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The Wheat Rally Continues

The wheat market continues a fierce move higher as both technical and fundamental factors are gripping this market. The primary factor behind the move is short covering from trend following funds. However, the lack of a substantial drop in open interest indicates that Index funds are likely also on the buy side. Additionally, users of wheat and flour were good buyers when the rally commenced on June 28th. In addition to the technical buying, wheat crops around the globe are struggling with dry conditions and in a few cases excessively wet conditions.

Thursday was a very important day in the wheat market. The Chicago Sept contract breached the 200 day moving average of 532 ½. This is significant from the standpoint of the 200 day moving average being the last of the closely watched moving averages to be breached. Establishing trade above this level triggered additional fund buying. Trend following funds, which may have been net short as much as 60,000 contracts on June 29th, are likely very close to even as of Thursday's close. Continued trade above this level and additional upward momentum will trigger additional buying and possibly the beginnings of a move to build a net long position. Whether or not this plays out immediately may depend on the value of the US Dollar Index. The dollar has been weak in comparison to many other currencies. A weaker dollar tends to trigger additional fund buying.

Potential buyers should be cautious as all three wheat markets have moved well into the overbought category. We may have (I assume we have) entered a phase where users of wheat that do not have enough coverage going forward are getting nervous. The complexity of this rally is astounding. The USDA will release a report on Friday morning that may indicate an estimate of the 10/11 carryout above 1 billion bushels. Certainly not a scenario that is typically associated with an 85 cent move higher over the course of 10 days. Additionally, the rally has taken place during the winter wheat harvest and the spring wheat crop has gotten off to a good start. Therefore, we are stuck with a market that is hard to buy from a standpoint of overbought conditions and a market that is hard to sell for obvious reasons. There is little in the way of resistance on the current wheat chart. Wheat futures have exceeded the highs of early May and late February, which leaves the highs of early January as the next resistance. I would like to believe the current supplies would provide enough resistance to squelch this rally, but that has not gotten me very far so far. However, this rally is a great opportunity for producers to sell old crop and new crop wheat. Producers looking to sell futures may have to wait for the market to signal a reversal. Producers can buy puts outright or buy put spreads to protect against a future downturn in the market. I like the put strategy because it allows the producer to take advantage of potential gains in the value of the futures market. If corn and soybeans can continue to hold or post new gains, wheat will continue to find some support. The real exposure from the standpoint of the producer will be on the basis. The potential of a billion bushel carryout does not bode well for the basis. Better quality cash wheat, especially higher protein wheat should continue to carry a decent premium on the domestic market. My concern stems from the reduction of the spring wheat crop in Canada.

Production problems in many key wheat producing areas around the globe are going to allow for a significant decrease in a very large global supply of wheat. On almost a daily basis, areas suffering from wet conditions receive rain and areas suffering from dry conditions expand. The Canadian wheat crop, which was already limited by excess moisture during plantings, is also subject to wet weather related diseases. Forecasts continue to call for periodic rain events throughout western Canada. Southeastern Europe and southern portions of the Ukraine are experiencing similar conditions. This problem in the Ukraine is limiting the ability to harvest. Meanwhile, western Europe is experiencing hot temperatures and dry conditions, which have reduced the potential of that crop. Northern Ukraine, Russia and Kazakhstan have also been subject to excessive heat and limited rain. Production in these areas may be reduced enough to allow the US back into the soft wheat export market.

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