J. Ganes Consulting, LLC

The Hard Facts on Soft Commodities℠

SOFTS: Fast Facts—January 2017

# WHAT'S AHEAD?

Softs Snapshot: What has Changed and What has Not?

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Watching the Weather: Dry Weather Again in Brazil

Fundamental Favorites: The New Year Starts with a Bang

ICE Update: 2017 Martin Luther King Day Holiday Trading Schedule

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***Market Research, Analysis and Advisory Services***

# Softs Snapshot

## Recap of What has Changed; and what has not?

***December: Transition Time***

Currency wars continue and as it relates to Softs can be a weapon of mass destruction if the dollar surges and commodities sink. As the dollar strengthens, capital flows out of emerging nations and this would tend to hurt domestic demand and also cause a surge in export volumes to get more foreign currency into the country. The markets were reeling from this late in 2016 and especially after Donald Trump secured the presidential nomination of the United States. The stock market roared higher to end the year on a strong note, while commodity markets swooned lower. It is expected that this jubilation will come to an end and the realities of the new Administration will ultimately cause the dollar to teeter and fall back down. However, this is going to be balanced against the divorce of Britain from the Eurozone and any nagging conflicts or uncertainties that stem from what could be a protracted process but seems sure to have repercussions that vibrate across other countries. Certainly most are watching to see if the euro can struggle to stay afloat as a currency for much longer or this proved to be a doomed experiment that is now starting to fail. Certainly the dollar's strength has not been linked only to Trump's victory but the concerns for the Eurozone not to splinter apart. Despite these worries, economic data pointed to a healthier picture with a steady expansion in domestic performance characterized by low inflation and increase in the labor market. The depreciation of the currency should also attract strong buying interest of European goods, which will help trade at a time when total global demand has been soft. The markets will continue to vacillate throughout the year as the political winds shift back and forth.

Key European elections, the May OPEC meeting and of course, Trump's tweets as he takes the helm will all be carefully watched and scrutinized.

The Softs are starting the New Year standing in the middle of the road with road signs pointing in multiple directions and it may be that the markets travel up and down a few different paths rather than set course on a straight journey. The markets are still in a transition period of having gone from weather related production woes for multiple seasons that helped to reduce a massive build in stocks that had previously occurred to a more neutral zone where some stock building is possible but also demand is hoped to recover. I am not as optimistic about consumption picking up steam except for the cocoa market due to rather attractive margins. The other markets are certainly not cheap to stimulate strong uptake and ongoing economic malaise in developing nations could crimp uptake. The slump is not broken yet, especially with the dollar as strong as it had been making purchases costly.

I believe the days of demand driven markets are gone for the foreseeable future. Prices are not cheap enough for starters, but life style changes also are having a negative influence. Consumers are staying away from overindulging and eliminating sugar from their diet. Substitutes play a key role in the manufacturing process to meet these shifts in consumer desires but also as a means to reduce costs. Consumers are comfortable with a wide choice of alternative sweeteners while manufacturers are reducing the sugar content in a plethora of products from baked goods to beverages. Coffee is being consumed in single serve appliances reducing waste. Cotton is losing market share to synthetic fibers as fashion trends flavor stretch materials that are moisture absorbent and look good from the gym to the boardroom. Yoga pants are in and denim is out as the go to leisure wear trend. Synthetic fabrics continue to grab more attention and a greater share of total usage. At the same time, the current generation is spending less on clothes and more on gadgets. Conservation and doing without has replaced over indulgence. Young adults are happy to shop virtually and slap a change of outfits on photos without actually buying new clothes to look their best on social media. No need to spend except on an App. Electronics and gadgets are more likely purchases and gifts than a sweater or scarf. The downgrade in apparel demand is apparent by nine retailers shutting doors and/or restricting in 2016 followed by the announcement already this year that Macy's, America's largest department store, is also shutting down hundreds of stores. Some demand is shifted to online sales, but the slump in apparel purchases can't be attributed to web based traffic.

J Crew sales dropped 8% following a plunge of 11% the year prior. The company had a few false starts with new product lines and business pairings to bolster their sales. Sears and Kmart closed the doors on at least 170 locations and some believe Sears could go bust this year.

Macy's income plunged more than 85% in the third quarter of 2016. According to Business Insider, Hugo Boss is no longer a cool and fashionable brand and has seen sales steadily decline. While Coach predominantly makes handbags, they also have a clothing line. Sales are sliding overall and they lost the luxury brand appeal. Nasty Gal, after being trendy for a decade, also has lost its cache with shoppers. It isn't better for Land's End with a 49% drop in apparel sales marking nine quarters of shrinking numbers. Aeropostale is closing 154 stores as teens stopped flocking to the once popular brand. Kate Spade is suffering from having to discount heavily to attract buyers. More brand names are expected to fall on hard times in 2017 and stores shut their doors.

Consumption of orange juice has been dwindling for years due to a proliferation of new healthful beverage options that have captured market share. High prices and less innovative packing has also contributed to the decline of what was once of the most popular juices. Production growth will need to stay in check to not rise too swiftly if consumption patterns are changed.

Prospects for demand growth were long centered on emerging market economies and expanding middle classes rather than traditional consumer nations.

For the markets to truly advance, production worries must occur as it is not likely to be an upsurge in usage to do this. The noted exception is cocoa as processing margins are favorable for the industry to convert more beans to products. But this does not mean that final end-user demand is on the rise to absorb the resulting by-products.

***Sugar:***

Brazil Crushing Season Ending: The crush of the 2016-17 sugar harvest is starting to wrap up with only a few mills left open. Sugar production will finish up shy of 17% better than last year, despite lower yields with more cane being allocated to sugar than ethanol compared to the prior year. Brazil was able to export greater than a 27% increase in sugar year over year with high prices and favorable exchange rates prompting this.

Outcome: Despite some short lived bouts of concern, sugar supplies from Brazil were not in short supply this past year. The outlook for 2017-18 has a few wrinkles due to lingering dryness in the north. Brazilian government tax policies should favor gasoline over ethanol, leading to continued expansion of sugar output even if the crush is not greater.

Indian Sugar Imports Not Necessary: India faced challenges with the sugar crop this season once again, but severe losses in one region were partially compensated for by gains elsewhere. Production through year end was slightly better than last year but this is because the State that had stronger production was harvested first, leading to the bigger numbers. But this won't lead to sugar imports.

Outcome: The currency crunch in India put a dent in domestic use with demand being reported down by 500,000 tonnes in the past three months and overall demand may now see a decline from last year rather than an increase. Prior to the problems with the shortage of currency, it was expected that sugar stocks would be sufficient to meet demand and India would not need to import sugar to cover the domestic shortfall. The currency debacle now assured this while a 40% import duty on sugar also will prevent imports from occurring. Chinese sugar production is also expected to climb but a big gap will still exist between supply and demand. The sale of Chinese reserve stocks will help to plug this hole.

***Coffee***

Strong Exports: For a market that had rallied up previously on tight supplies, I still don't see this. Export data from the ICO points to large shipments and likely destocking by producers to take advantage of the better prices. It also points to increased availability from medium size producers that are helping to counter the worries over limited Robusta availability from top suppliers, Vietnam and Brazil. Production is likely to continue to recover in 2017-18 although Brazil and Vietnam have still had their fair share of troubles with too much rain soaking the current Vietnamese harvest and potentially marring the first flowering of next year's crop while the northern areas in Brazil remain too dry.

Outcome: Brazilian Robusta premiums have surged to reflect the smaller crop but this doesn't mean there isn't other coffee to go around. Vietnamese November exports surged, compensating for the reduction in Brazil. Other Mild coffee producers and Colombian Milds also strengthened exports. Until shipments truly taper off, there isn't reason for bullishness absent any developing weather issues.

USDA Increases Production for Multiple Seasons: The bi-annual report from the USDA pointed to higher coffee production than previously reported with upward revisions for the past several seasons. This increased availability certainly kept any price gain in check. Market attention will shift away from the present 2016-17 season and towards early indications for 2017-18.

Outcome: High prices are the best cure for high prices. The run-up in 2016 may have been short circuited but could have signaled to producers worldwide to continue to invest in coffee production. Prices have backed off the highs, but still remain comfortably above the prior acceptable price range for coffee. While farm costs have certainly increased, diversifying farms enables producers to stay in the game and stick with growing coffee.

***Cocoa***

Seeking a Bottom: Ivory Coast crop arrival data (which is a measure of just how much cocoa has come down from upcountry to port cities as means of totaling what cumulative production is for the year) had been running behind early on and still has not hit the big numbers that were anticipated by this point in the marketing year. The slide in prices seems to be halted. The La Nina is not strong and lowered prices should help to boost cocoa grind. Now military unrest amongst soldiers seems to be disrupting peace in the world's top cocoa producing country.

Outcome: It is too soon to say that cocoa production in the Ivory Coast will fall short of expectations rather than crop is just being slow to be evacuated this year from upcountry. So far there is no anecdotal evidence to believe the crop will miss production targets resulting in a surplus that is not quite as large as the market had adjusted for. Typically West African cocoa production shows bigger gains in a strong La Nina, whereas the conditions have been for a fairly weak La Nina and ENSO is becoming neutral from January through March. The Ivory Coast has seen production flourish under reform efforts since the end of the civil war and better prices paid to farmers. Recent protests by soldiers in separate cities is not yet sounding alarm bells or impacting the crop arrivals but certainly needs to be monitored as a potential catalyst for a rally. I still believe that cocoa grind will improve and absorb the big supplies due to favorable processing margins this season compared to recent years.

***Cotton***

Price Jump Hurting Sales: In the final weeks of 2016, there was some impressive export sales reported that could force the USDA to revise the target for the season upwards and in turn cause ending stocks to be lowered. Prices advanced as a result. However, strong gains in sales are fleeting when the market has climbed and so the cause for optimism becomes short lived. High prices at this time of year are a recipe for a bearish market next season

Outcome: While dollar weakness would help to boost the competitiveness of US cotton in the world market, advancing prices are sure to push buyers back to the sidelines and could force demand more towards man-made fibers over cotton. More so than the worries over the impact on export sales potential, I would be more concerned over how high prices could lure farmers to planting more cotton this spring, leading to far too much production next year. Already preliminary figures are pointing to an acreage jump of around 8% to 10% in the United States alone. For this to not be bearish either yield's will need to be disappointing due to poor weather and large abandonment of the planted acres or demand will need to be very keen. For this to happen, prices would need to drop. The higher the market holds the more bearish the outlook for 2017-18 becomes. Foreign producers may also opt to plant more cotton, including China. China is set to auction off more reserve stocks and prices in China favor domestic supplies right now over imports.

***FCOJ***

Shrinking Consumption: The biggest challenge for the FCOJ market is that consumption continues to lose ground. Movement of FCOJ and chilled juice is being reduced on an ongoing basis in response to high retail prices and attraction of other new healthful other beverages crowding dairy cases in grocery stores. Stocks of orange juice started the season rather tight with production prospects poor, but a heavy influx of foreign imports is keeping stocks from declining even further.

Outcome: The winter is passing without incident. Temperatures in Florida remain balmy. There is no risk of a freeze in the weeks ahead. Investors dumped out of long positions. Fundamentals turned weaker as Brazil has shipped more product to Florida and this is closing the gap in supplies at the same time that demand continues to erode.

# Stats of the Month

The USDA reported that world coffee production for the current 2016/17 season is forecast 3.7 million bags higher than the previous year to 156.6 million bags with record Arabica output in Brazil more than offsets lower Robusta production in Brazil, Vietnam, and Indonesia. The USDA pinned global coffee consumption at a record 153.3 million bags. While the production value is higher than noted consumption, a statistical gap between reported exports and imports will cause ending inventories to fall to a 5-year low, with much of this depletion in producing countries. The stats are higher though than what was last forecast in June 2016 and therefore were not construed constructively and already adjusted for in the price.

A number of market watchers for sugar reduced their private views for the world sugar deficit, which contributed to the slide in prices. F.O. Licht is now suggesting that the 2016/17 (October/September) deficit has been reduced to 5.9 million tonne from 8.1 mln that was expected back in November. The smaller deficit is partly attributed to an upward revision of sugar production in Brazil's Centre-South for both 2016/17 and for the next harvest in 2017/18 which straddles the international marketing year.

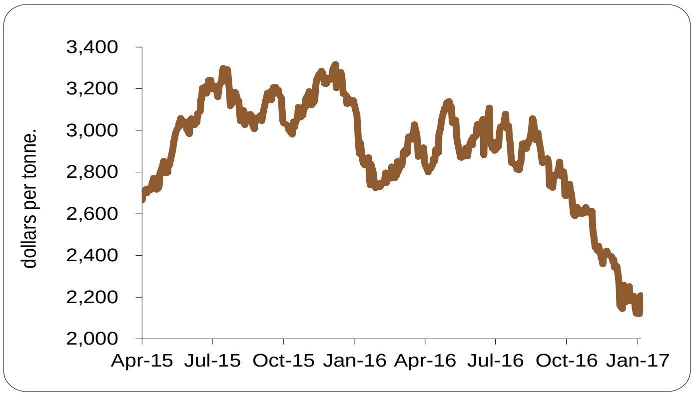
Australian ABARES also released a new projection for 2016/17 (October/September) putting global sugar output at 176.9 mln tonnes, against their forecast for global consumption of 183.9 mln tonnes.

According Sucden, a Paris based trading firm, the 2016/17 increase in global production was minimized due to sharp losses in India and the possibility of a small decline in CS Brazil's 2017/18 crop. They too believe the deficit will be five million tonnes or similar in size to last year. These estimates all pale in comparison to worries that the deficit would be far bigger this season, leading to widespread sugar shortages.

The International Cotton Advisory Committee Secretariat forecasts that the season-average Cotlook A Index in 2016/17 will range between 66 and 83 cts/lb, with a midpoint of 74 cts/lb, which would be 4 cts/lb higher than last season. According the press release, the current season started with a large shrinkage in stocks, particularly from countries in the Southern Hemisphere, which saw ending stocks in 2015/16 fall by 21% to 1.6 million tons, the lowest since 2009/10. They noted that the shortage in supply has carried through the first few months of the 2016/17 season, as the bulk of the crop was still being harvested, keeping prices firm. However, world cotton production in 2016/17 is projected to rise by 8% to 22.8 million tons, which may put pressure on cotton prices in the latter half of the season, said the report. World ending stocks may fall by 7% to 18 million tons in 2016/17, though stocks outside of China are expected to grow by 6% to 8.7 million tons.

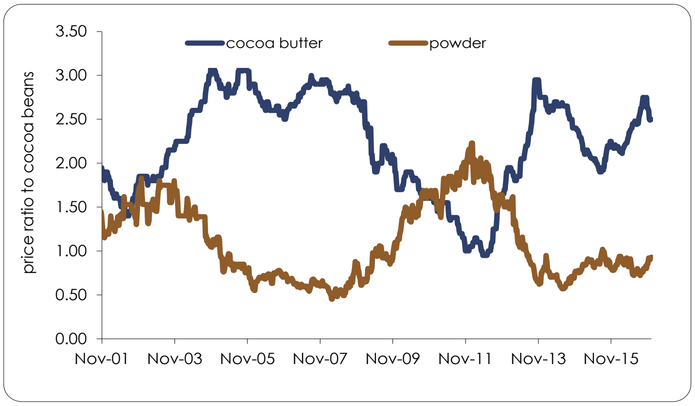
Bloomberg's Commodities Index final data for 2016 was up for the year for the first time in five years, which they feel is a signal that commodities may have bottomed. Metals led the charge this past year, whereas in 2015 the Softs were the only market's to post gains. In 2016, only cocoa finished the year lower, although the other Softs finished off early peak prices.

Cocoa was the Only Softs Market to Post Losses in 2016




Source: FutureSource

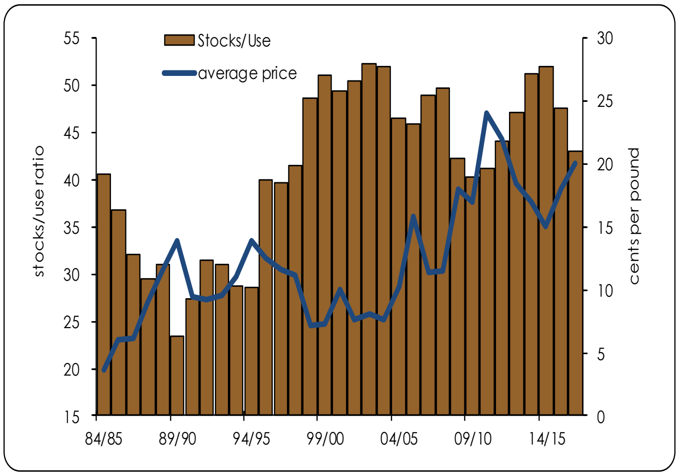
Cocoa Margins are Favorable Again which should help Demand




Source: Milling and Baking News

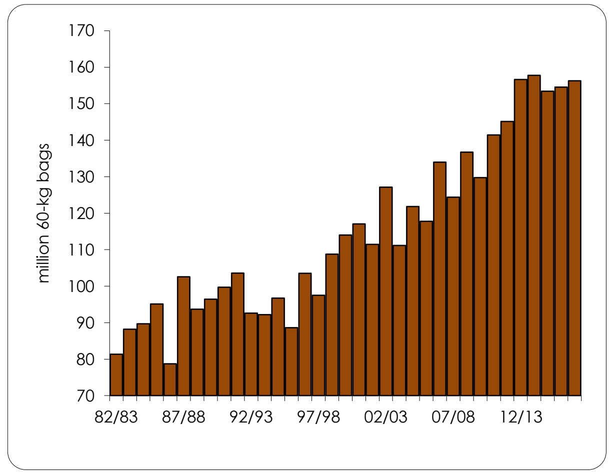
# MONTHLY OUTLOOK

## Sugar Stock Decline will be Less than Previously thought and Potentially Climb in 2017-18



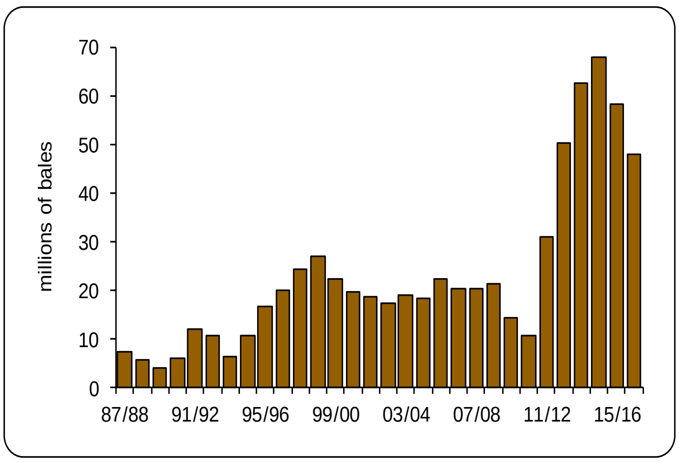

Source: ISO

## Global Coffee Production was Revised Upwards by the USDA but Still Short of Demand



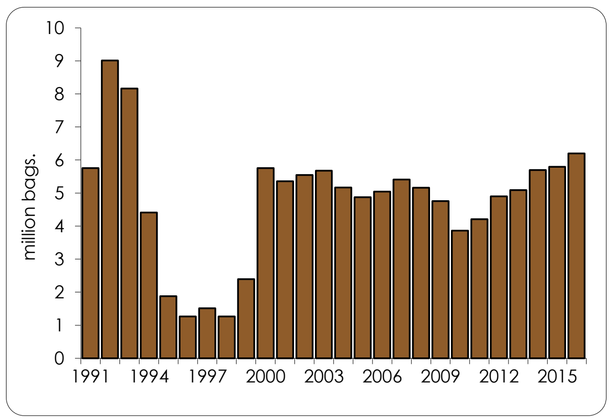

Source: USDA

## Upcoming China Cotton Auctions will Reduce Supplies that are Still Large




Source: USDA

## US Coffee Stocks Up on Large Exports




Source: Green Coffee Association

# Watching the Weather

## Upcoming Potential trouble Spots

Traders are starting to get a little nervous about the weather in Brazil with northern areas turning dry again and this could continue for the next few weeks, raising some alarm about coffee and sugar production for the year ahead. Extreme dryness at this time of year could stunt the growth of the coffee branches, which would hurt the prospects for the 2018-19 harvest and also comes at a critical point in the development of the coffee bean within the cherry. Under harsh conditions, the beans could be malformed or could turn black within the coffee cherry and marring the quality of the crop. Recall several years ago when outwardly the cherries seemed fine, but when the coffee was milled, producers were surprised by the poor results and lightness of the beans from the lack of precipitation. I think it is far too soon to sound alarm bells for the developing crop but certainly the situation needs close monitoring in case the weather remains dry. It was a combination of sustained dryness and searing heat that caused the problems with the 2014-15 Arabica crop and then kept Arabica production again limited in the next year. Production would have been smaller were it not for strong pruning and the comeback of production in Parana, the southernmost coffee producing state in Brazil, following a mild frost the prior winter. The situation is not expected to be nearly as severe or persistent nor as widespread, but with problems still in Vietnam from being inundated with too much rain, would it not be surprising to see the market react quickly to any potential supply disruption. Again, I stress that it is too soon to say with any certainty that even small losses would occur and the weather could certainly improve hereafter.

The Negative subsurface temperature anomalies that have been present since March have now weakened and recently returned to zero. The climate is moving towards a more neutral period with an ending forecast for La Nina. Since conditions were mild, Colombia never received the torrent of showers that destroyed production at the start of this decade and helped to send coffee prices soaring. A weak La Nina does not indicate that cocoa production would see strong growth but only modest gains. The weather could potentially turn less favorable for the mid-crop and then worries could begin for the following main crop, especially with prices as weak as they are.

The long range outlook for Florida shows absolutely no risk of a freeze this winter. Temperatures should remain well above freezing and not even dip much below 50F.

Areas that were previously parched in SE Asia have been getting an abundance of rain that could be potentially detrimental. However, too much rain is rarely a bad thing, except when it delays planting. It could lead to brighter prospects for Thai sugar next season.

# Fundamental Favorite

## The New Year Starts with a Bang

The Softs Complex was jolted upwards as the dollar weakened and traders zeroed in on weather forecasts for dryness in Brazil. The rallies have started to fizzle already and may not be a brilliant New Year fireworks display but some sparklers that fizzle out fast. My comments from last month still stand about the comfort level for each of the markets and without the benefit of either a true weather scare or significant currency play, the markets are more likely to stay in their comfort zones. In recap:

The coffee market rose and fell coming almost full circle to where it was a year ago. The market briefly fell back into the old familiar stomping ground of $1.20-$1.40 and then found support and climbed above this point. The market may need to test the water further and rest not to from where it is. As noted previously, the market will continue to closely track the Brazilian real/US dollar relationship and will a deciding factor for market action. Fundamentals still lean somewhat bearish due to ongoing large exports, sufficient stocks in consumer hands and bright prospects for 2017-18 production recovery.

World sugar prices finished with an increase in 2016, but certainly well off the highs. World stocks are being reduced for the second consecutive season, but the stock reduction is nowhere near as troublesome as many perceived earlier in 2016. There are still some worries for the balance of this year, but my concern is focused on the consumption side with no strong players needing sugar and that could limit price advances. The sugar market will continue to keep a close watch on energy prices as lower oil leads to higher sugar production in Brazil and greater exports.

The cotton market may be getting ahead of itself if prices continue to rebound. Higher prices were needed to assure that planting decisions include cotton over other crops, but now prices may be too attractive and lead to too much supply in 2017-18 if the weather is favorable for plantings and harvesting. Current prices are already too high and will have a negative impact on demand.

The FCOJ market has finally plunged on the realization that high prices were killing demand and the supply threat for this season is minimized from a lack of cold weather. This coupled with strong imports, have taken the edge off the market. Strong imports have forced prices lower.

The cocoa market remains at low levels relative to the rest of the Softs Complex and would seem to have fundamentals that are not quite as bearish as market action suggested. The tide seems to be turning and this is my favored pick for a market that has room to climb.

# ICE Update

## 2017. Martin Luther King Holiday Trading Schedule

ICE Futures U.S. will observe the trading schedule below for the 2017 Martin Luther King Day Holiday. Changes from regular trading hours and daily settlement window times are shown in bold, all times shown in New York time.

### Sugar No. 11® and 16, Coffee “C” ®, Cotton No. 2®, Cocoa, World Cotton and FCOJ Contracts

| DATE | TRADING HOURS | SETTLEMENT WINDOWS |
|---|---|---|
| Fri, Jan 13 | Regular Hours | Regular Times |
| **Mon, Jan 16** | **Closed** | **None** |
| Tue, Jan 17 | Regular Hours | Regular Times |

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