



STATE BANK & TRUST Co.

DOANE'S Farming for Profit®

December 2011

USDA reports took a back seat to the unfolding Euro-crisis on November 9th. Key changes are covered in the Market Monitor on back. So far global financial markets have been roiled by sovereign debt crises in Ireland, Portugal, and most lately, Greece. All three required EU bail-outs. The crisis is so serious that it can move global stock markets, gold prices, crude prices and the value of the dollar so much that these outside markets are the dominant factor in ag commodity price movement on any given day. And it's not over yet. Italy's 1.9 trillion euros (\$2.6 trillion) of debt is the world's fourth-largest, behind the U.S., Japan and Germany, and more than that of Greece, Spain, Portugal and Ireland combined!

U.S. Southern Plains rains defying La Niña? Not really. There's no question rains have been a little more frequent and a little more extensive in coverage than what was forecast for fall. But the bearish break in wheat futures notwithstanding, the U.S. Drought Monitor is still pretty ominous. As of Nov. 8th, it still shows the entire southern Plains in "severe" to "exceptional" drought; much of the SE still in "moderate" to "extreme" drought and a thick swath of the western Corn Belt from Missouri to Minnesota "abnormally dry" to "severe" drought as we head into winter. You can check it free online anytime. Just Google "Drought Monitor".

Congressional agriculture committees have had a really difficult time coming up with the structure of farm programs to submit to the Joint Committee for Deficit Reduction (the super committee). Time is running out. The conversation mostly revolves around some form of "shallow loss" protection that would kick in when revenue declines below insured levels, but not by enough to trigger crop insurance payments. However, policy makers from outside the Midwest say the plan is good for corn and soybean producers but is not fair to producers of other crops, especially cotton and rice. Senate Agriculture Committee Chairman Debbie Stabenow hints also that the next farm bill will make more land available for crops by reducing the size of the Conservation Reserve Program.

USDA has forwarded a stripped-down version of new Grain Inspection, Packers & Stockyards Administration (GIPSA) rules to the White House Office of Management and Budget (OMB) for review before final implementation. The rules forwarded to OMB retain the provisions on poultry production and marketing, but leave out major provisions strongly opposed by meatpackers and several beef producer groups. The new proposed rule does not include the ban on packer-to-packer sales and competitive injury language that would have made it much easier for producers to sue processors. Further changes to the proposed rule are possible before it is finally implemented.

It appears that Russia will be able to join the World Trade Organization by the end of this year. For a country to join the WTO, every member of the organization has to approve. Russia and Georgia signed an agreement on trade this week, which had been one of the key impediments facing Russian admittance. Under an agreement to join the WTO, Russia would be allowed to increase spending on trade-distorting farm subsidies to \$9 billion in 2012 and 2013, and the support would decline to \$8.1 billion in 2014 with further reductions in following years reaching the final limit of \$4.4 billion in 2018.

THE BLUE-CHIP BORROWER

The kind lenders compete for!

Managing "volatility" itself has become a big part of managing market risks for producers. Commodity futures frequently take big swings even within a single trading session now that the European financial crisis is so fluid and so severe that on some days just a new headline flashing across the wire service screen can move global stock prices, gold prices, crude oil prices and impact the value of the dollar versus the euro!

The stakes for farmers in the resolution of the EU crisis are huge. In one scenario the U.S. dollar soars as the euro crumbles; crippling U.S. exports. Commodity prices tumble. In a different scenario, the EU manages to contain the crisis with help from China, the IMF and World Bank, the dollar resumes a long-term downtrend, spurring our exports and the "new era" for commodity prices remains intact.

There's rarely been a time when it's more important for producers to recognize that at any time, you face price risk on 100 percent of your annual volume. How so? Because at any given time you face downside risk on whatever production you haven't priced if markets move against you. But at the same time, you also face "opportunity" risk on whatever production you have already priced if markets move in your favor after you've sold.

Options in futures often provide a good way to manage opportunity cost risk. Shrewdly purchased put options protect against downside risk without sacrificing upside potential. Shrewdly purchased call options protect against lost opportunity costs after you've made your sales. If you don't understand options, it's time to learn. They are one of the most overlooked risk-management tools in agriculture.

A word of caution: Discuss option strategies with your lender as a "test" of your own strategic thinking. If you can't explain to his/her satisfaction 1) what you want to do; 2) why you want to do it; and 3) the comparative outcomes if prices move higher OR lower, that's a good sign you might not be ready to execute the plan without a little more study and thought yourself!

Doane's **MARKETING MENTOR**

CORN

The EU debt crisis continues, as discussed on page one. USDA issued Crop Production and Supply and Demand reports Nov. 9th. The reports were neutral to positive to the corn price outlook. USDA revised corn production down 123 million bushels from October to 12.310 billion bushels. The production estimate came in 70 million to 90 million bushels below trade estimates. The 2011 national corn yield is now estimated at 146.7 bushels per acre, down 1.4 bushels from last month, 6.1 bushels below a year ago and the lowest corn yield since 2003. Lower production was largely offset with lower use. U.S. ending stocks are now pegged at 843 million bushels, down 23 million from October and well below 2010/11 ending stocks at 1.128 billion. Corn supplies will remain tight. We expect prices to work gradually higher into February/March.

WHEAT

The Nov. 9th Supply/Demand updates for the U.S. and global wheat outlook were both bearish. USDA trimmed spring wheat and durum production just 9 million bushels versus pre-report trade expectations averaging a 20 million bushel cut. Globally, USDA raised projected ending stocks by 230,000 metric tons versus pre-report trade expectations averaging an 800,000 decline. On a class by class basis, USDA cut their HRW export forecast by 30 million bu., but added that much to HRS exports. This reapportionment of exports by class jacked up projected HRW ending stocks to a 137-day supply, but cut HRS ending stocks to a 95-day supply and Durum ending stocks to a 90-day supply. Generally, a 90-day supply is the "threshold for tightness" whereby any shock whatever to the following year's supply becomes quite price sensitive. The USDA move helps explain why throughout October and into early November MGE futures gained on KCBT and CBOT futures.

SOYBEANS

USDA issued its November crop reports. There was a modest drop in the production estimate, down 14 million bushels from October. Forecast ending stocks rose to 195 million, which was greater than expected by the trade. Both domestic and export demand has been weaker than anticipated. We were curious to review USDA January soybean production forecasts in years similar to 2011, when production forecasts saw setbacks from the previous month in both October and November. USDA has

published those data since 1965 and there have been fourteen previous years similar to 2011 in this regard. For all fourteen years, the January production forecast was less than the November forecast. Even if the final crop estimate is reduced, that won't occur until January. Until then, market attention will be on demand and on South American production. So far down there, no problems.

SORGHUM

The November Crop Report showed USDA raising sorghum production 2 million bushels from last month to 246 million bushels. While the yield was up fractionally from last month (to 55.5 bu. per acre) it's still down sharply from the 2010 yield at 71.8 bushels per acre. On the demand side USDA cut exports by 10 million bushels and boosted feed use by a similar amount resulting in no net change in total use at 245 million bushels. Ending stocks are now projected at only 28 million bushels, up two million from last month and about steady with 2010/11. USDA's price forecast was unchanged from October with a midpoint at a record high \$6.50 per bushel. Usage must slow in order to maintain even minimal ending stocks. As a result, prices should move higher into mid-to-late winter.

CATTLE

The cash market still looks quite strong. Feedlots are current and supplies are seasonally tight. Packers are bidding aggressively for higher quality cattle at this writing. However, demand is expected to soften once this transition is completed and preholiday holiday buying generally winds down. However, continued strong export demand is expected to hold domestic supplies in check and provide underlying support for prices. We expect winter lows in the \$118 to \$120 range. The long-term outlook for the cattle market remains very positive. USDA reinforced that view with its November supply/demand update. Beef production is forecast to decline by 5 percent in 2012. USDA did increase the price forecast sharply for 2012, boosting the fed steer price by \$5 per cwt from October to a midpoint of \$121.50.

FEEDER CATTLE

Calves have been moving aggressively into feedlots so far this fall as back grounding opportunities have dwindled because of the ongoing drought. This situation may limit upside potential in the calf market through the remainder of the fall, but it also reduces available feeder cattle supplies in 2012, which is bullish longer-term. Feeder cattle values have been supported by strength in the

deferred live cattle futures. Deferred fed cattle futures may ease along with expected weakness in the nearby contracts over the next few months. But spring and early summer futures are well past the winter bulge in supply and will reflect a much tighter situation next spring. This should continue to be supportive to feeder cattle through the fall and winter.

HOGS

The European financial crisis continues to be a major market factor for commodity markets, including meats. Pork prices have fallen to the lowest level in five months by mid-November. Hog supplies remain large and average slaughter weights have been on the rise since early August. Average slaughter weights for Iowa/s. Minnesota increased to 274.7 pounds last week, up about 14 pounds from the summer low hit in early August. The increased supply of pork has pressured prices as domestic demand has slowed seasonally, although export demand remains strong. Until pork prices can stabilize and turn higher, weakness in the cash tone will likely continue. China and Japan are seen as good markets for U.S. pork, but there's significant downside price risk if June futures should approach \$100.

MILK

Milk production in the U.S. was up 1.7 percent in September. However, herd expansion appears to be slowing. Cow numbers in the September Milk Production report were estimated at 9.209 million head, up just 1,000 from June. The increase in production is coming from the 0.7 percent increase in output per cow and year-over-year cow numbers being up 88,000 from year ago. Price weakness for milk and dairy products from the high levels this summer is expected to be limited by solid domestic demand for cheese and butter. Demand for dairy products has more than made up for the 1.6 percent year-over-year decline in fluid milk sales. Export demand has been very strong this year and is a big reason for the rally to record levels. However, export demand is slowing and international prices are easing as export competitors are seeing an increase in exportable supplies. Farm-level milk prices peaked in August at \$22 per cwt, but slipped to \$20.90 in September. Prices are expected to moderate in the fourth quarter, but for the year should be record high at just above \$20 per cwt., nearly \$1 per cwt higher than the previous annual average high of \$19.13 in 2007. Current projections are for milk prices to average around \$18.50 per cwt in 2012.

