Larry Martin

COMMENTARY – The increasing impact of currency volatility

In follow up on last month's commentary, I can't remember a time when currencies were having so much impact on commodity prices.

On Monday, March 16, May corn futures closed at US$3.79, while cash in Southern Ontario was around CDN$4.61. Soybeans were US$9.72 on May futures, while cash was CDN$11.59 in Southern Ontario. Removing the exchange rate effect, local prices are about where they would normally be – about a dollar lower for corn and almost two dollars for soybeans, but the local basis is quoted in Canadian funds vs. U.S. funds. So, while U.S. prices have trended downward, local prices have been flat to higher during the loonie's slide.

The recent U.S. Fed decision to hold off on raising interest rates took commodity volatility to a new level. On that day, wheat bounced up by $0.23 and soybeans bounced $0.27 over two days. Even Brent Crude reversed a downtrend and had a $4 trading range that day. All this came because the market perceived that the strong dollar was pressuring commodity prices downward. When the Fed took away the threat of higher interest rates, the market adjusted the premium on the U.S. dollar and the discount on commodities.

Buying (or selling) commodities is way more complicated in Canada than the U.S. because of both currency and basis. Like most things in the food industry, it's becoming even more complex. I suggest buyers learn to watch all the factors affecting prices. I hope this column helps take a little of the uncertainty out.

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MARKET HIGHLIGHTS

Commodity prices moved sideways during the month, with downward pressure from the strong U.S. dollar. This reversed in mid-March. Grain markets are reacting to weather, weather fears and export demand, resulting in some opposite movements.

> Corn – Corn prices continued sideways, then threatened to move below support at $3.74 on the May contract. To date, however, support is holding following last week's drop in the U.S. dollar. The underlying fundamentals include continued adequate stocks, apparent large crops in Argentina and Brazil, and a recent cooling of export demand. Hog profits in the U.S. have also declined, perhaps slowing the growth in demand for feed. Drought in the Western corn-belt could become an issue as seeding approaches. We continue to like pricing hand to mouth while protecting above major support at $4.23, though we would likely move that down to $4 if futures fall below $3.73. Some analysts expect a spring rally, likely caused by weather fears.

> Soy oil – The soy oil rally reached the 23.6 per cent retracement at about $0.33, before sputtering before a large Malaysian palm oil crop and a large soybean crop in Brazil. The latter includes a new Conab estimate of 95.9 million tons to go along with others in the 94 to 95 range. With declining export demand for soybeans and Malaysia's decision to levy an export tax on palm oil, this likely means a flat to weaker market for now. Protect just above major support at $0.296.

> Wheat – Wheat has a 30 per cent world stocks/use ratio, up five per cent from last year. However, warm, dry weather in European Russia and dry weather in the U.S. Western corn-belt are causing fears about 2015 production after again testing contract lows at $4.91¼ on the May. We continue to believe that pricing near contract lows makes sense. Barring that, protect above resistance at $5.50.

> Sugar – Sugar continues to make new lows (12.9 cents on the May) not seen since 2009. The continued large crops in Brazil, India and Australia are weighing heavily on this market. We still think, as long as the trend continues, it makes sense to buy hand to mouth and use the old contract low of $0.144 as the level above which to protect.

> Natural gas – May futures have been in a range between 2.6 and 3.2 cents since mid-December, mostly below three cents. Currently, it is 2.76 cents. We continue to ask how can one go wrong at these prices? At least protect above three cents.

> Crude Oil – Brent crude oil prices rallied by 23.6 per cent after the Saudi king's death. Now production is coming back on line in Libya and U.S. production is maintaining higher than expected. In combination, these supply pressures are reducing oil prices. May declined from $63.70 to the current $54.10; the contract low is $48.95. Distant contracts are at significantly more premium than carrying cost. Therefore, the spread must narrow. Energy buyers should continue to buy hand to mouth, but protect above $63.70.

> Canadian dollar – Thank heaven the Bank of Canada chose not to reduce interest rates again and create even more havoc. The March 18 meeting of the U.S. Federal Open Market Committee created some of its own by making clear it has no intention of raising interest rates in the short term. This caused currency and some commodity prices to bounce because the expectation of higher interest rates was built in. The loonie bounced, but much of the bounce was quickly squelched with the June contract, currently at $0.794, off the low of $0.771. The loonie will now carefully watch the oil market for the next signal on direction. Meanwhile, for those who are affected by this interest-rate/currency uncertainty, we recommended to buy Puts when the loonie was over $0.90. There may be another leg down, but we think now is a good time to offset those Puts and take a profit. We also now recommend that those who risk a rising currency buy Calls.