

Wheat Fundamentals Remains Weak, Short Covering Rally?

Going into Wednesday's trade the wheat market was severely oversold. The market did post a very modest rally. Attribute this rally to short covering. Fundamentals remain bearish, but a legitimate short covering rally would take the May contract in Chicago to \$5.50 or possibly \$6.00. Current fundamentals, however, do not support a move to \$6.00.

Wheat remains a follower of the other markets. The US dollar trade has a lot of influence on the price of wheat. The market is focused on the ability to do business, specifically soft wheat business. The US continues to sell to routine hard wheat customers and the possibility of selling hard wheat to Brazil still exists. The market into Mediterranean countries is too competitive given the disadvantage created by the increase in ocean freight costs and the proximity of willing sellers in the Black Sea region and Europe. It appears that these countries will continue to sell wheat. I question how much longer demand will stay strong. We continue to see tender activity, but buyers are willing to look for the better deal. Right now the better deal is not coming out of the US. Perhaps periodic down grades of the global 2009-2010 wheat crop will continue to keep wheat importing nations interested. Global production for 2008-2009 is believed to be 688 mmt, which is enormous. Recent estimates on the 2009-2010 wheat crop put the crop size in the neighborhood of 650 mmt. The trade expects global production to be lower. Fewer acres were or will be planted in many key growing areas. Producers in many areas have reduced the amount of fertilizer and other key inputs in an effort to control production costs. Weather is the final factor, of course. Many northern hemisphere growing regions experienced better than average wheat growing conditions. The southern hemisphere crop suffered from dry conditions.

Economic factors will also weigh on these markets, but that is not necessarily a long term bearish factor. Products made from wheat are generally a very economical food source. Wheat for human consumption will continue to have value. Currently, basis levels for quality Hard Red Spring wheat are firm. Basis levels for quality Hard Red Winter wheat are also relatively firm. Basis strength can be attributed to demand for higher quality wheat by domestic and foreign users. However, do not lose sight of the fact that the pace of producer sales of Hard Red Winter wheat has been slow. Deliverable stocks in Duluth remain small and the March/May spread in Mpls continues to trade at a 15 to 20 cent inverse. Producer sales will increase into spring putting more emphasis on how well domestic and foreign demand recovers.

Until the domestic economy shows signs of bottoming, wheat prices are going to depend heavily on the action of trend following hedge funds and long only index funds. Trend following funds sold a lot of wheat last week. Weakness in the economy triggered additional fund selling. Trend following funds were sellers last week. It appears trend followers will be more than willing to increase their net short position on additional weakness. If the index funds decide to liquidate, lookout below, since current fundamentals cannot support a wave of fund selling. A large net short fund position does provide the possibility of a pronounced short covering rally. However, I do not see a scenario that would spark a \$1.50 to \$2.00 rally in wheat at this time.

The US soft wheat crop appears to be in good shape as it starts to come out of dormancy. Most growing regions have adequate moisture. The lack of moisture in the southern plains has not been alleviated. Many of these areas have experienced warm

temperatures. The trade will be keeping a close eye on dry areas as the US Hard Red Winter wheat crop comes out of dormancy.

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