

August was a challenging month where thoughts concerning yields were spot on, but total supply was a swing and a miss. After a really great growing season through the month of July, USDA confirmed that the crop was in great condition as of the beginning of August. Yield expectations came out at record levels, but they also shifted acreage around. With a shift of ~2.5 mm acres from beans to corn, the corn production became absolutely enormous while soybean production actually fell from their initial projections in July.

Delving further into soybeans, the record yield/smaller acres package resulted in a decline of ~43 million bushels (mb) in production. USDA cut exports by a similar 40mb, but due to a smaller beginning supply, cut the ending stocks by 20mb to 290mb. The market seemed to take the cut in exports as a sign of demand rationing and quickly ran 50 cents higher. As we take a look back at August weather, it was not good for especially the Eastern Corn belt and the Mississippi delta. While production potential was certainly lost, USDA's demand estimates look overly optimistic. With China and the US still embroiled in the trade war, there is no incentive for the Chinese to buy US soybeans. South American supplies coupled with surplus stocks in country, can allow the Chinese to stay away from the US completely. In my opinion, USDA is not taking that lack of demand into account. Simply looking back at the 24/25 crop year, the Chinese took ~850mb. Assuming the rest of the world (ROW) takes more US and less South American supplies, it is nearly impossible to replace that lost demand. If the US gains 60% of the loss in Chinese business to the ROW, that would still imply a loss of 200mb from the latest USDA export estimate. Instead of 290mb ending stocks, USDA would eventually need to raise that figure to 490 (assuming unchanged production). The bottom line is without a solid export bid, the ending stocks will get looser over time and price should move lower.

For corn, USDA projected a record yield at 188.8 bushels per acre (bpa) and raised production by over 1 billion bushels. In order to keep the ending stocks from ballooning, USDA added demand just about across the board to the tune of 550mb. Like soybeans, those demand projections are optimistic. With Brazil producing a record crop, competition for exports should be fierce for the Nov-Jan timeframe. Also like soybeans, the August weather has likely trimmed some of the production potential. If/when USDA cuts production, there are plenty of places to trim demand to keep the ending stocks unchanged. Using a more realistic demand structure, yields can fall ~6 bpa and still leave the USDA ending stocks unchanged or higher. The program has been tactically long a small amount of corn, but that position is living on borrowed time. Without a massive cut to yields, rallies will be sold.

Turning to the cattle market, it has been in a structural bull market for the past two years. While the overall feeder cattle supply will probably not grow for the next two years, there are some concerns currently. Beef prices have moved from ~\$360 in late July to a recent high of \$416. That 15+% move higher certainly causes some demand concerns. In addition to the high cost of beef, packers have been cutting kills for several months now. Those kill cuts have allowed the cattle feeder to keep making the current inventory even heavier all while marketing fewer cattle. Despite all of the optimism, cattle supplies are not much smaller year over year. In addition, cattle on feed for over 150 days is record large. Assuming that those backed up, heavy cattle need to move over the coming quarter, we could see a counter-seasonal increase in slaughter and beef production. That combination should lead to a big correction to the cash price of cattle. For these reasons, a relatively small tactical short position is in place.

Sincerely,



Stephen Davis

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