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Newsom on the Market

The Curious Case of Corn

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What do you do if you are the corn market and almost everyone is trying to throw dirt on you? In September, USDA projected your new crop would yield a record 161.9 bushels per acre and produce the second-largest crop on record of 12.954 billion bushels. Usually such fundamentally bearish news would be enough to put a market 6 feet under for the next marketing year, hoping that reduced acres the next time around has a "Lazarus Effect" on price.


The difference in this high-production year for corn is demand. (DTN file photo)

For example, the last time the national average yield crested above 160 bpa was in the 2004-2005 marketing year when the national average farm price was calculated at $2.06. That year saw 80.9 million acres planted and 73.6 million acres harvested, well below USDA's September 2009 estimates of 87 million planted acres and 80 million harvested. Yet the national average cash price is near $3.15 heading in to Wednesday's Quarterly Stocks report. Market bears are shaking their grizzly heads and asking, why?

The answer is demand. In 2004-2005 total demand was 10.7 bb, putting ending stocks at 2.1 bb and ending stocks to use at 19.8 percent. Fast forward to what is projected for 2009-2010: total demand of 13.025 bb reducing (yes, reducing) ending stocks to 1.635 bb from last year's 1.695, creating ending stocks to use of 12.6 percent. That is as tight a supply and demand situation as has been seen since 2006-2007 when ending stocks to use was 11.6 percent, meaning there is little margin of error this year for problems with corn production.

And so, corn markets -- both futures and cash -- are rallying into harvest. Since Monday, Sept. 21, the December corn contract has rallied from $3.10 to $3.47 (high on Tuesday, Sept. 29) while the DTN National Corn Index has moved from $2.90 to approximately $3.15. But aside from the debate over fundamentals, a debate that could be even more heated following Wednesday's Quarterly Stocks report, there are a couple of other arguments that have also been heard.

Let's look at the more bearish offering of two. Corn is rallying because, quite frankly, it has nothing better to do. Yes weather forecasts are as changeable as underwear, with every Tuesday for the past three weeks bringing some sort of frost concern into play (no comment on the weekly correlation with the changing of underwear). Therefore, because traders are growing disinterested waiting for harvest and the end of the month/end of the quarter is at hand, they buy. Not in huge quantities as total volume in the market has been declining, but buying enough to keep the market rolling higher 2 to 4 cents every day. Then when harvest finally rolls around, the market will be primed to move back into its seasonal downtrend.

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Admittedly, there is a certain logic to this argument. Markets are known for testing the limits of human psychology, most notably in this case those producers holding short futures hedges to protect against what looked like an inevitable decline. And just when they can't take anymore and get out, the market invariably turns back around and goes lower. I've seen it, and lived it, hundreds of times if not more.

However the second school of thought has a pretty good counter-argument. Using DTN Six Factor methodology the picture is actually more bullish than it might appear at first glance. To begin with, the short-term trend has indeed begun to turn up on the aforementioned buying interest tied to noncommercial short-covering. Again, it hasn't a lot but enough to keep the market moving. Then there are the futures spreads. While still showing a strong carry -- reflecting continued projections of almost 1.7 bb of ending stocks -- these spreads have begun to weaken of late, indicating increased demand from the commercial side of the market. This is key, for if a market is to steady itself after a long sell-off like what corn has gone through it needs support from both sides.

Finally, this buying interest re-emerged as the December contract moved into the lower percentages of its price distribution range for the last three years. When it posted lows of $3.02 (Sept. 8) and $3.10 (Sept. 21) the December contract was trading in the lower 1 percent of the price range established since 2006 - the beginning of the current demand-driven market; The demand-driven market that has come about due to increased domestic demand from both feed and ethanol - both projected to increase again in 2009-2010 - as well as export.

The next few weeks should be fascinating in this most watched of agricultural markets. There is a very strong chance that we will learn a great deal about the structure and strength of corn going forward, and more importantly a clearer definition of exactly what kind of market we are dealing with.

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