

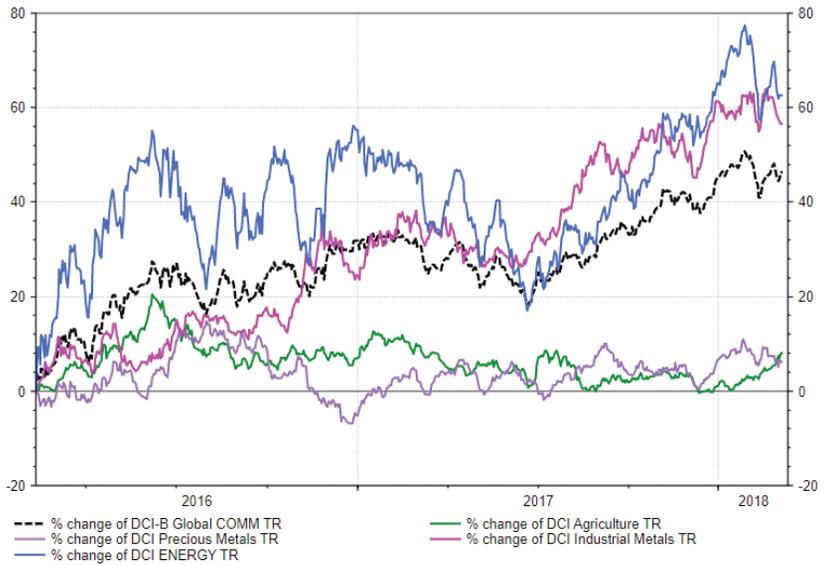
# 40 / The long-term price action in the grains sector is about to form a major bottom in Q2 2018

**T**he agriculture sub-sector has been one of the most neglected sub-sectors in the commodities asset class, and has just edged out the precious metals sub-sector for the most laggard position since the cyclical trough of commodities in February 11, 2016 (see 1st chart on this page).

**N**onetheless, we believe there are good reasons to revisit the grains sector, as any significant setback from current levels may provide entry levels for long trades positioned for another episodic surge of prices over the next year or so. . Over the past decade, grains have exhibited behavior which can be very profitable if timed correctly. Technically, grains are starting to show stable structures as corn, soybeans, and wheat prices have been rising strongly off the lows seen in August last year. A decline in Q2 2018 may provide good entry levels for long trades. (see 2nd chart on this page).

**W**eather developments are also lending a positive spin to the agriculture sector – the dreaded La Nina phenomenon is making an impact on grain prices. . La Nina is a cooling of the water in the equatorial Pacific Ocean that takes place at irregular intervals. The weather condition typically lasts from 10 to 12 months. The phenomenon favors the northern jet stream and that tends to weaken the southern jet stream – which in turn drives more moisture towards the northern part of the United States, while the southern tier stays drier than normal. The latter event is what makes La Nina important to grain prices. The La Nina event is the obverse of the more famous El Nino – La Nina is the other side of the coin, so to speak, of El Nino (see 3rd chart on this page).

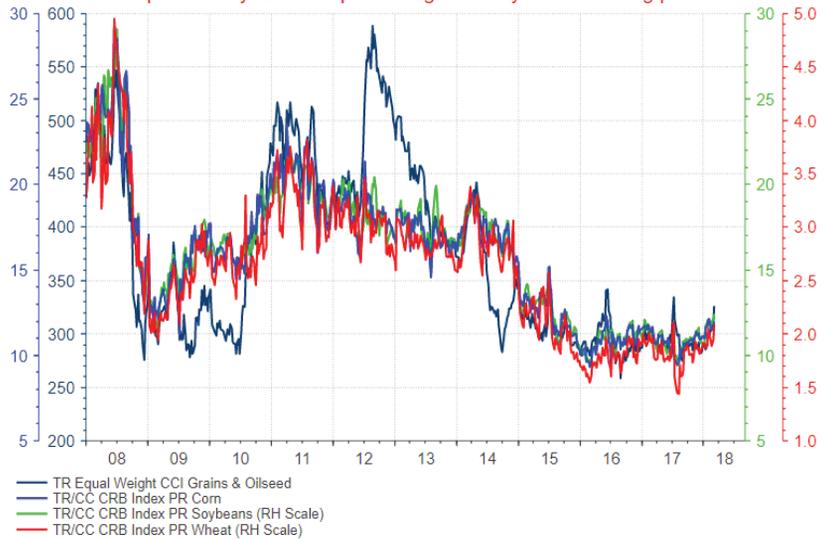
COMPARATIVE CHART (Ref: Feb 11, 2016): COMMODITY SECTORS



Source: Thomson Reuters Datastream / DCC & Robert P. Balan Models (c)

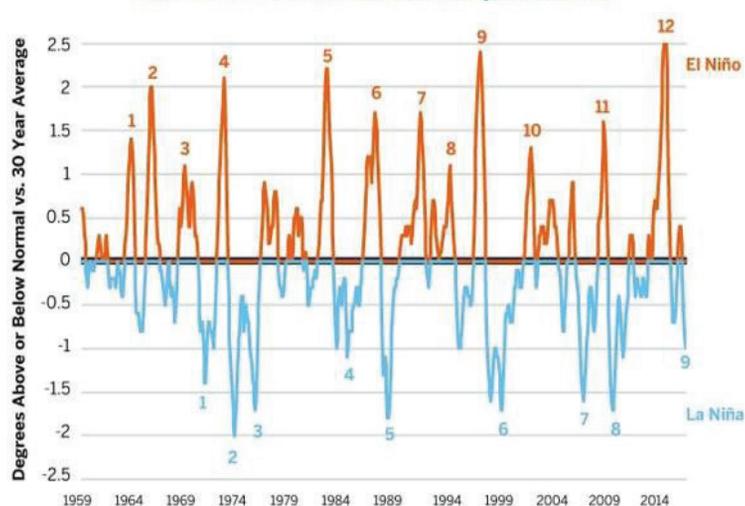
## The grain sector -- a sharp recovery off last August's lows

A final pullback by Q2 2018 provides good entry levels for long positions



Source: Thomson Reuters Datastream / DCC & Robert Balan Models (c)

## El Niño/La Niña: Sea Surface Temp. Anomalies



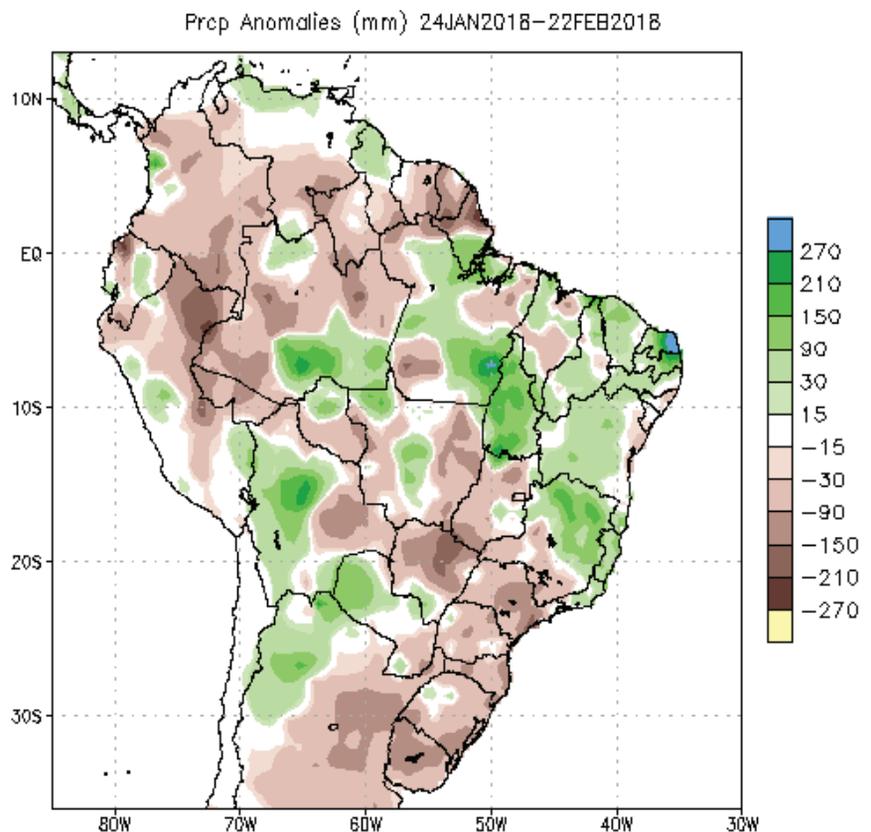
Source: NOAA, National Weather Service, Climate Prediction Center

**A**s we head into spring season, the current La Nina weather pattern could make the southern portion of the United States experience periods of drought-like conditions. Parts of Southern California, Arizona, Utah, Colorado, New Mexico and Texas could be a lot drier than average over coming months. **The dryness is already starting to be felt in those regions.** That becomes more significant in a few weeks, when farmers across the US will start planting crops for the 2018 season.

**T**he outlook of La Nina on the prowl is what has been pushing grains higher in the past several weeks. **If the 2018 crop year does not turn out to be the sixth consecutive year of bumper production, we could see prices for grains move appreciably higher towards the middle of the year.** It is of course possible that La Nina will not materialize in the US; on the other hand, dry weather could turn out to be worse than expected, and could spread across the fertile plains of the country. What is sure is that the prevailing weather conditions in the near-term will determine the size of the crop yields, and therefore the path for the prices of corn, wheat, and soybeans over the months ahead. We believe there is a good chance that La Nina impact will be at least as expected (which is bad for crops), but it could be much worse than expected (which is very good for prices).

**T**he current example of an errant weather regime can be found in Argentina. Argentina and large swaths of South America have been suffering their worst drought in decades and this has created a bullish spiral in soybean futures in the last few weeks, even in the midst of huge global stocks.

**D**evelopments over the past several years could make the current La Nina episode very positive for prices, even if we do not get the worse that the weather phenomenon has to offer. The world has become accustomed to abundant supplies of agricultural commodities over past



**Data Source:** CPC Unified (gauge-based & 0.5x0.5 deg resolution) Precipitation Analysis Climatology (1981–2010)

years, causing prices to moderate. There were significant shortages in 2008 and 2012 caused by adverse weather developments (El Nino in these instances) but those memories have faded. The prices have become consistently low, so most consumers have been purchasing requirements on a hand-to-mouth basis rather than hedging or locking in price risk. A La Nina or another weather event in 2018 could therefore have potential to push prices appreciably higher.

**T**he drought of 2012 provides a stark example. In 2012, agricultural prices exploded higher, and supply deficits took corn, soybeans, and wheat to dizzying heights. In 2012, the price of wheat rallied on the back of dry weather; the price went to a high of \$9.4725 per bushel -- more than double the price of wheat today. Corn reached \$8.4375 per bushel, while beans traded to a high of \$17.9476 in 2012. Corn price today is less than half the price that traded in 2012; beans are also appreciably lower today compared to that prevailing in 2012.

**D**emand limits the downside potential for prices while any unexpected weather event could lead to explosive price action on the upside. Grain prices have been firm despite significant stock levels because of the rising level of global demand from increasing population and wealth has been keeping pace. Each quarter there are twenty million more people on the earth and more mouths to feed. The global growth uptick means more money is available to bus these staples, putting upward pressure on prices. **There has been five consecutive years of bumper crops, but there is no guaranty that we will see the sixth of such bumper crops.** An opportunity to open long positions will come within the next few weeks (in Q2 2018), We will be tracking agriculture price, and inform readers of such an opportunity.