market Commentary

The month of January was marked by a two main inputs: a shocking report out of USDA regarding production of corn and soybeans and political uncertainty surrounding tariffs and overall policy with the new Trump administration. Despite the volatility, the program was able to squeak by essentially unchanged. The increased volatility and uncertainty is pushing us to have less overall risk and to take profits (especially regarding short options) a little bit sooner than normal. While overall risk will be lowered, the greater magnitude in swings and shortened duration of moves should still allow for similar returns.

Regarding the USDA Annual Crop Production report, they dropped soybean yields by a record 1 bushel per acre (bpa) from November to final and corn was reduced by 3.8bpa which is tied for the largest on record. While we were expecting a small cut, the magnitude caught us completely off-guard. Looking directly at the USDA balance sheets, they are now expecting world corn stocks to fall by ~24 million metric tonnes (mmt), while soybeans are projected to increase by ~16mmt. Both are showing slightly tighter world ending stocks which caused the rally in prices.

As we turn to policy, let me state the obvious: only one person knows what the Trump administration will do in advance. However, we can lean on what was learned during the previous administration to at least give a guideline for the future as well as the recent tariffs imposed and then delayed or retracted. It appears that the tariffs are simply the hammer that this president will use to get other countries to fall in line. For countries like Canada and Mexico, it is a big hammer. With the majority of exports from those two countries going to the US, 25% tariffs would prove massively harmful to their overall GDP. It remains to be seen how China will truly react to the 10% tariffs enacted against them. The initial reaction has been muted, but there is still a lot of time. The first two weeks of the new administration have been anything but dull.

Let's turn to the fundamentals of corn. In the January report, USDA cut production by 276mb and lowered demand by 75mb. In addition, released at the same time was the stocks in all positions report. Despite a drop of 276mb in supply, the stocks came in only 92mb smaller than the average guess (which coincidentally was very similar to mine). While the 1st quarter stocks report is not a great indicator of final usage, it does give us a hint. It was widely discussed at harvest that the crop was being harvested at a low moisture level. While low moisture can certainly impair the yield (less weight=lower bushels), it should have an inverse effect on the density. The lower moisture corn should convert better in feed and in ethanol. Again, there isn't a lot of data yet to lean on for ethanol conversions, but the October-December would indicate that each bushel of corn is converting at 2.93 gallons vs. 2.83 last year and close to 2.87 for normal. Assuming that demand for ethanol doesn't change, that would equate to roughly 100mb lower usage to convert the same total gallons of ethanol. While there is hard data for ethanol, there is nothing for feed/residual use other than the quarterly stocks reports. The next stocks report isn't until March 31. We will be watching it closely as the 2nd quarter report gives a much larger hint regarding the total feed/residual use. If the ethanol data is also being borne out in animal conversions, odds are high that USDA is also overstating feed/residual use and the ending stocks will end up larger than currently projected. Based on current USDA ending stocks, corn is properly priced today. If our thesis holds true of better conversions, ending stocks will be higher and prices will be lower.

For soybeans, the yield reduction in January was a big change, but it hasn't changed the overall demand picture out of the US. Our thesis that USDA is overstating demand still holds true. While it is hard to argue with USDA today that crush projections are too high, the cracks are becoming more evident. Board crush margins have dropped from $1.60 per bushel to $1.20. More importantly, the soybean meal basis has cratered with crushers in the Northern Plains reporting cash trading at $70/ton under the board. In the more important IL locations, cash is running ~$35/ton under the board. While we have certainly been crushing soybeans at a record pace, the weight of the soybean meal is showing. In addition to the meal issue, the Biden administration never issued the subsidy for renewable diesel or biodiesel. With the current administration less

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favorable to biofuels, the timing and amount of any subsidy is anyone's guess. With no subsidy starting January 1, usage of oils is slowing materially. The lack of demand for both products should slow the crush and lead to a higher ending stocks. Turning to South American growing conditions, central and northern Brazil have pretty much been a garden since October. Harvest has begun and reported yields are coming out as record or near record large. Far southern Brazil and Argentina have been treated less well. It is far from the disaster of two seasons ago, but weather has been cutting some production in both areas. When taken in aggregate, total South American soybean production is steady with the previous USDA estimate to maybe a little larger. The bottom line is that South American soybean production appears to be record large. Competition for soybean and product exports is ramping up and the US will become the residual supplier for the rest of the crop year. With harvest ramping up in Brazil, a decent forecast for the next 15 days for South America as a whole, and US demand on the decline, odds are high that we see a resumption of the bear trend in the whole complex.

Sincerely,

Stephen Davis

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