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THE FARMER'S EDGE

Hurley & Associates
Agri-Marketing Centers

Trade Politics Creating Greater Uncertainty For Texas Gulf Grain Traders

By John Miller

When thinking of political impacts on agriculture, one most often thinks of changes to domestic programs like the farm bill, crop insurance rule changes, or maybe the ethanol mandate. Over the past few months, however, we have been sharply reminded of the potential impacts from changes in trade policy whether initiated by foreign countries, or our own government. For sure we have become very familiar over the last decade or so with uncertainties associated with changes in grading, gene trait approval, or phytosanitary rules that can interrupt normal trade flows and affect prices. And while highly perishable crops such as fruits or vegetables often have to almost silently deal with abrupt changes in tariffs or quotas, it is not that often that bulk commodities fall into that discussion. Given the degree to which our bulk commodities such as corn, soybeans, wheat, sorghum, rice and cotton depend on a vibrant export business to help work off excess production, the recent back-and-forth with China over potential tariffs created a considerable amount of worry among the export trading community.

The recent publicity from China's on then off tariff on US sorghum provides us with a great illustration of how quickly trade policy change (or the threat of…) can interrupt the mostly quiet business of trading and moving bulk ag commodities. Prior to the fall of 2013, for example, the Chinese purchased virtually no sorghum from the US, preferring to source their needs from Australia or elsewhere. The start of a 13 percent Chinese import tax on corn in late 2013 helped prompt Chinese buyers to start sourcing sorghum out of Texas Gulf ports. As the US Exports of Sorghum, 2013-2016 chart below shows, China quickly become the dominant destination for US sorghum, accounting for upwards of 90 percent of exported sorghum by 2014, pushing aside longtime sorghum customers such as Mexico. The US sorghum sales to China remained strong through the end of calendar year 2017 as users in China grew more accustomed to our supply capabilities and quality. While sorghum basis bids at the Gulf did closely follow a reduction in China's corn support prices in mid-2015, the Chinese did continue to out bid other potential customers, dominating the sorghum export trade until just recently. As the Weekly Sorghum Exports to China chart below shows, sales of the 2017/2018 sorghum crop closely followed the prior

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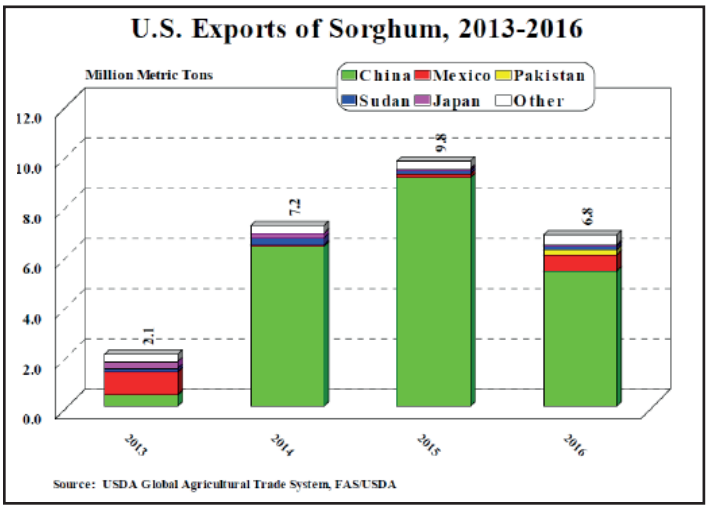
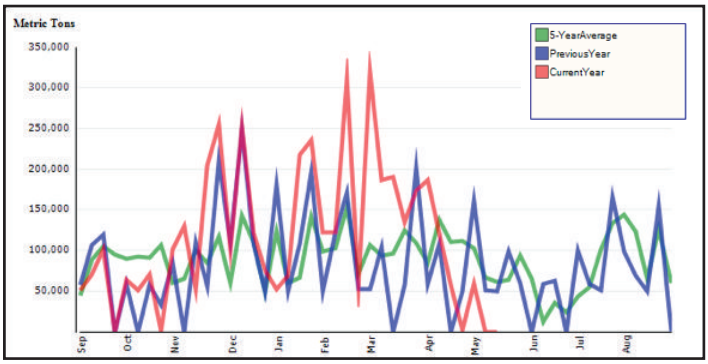
year until when, in late February, our government suggested that tariffs on certain Chinese goods might be necessary to correct trade imbalances.



Weekly Sorghum Exports To China (USDA-FAS)



All it took for a melt-down of sorghum sales to China was the Chinese response of a 'possible' tariff of 25 percent on a wide array of US agricultural commodities. When that announcement was made, all bids were pulled at the Texas Gulf, and existing sales, and even those in transport were felt to be in jeopardy of getting unloaded. After the Friday afternoon news release, and by Monday morning at 8am, new crop sorghum bids at Corpus Christi fell from +40 CZ18 to +5 CZ18, and shippers were hoping not to buy any at that level. The next order of business was about what to do with sorghum either intended or destined for China. To simply curtail any risk, some Kansas sorghum ended up being used in ethanal there rather than being railed to the Gulf. For grain in-store at the Gulf, handlers began operating around the clock to get ships loaded, hoping to make it to China before the proposed tariffs became enacted. The initial news release from China made it seem like the results of a 'dumping' investigation and potential tariffs as a result would be up to a year process. Among the export brokers that I routinely visit with, it was clear that they understood the uncertainty of the situation and that China could impose the tariffs at any time. And perhaps because of the market uncertainties we all experienced in the 2007-2013 timeframe, exporters have become much more conservative and seem to have a much lower tolerance for risk in cash transactions, especially of the quantities and distances involved. Little did we know how prescient those concerns were, and how soon their fears justified.

Our exporters did an incredible job moving most of the 100 million bushels or so of contracted sorghum left to be shipped to China from the time of the original suggestion of tariffs in early February until late April when this issue took a sharper turn. On Tuesday April 17th, China announced that the sorghum 'dumping' investigation was complete and that a 179 percent tariff on sorghum would start the next day. And it did. I was told that up to two dozen, or more, vessels were still afloat and subject to the sizable tariff if unloaded. Fortunately, new homes were found for these boats in mostly Spain and Mexico. And a considerable amount of the remaining old crop sorghum still in the US was offered at attractive prices and moved by rail to Mexico. It was interesting how after years of sorghum being sold at Gulf ports or 'mid-bridge' at a considerable premium to corn that buyers were so quick to want to buy sorghum at the perceived 90 percent 'milling efficiency' equivalent to corn. Major buyers of US Sorghum prior to China's entry into that market in late 2013 immediately started reaching out to export brokers but were not willing to discuss buying sorghum at a premium to corn. After a few days of pulled bids, new crop sorghum quotes at the Gulf dropped from +5 CZ18 to -40 CZ18, a depth rarely seen there.

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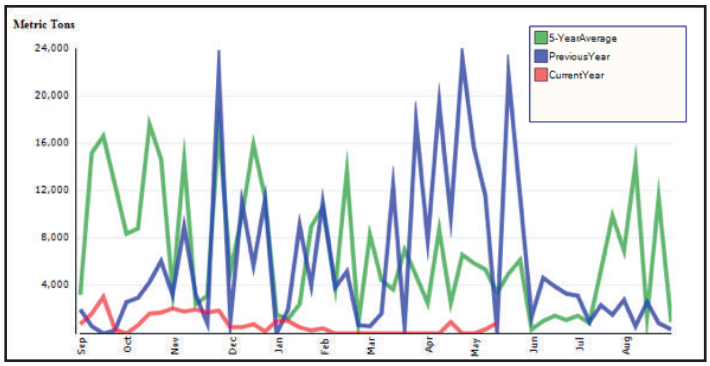
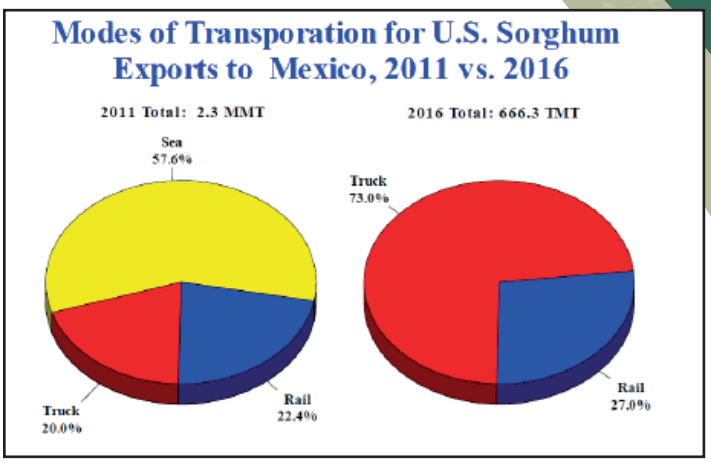
As you can see from the Weekly Sorghum Export chart below, Mexico has been a low volume purchaser since 2013, buying intermittently to supplement their own crop and basically picking off border truck markets and the occasional rail purchase in an almost speculative way. You can see from the current crop year line that Mexico purchases fell to almost zero for months since China again helped to run delivered basis at the Gulf to over +100 CH18. Of course, there are several things going on here. Over the past decade, Mexico has heavily subsidized additional grain production to try and reduce their dependence on imports. In addition, the growing feeding industry there has basically become a domestic market for Midwest rail shipments of corn. Under the terms of NAFTA, Mexico's targeted import quota (or coupos) came to and ended at about the same time that unit train rail began to service the rapidly expanding hog and poultry feeding building in the Central Highlands. China's entrance into the US sorghum market simply helped to speed up the conversion of large feed mills from sorghum to some combination with corn. As you can see from the Modes of Transportation chart, this 'switch' basically ended any vessel shipment of sorghum to Mexico since trucks supplemented by rail could handle this demand. It is common for sorghum produced in Texas to make the 15-hour drive from border crossing to feed mills near Guadalajara. It is interesting to think that China's decision to tax incoming corn would change the entire complexion of sorghum trading and transportation.

Weekly Sorhgum Exports To Mexico (USDA-FAS)





Fortunately, China completely removed the 179 percent tariff back on May 18th. The export brokers seemed to have whiplash from all that had happened since later February. There was minor consolation in the fact that any tariff that was paid to China was reimbursed; but that does not help recover the costs from rail and vessels full of sorghum that had to be resold into secondary markets. The final chart shows sorghum basis at the Port of Corpus Christi from the Spring of 2013 to present and clearly illustrates the price impacts from both Chinese and US political decisions. The imposition of Chinese import taxes on corn can be seen in the fall of 2013. The sharp reduction in Chinese internal corn support prices in early September of 2015, and continued erosion of that support, illustrates how trading sorghum basis as the port can be an adventure. And then of course the recent on and then off Chinese tariff on sorghum framing the right side of the chart. The decision by China to remove the tariff led to a quick reversal of sorghum basis at the Gulf from -40 CZ18 to +40 CZ18 adding up to real dollars!

Weekly Sorghum Basis – Texas Gulf

While the US agricultural marketplace is no stranger

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U.S. Economy Rolls Along Despite World Difficulty

By John A. Johnson

The world's economic news is dominated by political events in Italy, as the newly formed transitional government seems to be falling apart. Now, it seems likely that there will be another election as early as this fall to try to piece together a more stable government. Most of the anxiety stems from the fact that many are fearful that the new government-to-be is likely to be antagonistic toward the European Union, and consequently the Euro, which has come under duress ever since Great Britain's much publicized "Brexit" controversy concerning their exit from the Union.

Other economic considerations include continued unrest in the Middle East, as Israel and the Palestinians ratchet up their conflict. The Palestinians have been firing rockets into Israel from Gaza, and the Israelis have been bombing and returning fire. This is said to be the most intense fighting in the area since the 2014 war.

Escalating Middle East tensions, along with economic problems in Iran and Venezuela, are affecting their respective capacities for oil production. These shortfalls are coupled with restrictive production quotas for other OPEC members, and are creating a situation that causes world crude oil prices to trade in a higher range than just a few months ago. More expensive crude, and therefore higher gasoline prices, have some Americans to rethinking their summer driving plans as gasoline approaches $3.00/gallon, which seems to be a very significant psychological number that affects many travelers. Elsewhere in the world, the U.S. is somewhat troubled by growing tensions in the South China Sea as the Chinese continue to build and equip "islands" with military capable runways in these shipping lanes. They also continue to increase the size of their blue water navy as they build new aircraft carriers in an effort to exercise complete control over South China Sea waters that were heretofore regarded as international waters. These shipping lanes are among the most important areas of the globe in economic importance, as over 1/3 of all the goods that are traded in the world's economy must traverse these waters.

The U.S. business economy is on a roll with stocks retracing to near all-time highs, wages up, record revenue collections, low unemployment and production reaching near capacity in many areas. Hopefully, the recession is finally behind us and the rest of the world can get their problems under control to join in a great global economic boom.

Consultant Spotlight: JULIE LOEBS

What do you most enjoy about your job?
Working with the clients one on one. They are so appreciative of what we do for them and their operations.

How did you get started in your career?
As an office assistant in the Britton Hurley office. I had no idea I was about to find one of my passions in life.

What are you most passionate about when it comes to serving our clients?
Educating them about all of the tools they can use to market their crops.

What would be your ideal vacation?
Sun, sand and waves.

Julie grew up "out east" in Pennsylvania. She has grandparents from North Dakota and found out early on that she liked the prairie better than the mountains. Julie figures that God brought her to South Dakota to meet her husband. She has lived in the Britton area since 1993. Julie has a passion for rural living and enjoys the strong farming community that she lives in.

Julie became associated with Hurley & Associates early in 2004 when she started working as an Assistant in the Britton office. In 2006, she moved into a consultant role, working directly with farmers to manage their market risk.

After a brief absence, when Julie tried her hand in a bookkeeping role, she has happily returned to her position as a full-time Farm Marketing Consultant. Julie has a deep appreciation for the farmer and their chosen lifestyle and enjoys working with them one on one to help navigate the sea of marketing.

Julie and her husband, Blair, have 3 children and 2 grandsons at this time, and they are anxiously awaiting the arrival of more grandchildren.

What in the World is Driving Ag Community Prices?

By Freddie Norman

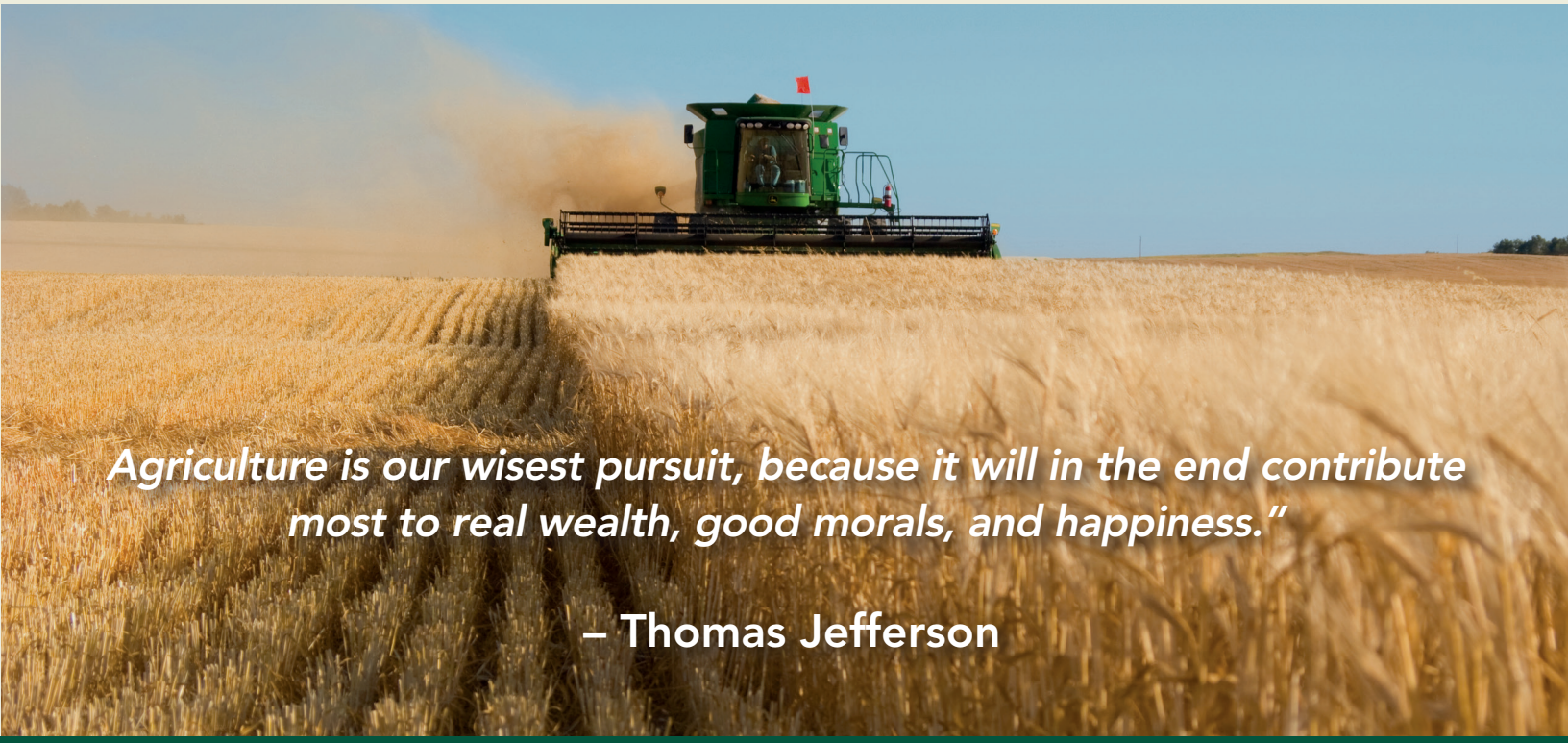
The past three years have been difficult for those of us trying to determine the direction of Ag commodities. Over the past three years, the US has enjoyed huge yields in both corn and soybeans. Most people thought this would pressure prices to $3.00 corn and sub $9.00 soybean prices for an extended period of time. U.S. corn ending stocks have grown from below 1 billion bu. in 2012-2013 to nearly 2.3 billion bu. projected for 2017-2018 marketing year. In that same period, soybean ending stocks have grown from under 100 million bu to over 500 million projected for the 2017-2018 marketing year. We did spend some time in the lower $3 range in corn and soybeans trade below $9 for a while. The markets have given opportunities in the $4+ corn and $10.50 soybean areas.

This has surprised many commercials and other fundamentalists who focus on the growing U.S. supply situation expecting lower prices. However, if we turn our attention to the World Supply Demand reports, we find that world stocks of corn and soybeans are projected to decline. World corn ending stocks for 2016-2017 were 227.53 mil metric tons. 2017-2018 were projected at 194.85 mmt., and 2018-2019 projection of 159.15 mmt.

World soybean ending stocks are projected to decline from 96.39 to 86.70 mmt during the same period. Several factors are contributing to this decline. A major drought in Argentina, the world's largest soymeal exporter, is cutting both soybean and corn production as well as lower projected U.S. 2018-2019 carryover based on lower acres and trendline yields on corn and soybeans.

Cotton is another Ag commodity that has seen a drawdown in world ending stocks while U.S. supplies have increased. A few years ago, world cotton supplies were over 100 million bales while U.S. carryover was in the 2.5 million bale range. World supplies for cotton are projected at 83.75 million bales for the 2018-2019 marketing year while U.S. supplies are projected to climb to 5.2 million bales.

As this article was written, cotton prices for December 2018 cotton rose to 90+ cents/lb. The answer to why prices are higher than expected based on U.S. supplies may very well be found in the world numbers.



Managing Upside through Uncertainty

By Jessica Way

Uncertainty and volatility go hand in hand. As the calendar turns over to June, we are in the midst of growing season volatility. Historically, this late spring/early summer timeframe is when the grain markets have the opportunity to reach their yearly highs, but it is also when we know the least about how the crop is going to turn out.

Let's say you are facing the following situation:

> *Markets are currently at profitable levels, but it's July 10th and you have already sold up to your crop insurance guarantee. You feel okay about the crop at this point, but there's a lot of growing season to go yet. Do you let the opportunity pass? Or do you protect it?*

As hedgers, you know the value that floors provide. Protecting your downside risk is vital. However, once the crop is sold, your risk is now of the market going higher. Upside can be necessary for two reasons: production risk and price risk. In the hypothetical scenario above, you are facing a combination of both. You know that this price makes sense for your operation – what you have now is upside risk. By keeping upside open on this sale, you are able to get more aggressive and protect attractive levels. Upside management is equally important as downside protection. While flooring 100% of the crop and maintaining upside on all of it all year long would allow you the most protection and flexibility, there can be substantial premium involved. We need to find the right balance. The essential components in building a plan are being aware of your risk factors and knowing what the market means to your bottom line.

Production Risk

Crop progress is always on the forefront of a producer's mind. Throughout the growing season, you are continually reevaluating yield potential. There are a number of things to consider when determining your production risk including, but not limited to, time of year, current crop condition, retained soil moisture, geographic concentration of your fields, and crop insurance coverage. Successfully reaching key milestones in the crop year brings you closer to confirmed grain in the bin and may afford you the ability to be more aggressive in your marketing. Prior to planting, we have a rough idea of what acres we are planning to seed to each crop. However, until that seed is in the ground, things can change quite a bit. Pollination is always a big hurdle that once overcome provides confidence in final production. Until harvest is complete, you will always have some level of production risk. Because of that, you may need to keep a certain level of upside until then. Crop insurance is a key pillar in your overall risk management plan. However, your insurance and marketing need to work together to successfully manage production risk. Everyone carries different types and coverage levels of insurance. Understand what your insurance covers and where marketing needs to play a role. Crop loss concerns are a large part of why some producers fail to price protect their production prior to harvest. Maintaining upside where you have concern allows you to proactively protect your crop while it develops.

Price Risk

When you think of price risk, it's easy to jump to the conclusion that it means "risk of missing out on the high." The only reason we care about higher prices is because they translate into higher profitability. So instead of using price measures like "top-third of the market" and "more than my neighbor," let's put our focus on what actually matters to us. Utilizing financial measures and growth goals gets us a lot closer to where we want to be than attempting to price pick the top.

Financial Ratios are the tried-and-true method of profitability analysis. They are straightforward, consistent, and objective. There are a wide array of different calculations out there. Find what works for you. Here are a couple that I use with my clients that provide a snapshot of the financial health of an operation:

Gross Profit on Cash Revenue (GPOCR)

$$\frac{\text{(Total Cash Revenue – Total Cash Expenses)}}{\text{Total Cash Revenue}} * 100 = \%\ \text{GPOCR}$$

<5% Weak, 8-10% Minimal, >20% Strong

Current Liabilities Percent of Total Revenue (CLPOTR)

$$\frac{\text{Current Liabilities}}{\text{Total Revenue}} * 100 = \%\ \text{CLPOTR}$$

Should not exceed 75% of GPOCR
(For example, if your GPOCR is 20%, then your CLPOTR should not exceed 15%)

While financial ratios give us a clear cut number on where we are, they can be abstract. Setting specific growth goals paints a picture of what a certain level of profitability

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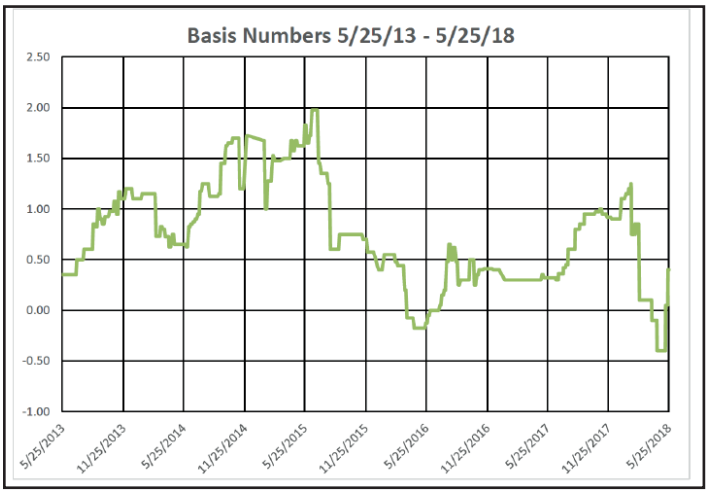

to unexpected turns on the political front, the current uncertainties created by a greater emphasis on trade imbalances, especially with China, has changed our conversations with our customers about managing price risks. There are many other implications of a trade war that could be investigated. For example, the threat of tariffs on sorghum affected cropping decisions by some of our customers and required a rethink of how to move forward in the marketing plan, especially where sales or price floors had been established. Managing basis risk, which often provides the profit margin, was now in extreme jeopardy. The unknown duration of pending tariffs and its impacts prompted a change in thinking on which crops to store versus which ones to move at harvest. The most recent news at our disposal suggests that the hard part of the trade negotiations with China may not be over. And we need to write another paper on the potential implications of a prolonged negotiation period to renew NAFTA, the key format for trade between the US and its neighbors. After the experience of the last few months, it is hoped that we can carry this experience to other commodities that may ultimately get pulled into this sort of situation. While we can imagine a tariff on another commodity of the magnitude of 179 percent, remember that it was the threat of 25 percent back in February that got the boulder rolling.

Managing Upside through Uncertainty

By Jessica Way

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means to our operation. A growth goal is a specific dollar amount needed to achieve something you desire. This can run the full range from investing in additional storage to remodeling the kitchen. For example, if your goal is to set aside $30,000 towards your retirement planning, you now have a measurable goal. If the market gives you the opportunity to cover your costs and obligations as well as your goals, consider locking some of this profit in, provided you are comfortable with your production.

Utilizing financial measures and growth goals allows us to quantify adequate profitability and give a black and white answer to 'when is enough, enough?'. Set goals and if you reach them, capture it, and know that you are doing great things for your operation.

The heightened volatility and uncertainty of the growing season comes with elevated stress, emotions, and tension. This all makes for a very difficult decision making environment. Properly managing your upside by objectively measuring your production and price risk, can help you make business based decisions. Be prepared for volatility. Have a plan.

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