THE HIGHTOWER REPORT
Futures Analysis & Forecasting
SPECIAL REPORT
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Wall of Supply for Soybeans?

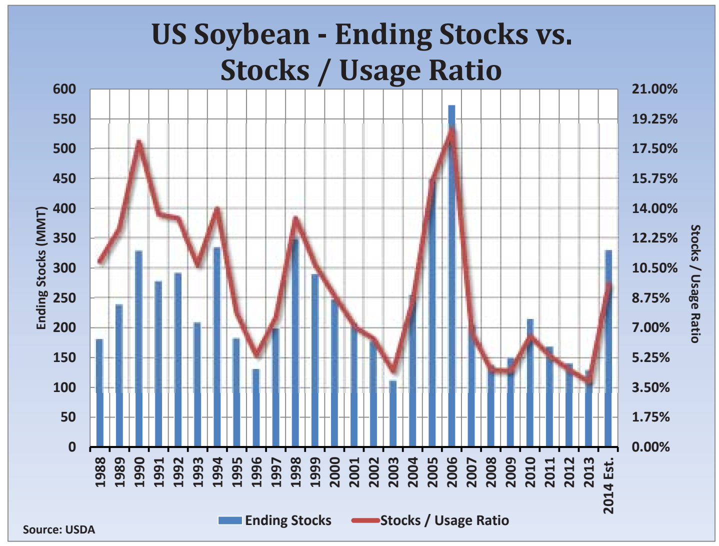
Producer Hedge Strategies for the 2014 and 2015 Crops

In the stock market, there is an old saying, "don't fight the tape." For grain traders, the saying is "don't fight the weather." The weather outlook for the next several weeks looks ideal for growing soybeans, and this suggests a "sell shallow rallies" mentality will develop for grain traders. The June 30th Planted Acreage and Stocks reports from the USDA is the next key volatility event for the soybean market, but the key focus in the weeks ahead of that will be the weather. We think that given the great start to the crop, soybean producer-hedgers should look to sell November 2014 Soybeans on any minor bounce and then consider using short-dated new crop call options for a "hedge of the hedge" against significant adverse volatility going into the key USDA report date.

The soybean and soybean meal export pace for the 2013/14 marketing year continues to be a supportive force. Crush margins remain high, crushers still need soybeans for August, and end-users need soybean meal for August and September. However, import activity is increasing, and once the US crop starts to look like a “bin-buster,” the US farmer may be more inclined to sell some of their old crop soybeans rather than risk losing the $2.70 premium they carry to the new crop. The July/November Soybean spread has pushed to a new contract high, and spreads, rather than flat prices, may help ration supply going into the late summer.

The market is in a transition period, as 2013/14 US ending stocks are projected at just 130 million bushels while the early estimates for 2014/15 ending stocks are more than double that level at 330 million. The stocks/usage ratio is expected to climb from a record low 3.8% to 9.6%, the highest level since 2006/07.

A large portion of the Midwest looks to receive 1 1/2 to 3 inches of rain over this week, spread out over several different rain events.



Some areas of central and southern Iowa could get as much as 4 inches. Warm and wet weather is ideal for the crop, and by the third week in June it should be in excellent condition.

As of May 25th, there were still nearly 6 million acres of corn in the northern Midwest that had not been planted. Given the rainfall that region has received since, at least 1 million acres could be switched from planting corn to planting soybeans.

There were also about 2-4 million acres that were planted to other crops across the US last year that did not show up in the March Prospective Plantings report. The excellent weather for late May and early June and the surge in soybean prices into the May 22nd peak may have created an opportunity (and incentive) to plant more acres across the Corn Belt. As a result, the June 30th Planted Acreage

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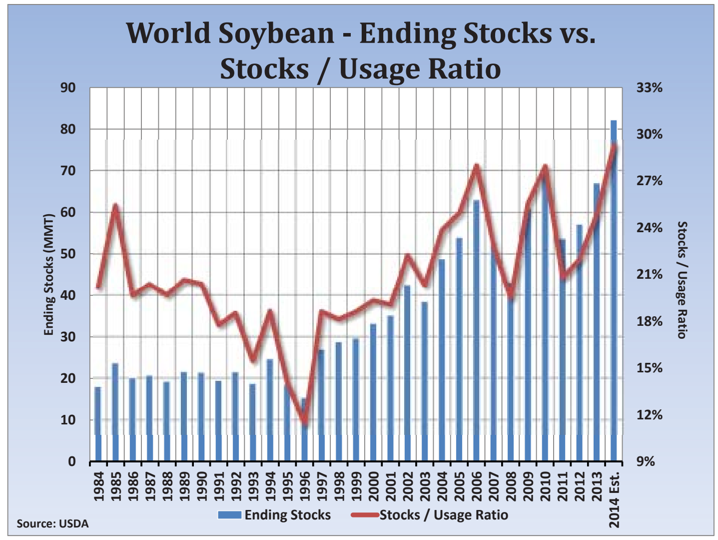
report could show an increase of as many as 1 million acres planted to corn and 3 million acres to soybeans.

If the weather remains favorable, the trade will soon be talking about a 46 bushel-per acre average yield for the new crop season, versus the current estimate of 45.2. That on top of the general idea that actual plantings will be up at least 1 million acres from the March Planting Intentions report will have fundamental traders talking about a "wall of supply" for the 2014/15 crop year.

The enclosed table shows the results under various planting scenarios. If there is a 1 million-acre increase in plantings from the March estimate and yield does indeed reach 46 bushels per acre, ending stocks would come in at 444 million bushels with a stocks/usage of 12.9% (assuming no adjustments in usage). If actual planted acreage is up 2 million from the USDA estimate, ending stocks could push up to 490 million bushels.

And if planted area increase by 3 million-acres, ending stocks could climb to 536 million bushels, and the stocks/usage ratio could reach 15.5%.

The US supply situation should remain tight throughout the summer, but world stocks on September 1st (before the US harvest) are expected to be the second highest on record at 66.98 million tonnes. By September 1 2015, world stocks are expected to reach 82.23 million tonnes, 12 million tonnes higher than the previous record.



USDA SUPPLY/DEMAND								2014/15 Estimates		
US SOYBEANS					May	May	May			
					USDA	USDA	USDA	Acreage Estimates		
	08-09	09-10	10-11	11-12	12-13	13-14	14-15	Low	Mid	High
Planted Area (M Acres)	75.7	77.5	77.4	75.0	77.2	76.5	81.5	82.4	83.5	84.5
Harvested Area (Acres)	74.7	76.4	76.6	73.8	76.2	75.9	80.5	81.5	82.5	83.5
Yield (Bu/Acre)	39.7	44.0	43.5	41.9	39.8	43.3	45.2	46.0	46.0	46.0
Beginning Stocks (M Bu)	205	138	151	215	169	141	130	130	130	130
Production	2,967	3,359	3,329	3,094	3,034	3,289	3,635	3,749	3,795	3,841
Imports	13	15	14	16	36	90	15	15	15	15
Supply,Total	3,185	3,512	3,494	3,325	3,239	3,519	3,780	3,894	3,940	3,986
Crushings	1,662	1,752	1,648	1,703	1,689	1,695	1,715	1,715	1,715	1,715
Exports	1,279	1,499	1,501	1,365	1,320	1,600	1,625	1,625	1,625	1,625
Seed	90	90	87	90	89	95	92	92	92	92
Residual	16	20	43	-2	1	0	18	18	18	18
Use, Total	3,047	3,361	3,279	3,155	3,099	3,390	3,450	3,450	3,450	3,450
Ending Stocks	138	151	215	169	141	130	330	444	490	536
Stocks/Use Ratio	4.5%	4.5%	6.6%	5.4%	4.5%	3.8%	9.6%	12.9%	14.2%	15.5%

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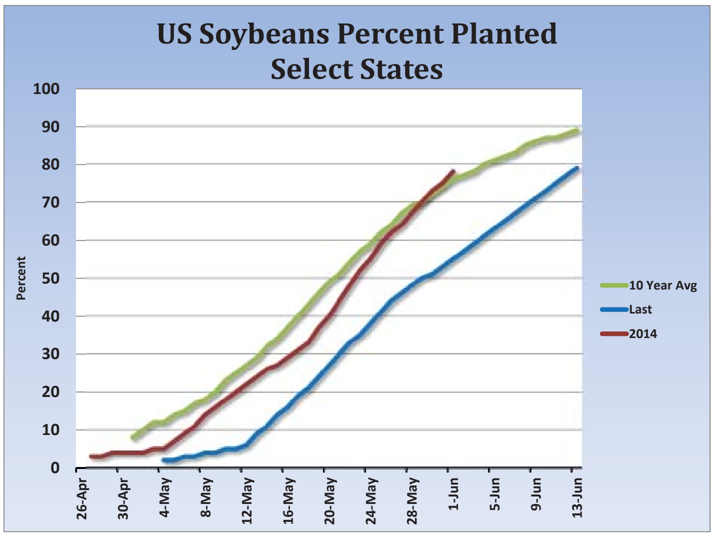
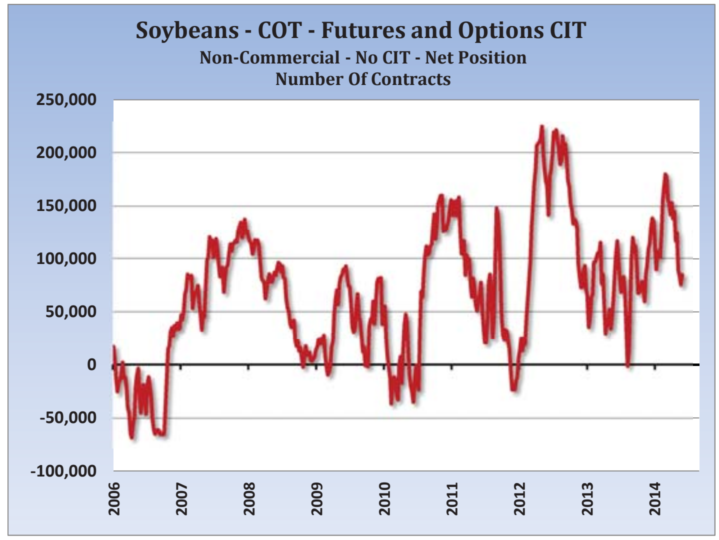
For the weekly Crop Progress Report as of June 1st, traders were expecting plantings to have reached 71% complete, but the report actually indicated that 78% had been planted, up from 59% the previous week and 55% a year ago. The 10-year average for this time of year is 76%. Overall, that report leaned bearish, as the planting pace has managed to catch up to normal after a slow start. It is still early, but the speed with which the crop went into the ground should discount any headline risk of talk of freeze/frost damage later in the growing season.



Given the strong start to the crop, futures look vulnerable to a long liquidation selling trend just ahead, as fund traders have added to long positions in recent weeks. The Commitments of Traders reports as of May 27th showed non-commercial traders were net long 141,790 contracts, an increase of 9,690 contracts for the week. Non-commercial and non-reportable traders combined held a net long of 79,063 contracts, up 5,814 contracts for the week. Trend-following fund traders reached a net long of 84,422 contracts, up 8,818 contracts for the week. This is the group most vulnerable to exiting longs in the weeks just ahead.



Producer Hedge Strategies for the 2014/2015 Crops

For now, the trend has turned down, and unless a serious weather problem develops in late June and early July, the US crop looks to reach a new record, and world ending stocks look to be revised even higher. For producers, it may be a good idea to get fully covered in their 2014 crop well ahead of the USDA Acreage and Grains Stocks Reports at the end of the month.

Hedge Strategies

1) Producers who have not already established a base short position in their 2014 crop could consider selling November 2014 Soybean futures into the $12.26-$12.49 resistance zone. Once that base hedge is in place, look at buying short-dated new crop call options as a "hedge of the hedge" to guard against a bullish outcome from the USDA reports or from a sudden shift in the weather.

An example of this approach would be to buy the September Soybean short dated new crop $12.80 calls at some point before the June 30th USDA reports. As of this writing, the calls were trading around 24 cents, but if November Soybeans fall to the downside targets of $12.06 and $11.83 in the next few weeks, the calls should trade down to the 12 to 16 ½-cent range.

If conditions change (there is a turn for the worse for weather, the USDA tightens stocks and/or lowers the acreage estimate from the June 30th reports) and November 2014 Soybeans rally to $13.50, the September $12.60 calls call could reach 85 cents. Under those circumstances the producer-hedger could lift the call for a 71-cent gain. This would raise the effective hedge price for November Soybeans from $12.37 ½ to $13.08 ½.*

2) Producers who have not started to price their 2015 crop and believe $12.00 price a level worth hedging could consider selling a November 2015 Soybean $12.20 put for 99 ½ cents and buying 5 November 2015 Soybean $10.20 puts for 22 cents each. The net cost of the hedge would be 10 1/2 cents.

If in 90 days November 2015 Soybeans are trading down at $10.00, the $12.20 put will be trading around $2.20 and the $10.20 puts near 78 cents, for a spread value of $1.70. This means that on a $1.90 break in the futures, the hedger will see a net gain of $1.59 ½.*

If in 90 days November 2015 Soybeans are trading down at $9.00, the $12.20 put will be trading around $2.98 and the $10.20 puts near $1.40 ½, for a spread value of $4.04 ½. This means that on a $2.90 break in the futures, the hedger will net a gain of $3.94.*

If in 90 days November 2015 Soybeans have rallied to $13.00, the $12.20 put will be trading around 32 cents and the $10.20 puts around 6 ¾ cents for a spread value of 1 ¾ cents. This means that on a $1.10 rally in futures, the hedger will net a loss of 8 3/4 cents. If this occurs, the hedger will be in a position to lift the short $12.20 put for a gain of 67 1/2 cents and hold the 5 out-of-money puts to see what develops in the future.*

Keep in mind that 90 days from now the November 2015 Soybean puts will still have 416 days until expiration.

**Projected option values are based on pricing models and are not guaranteed.*

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