

# MARKETWATCH

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## DISAPPOINTING YIELDS LEAD TO CHALLENGES IN MARKETING WHEAT

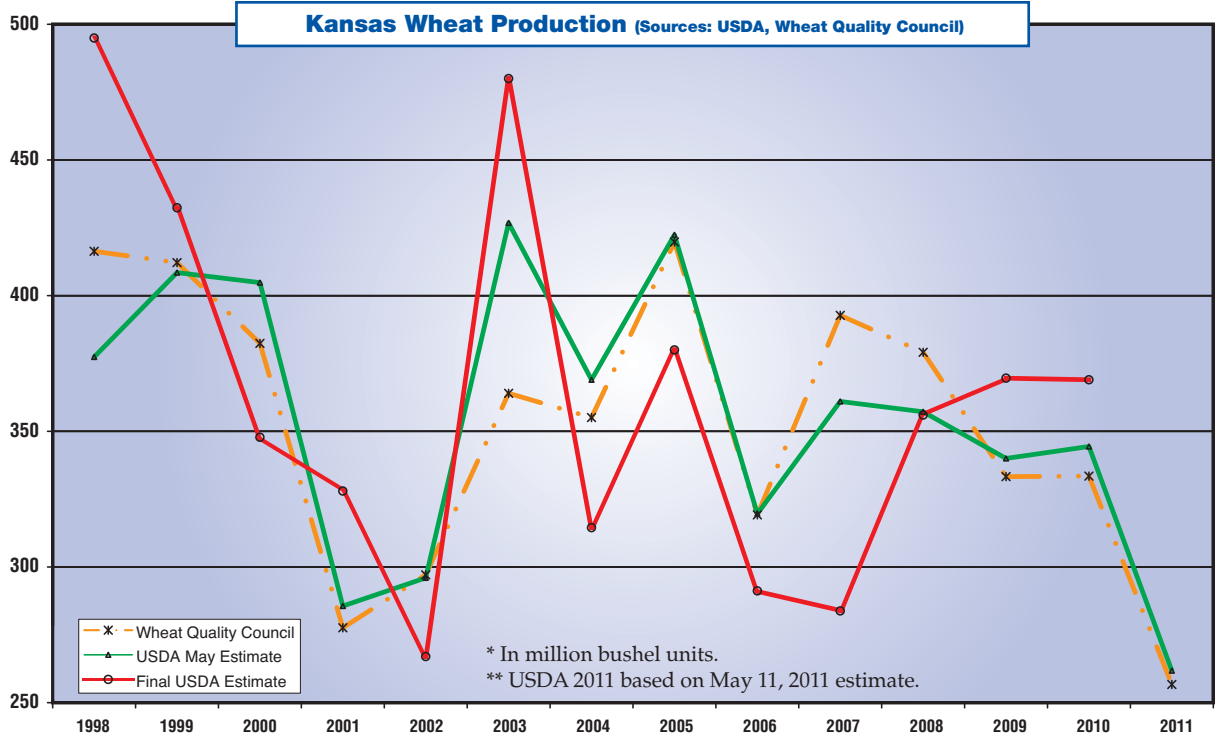
Conditions in the world marketplace have created a unique environment for U.S. wheat prices.

**T**he Kansas wheat crop is expected to produce a notably lower yield this year, possibly the lowest since 1996 according to the Kansas Wheat Commission and production reports released by the Kansas Department of Agricultural Statistics. Drought stress is the number one factor relating to decreases in production estimates, with areas of Kansas receiving well-below-average amounts of rainfall this year. With tightening U.S. wheat supplies and additional wheat production challenges worldwide, this has created a unique market environment and soaring prices. This MarketWatch will address the features of the 2011 wheat crop and its bearing on constituents in the grain industry marketing chain.

### Disappointing yields anticipated by crop tour participants and the USDA

The 54th Annual Hard Red Winter Wheat Crop Tour sponsored by the Wheat Quality Council embarked on a three-day assessment of the Kansas wheat crop and announced an estimate of Kansas wheat production at the end of the tour on May 5, 2011. With the largest number of participants in tour history of 72 crop scouts, the group made a total of 561 field stops. The calculated average for the tour was 37.4 bushels per acre compared to 40.7 bushels on the same routes in 2010. Tour participants individually submitted estimates at the end of the tour of total Kansas wheat production based on observations, with the weighted average at 256.7 million bushels. This compares to the 2010 estimate from the tour of 333.5 million bushels.

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The largest concern noted among crop tour participants was the lack of moisture and the development stage of the crop at the time of the tour. Late planting and wheat planted following row crops from last year were prevalent and made a difference in the condition of the wheat crop at the time of the tour.

Below-average fields were more evident on the second day of the tour as the group traveled six different routes from Colby, Kan. to Wichita, Kan. Drought stress was more evident in this area of the state, with fields anywhere from tillering to a headed stage and smaller-than-average heads.

“Most fields are seriously short of moisture. As the tour progressed, I became more convinced that the crop would be much lower than

average,” said Ben Handcock, Executive Vice President, Wheat Quality Council, Pierre, S.D. “I think there is a lot more downside potential to this crop than upside.”

The Wheat Quality Council Crop Tour takes place a week before the USDA releases the May crop production report. The USDA estimated the Kansas wheat crop on May 11, 2011 at 261.8 million bushels and 34 bushels per acre. The USDA total production estimate is 5.1 million bushels more than the tour estimate.

### Market reactions to estimated production numbers

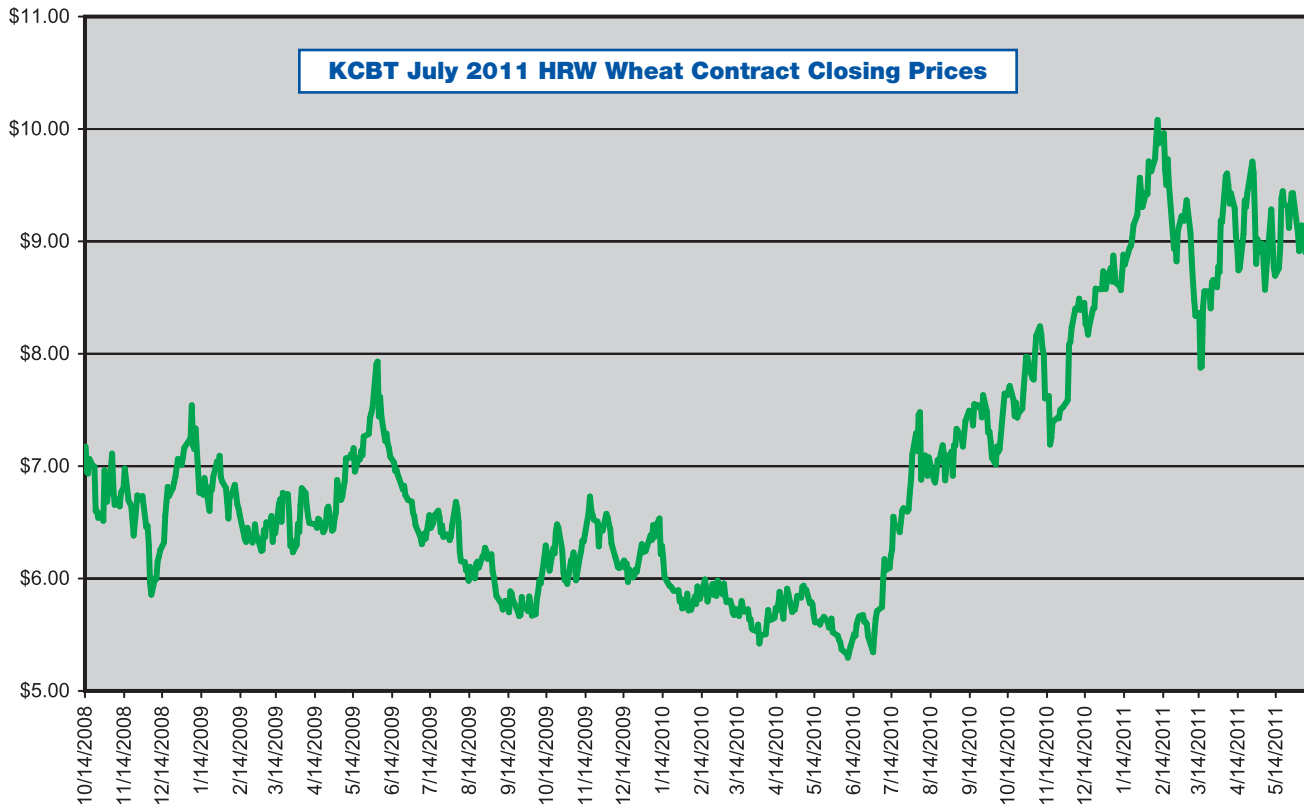
“The market is currently bullish wheat, but in order to continue the support seen in the marketplace, traders will need to see what the

yields and bushels are,” said Darin Newsom, Senior Market Analyst, DTN, Omaha, Neb. on May 26, 2011. “Traders are taking a cautious approach and not buying into the market at full force until some numbers are actually reported.”

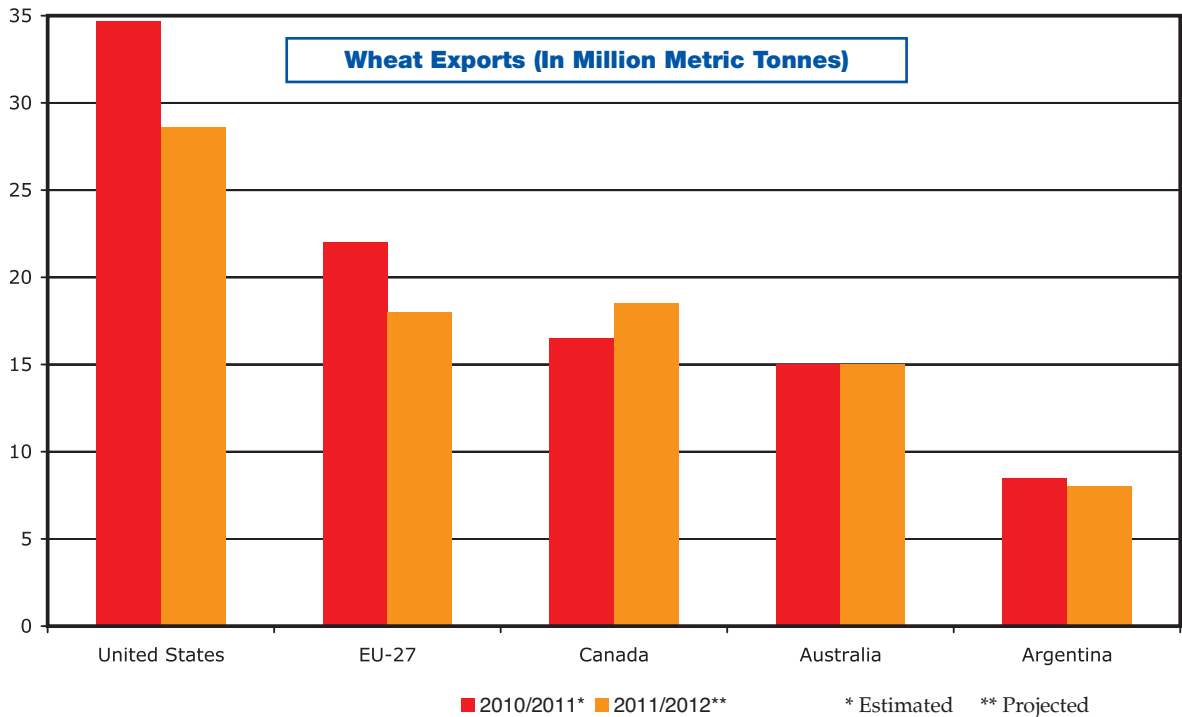
Newsom is anticipating a very low production year for HRW wheat, with some fields in southwest Kansas possibly producing 0 to 10 bushels and a debate over whether or not to harvest.

From a producer standpoint at this time, Newsom recommends looking more into a put option strategy rather than forward contracting wheat due to the possible shortage in production. “If there is any kind of rally in the market, buying a put option in the September and no further out

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\* Source: KCBT



\* Estimated \*\* Projected

\*\*\* Source: USDA May 11, 2011 Supply and Demand Report

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than the December contract month is recommendation for price protection at this time,” Newsom said.

Again, Newsom is wary of actual production numbers that will start being reported from the Hard Red Winter Wheat harvest.

### Strong correlation of corn and wheat prices

“Strength in U.S. corn prices have been a driving force in stronger wheat prices,” according to Newsom, “and the long-term rally in corn can be traced back to mid-May of last year.”

“Quarterly stocks reports released in June of last year anticipated a number of million of bushels to be used and brought support to corn prices. New crop corn at that time was beginning to find strength from hot summer nights that were limiting production anticipation.”

For the short-term, a rally of corn prices to new all-time highs topped

out on April 11, 2011 with the Chicago May corn futures settling at \$7.76. “Because of problems with last year’s crop, there has been a tightening of corn supplies. There was also a significant decrease in acreage numbers released by the USDA on March 31,” said Newsom.

Chicago corn futures traded limit higher on March 31 after the USDA estimated corn supplies 179 million bushels below average trading guesses. “This sparked the rally into the new highs seen in April,” said Newsom. “Now that the new crop is already experiencing slow planting due to wet weather and problems already with the crop, support is already being seen in new crop corn futures.

“After trailing corn prices higher, the markets should see wheat starting to divorce itself from corn in the July and September contracts. Old crop corn is running out of reasons to rally, with carryout numbers for corn coming out higher than expected in May supply and demand reports. As July old crop

corn starts to retreat, it could possibly pull SRW wheat into feed grain price levels, but new crop HRW wheat should be able to hold its own into higher territory.”

### World wheat crop issues have affected U.S. HRW wheat prices

Outside of problems that are already evident with the U.S. wheat crop going into harvest season, issues with world wheat supplies started back in the summer of 2010 with a drought in Russia triggering a ripple of reactions in world wheat markets.

A severe drought in Russia set wheat futures prices in motion back in August, with uncertainty going into the Russian winter wheat planting season and the future for wheat exports from the Black Sea area sending markets into turmoil. Russian Prime Minister Vladimir Putin announced a ban of all

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grain exports beginning August 15, 2010, initially intended to be lifted by December 31, 2010. The ban was extended and on May 28 Russia announced intentions to let the ban expire on July 1, 2011. Wheat futures markets reacted dramatically to news coming off of the Memorial Day weekend holiday and traded 35 cents lower in the KCBT July contract on May 31, 2011.

Justin Gilpin, Chief Executive Officer, Kansas Wheat Commission, Manhattan, Kan. relates that the Hard Red Winter Wheat Tour was very important this year for a number of reasons.

"This was one of the best ever years for U.S. wheat exports, with the U.S. exporting 34 million metric tonnes, or 1.2 billion bushels of wheat," said Gilpin. "With two consecutive years in a row of good wheat production in the U.S., carryout was comfortable enough to meet the demands encountered upon Russia's shortfalls.

"The wheat tour clarified an anticipation of lower HRW wheat production this crop year and led to a further focus on the Russian wheat ban, problems with the French wheat crop and potential planting delays in U.S. Spring wheat areas due to excessive rainfall. Although it is not a surprise that Russia lifted the wheat ban, the bigger picture now in the world marketplace is the facing of other uncertainties including dryness in China and Europe."

Now there is anticipation of whether

or not Russia will become the third-largest exporter of wheat again.

"This is hard to say with an anticipation that Russia will go to extremes to have ample wheat supplies for their own population before exporting to others," said Gilpin. "Russia will probably make up for some of the supply to North Africa, including Egypt, due to logistical advantages in exporting.

"At this time, Nigeria is consistently one of the top purchasers of U.S. Hard Red Winter Wheat. Nigeria's interest in the U.S. wheat is due to their consumption of pan bread that is similar to the sliced bread consumed in the U.S."

In addition, Gilpin mentioned that over time the Nigerian milling industry has grown more supportive of the U.S. as a source and has built a strong allegiance with producers and exporting companies. "There has grown a heightened sense of awareness of global competition and buyers of wheat in the world marketplace are more closely viewing purchasing mechanisms, risk management mechanisms and where the wheat is actually coming from," said Gilpin.

This is reflected in visits of trade teams from various U.S. HRW wheat customers, including upcoming visits from a Peruvian trade team and from South Africa. The Kansas Wheat Commission includes a visit to the Kansas City Board of Trade in the itinerary for trade teams for them to get a

better understanding of the role of the exchange as a price discovery mechanism and risk management tool.

### **KC wheat futures prices going into the HRW wheat harvest**

In the month of May and prior to the beginning of the 2011 HRW wheat harvest, the Kansas City July wheat futures price was trading in the \$8.75 to \$9.60 range amidst highly volatile conditions. For future market direction, traders will rely on production numbers coming in from the U.S. harvest and weather conditions in Europe.

To follow Kansas City wheat futures and options markets daily, refer to the Kansas City Board of Trade Review available on the KCBT website at [www.kcbt.com](http://www.kcbt.com). The KCBT Review is listed under Market Commentary.

Using Kansas City wheat futures and options can assist customers in the management of risk and volatility in a marketplace that continues to fluctuate on domestic and global terms.

The Kansas City Board of Trade is the benchmark institution for the price of hard red winter wheat. Our website, with updated daily quotes, market commentaries, historical data and charting services is available online at [www.kcbt.com](http://www.kcbt.com).

Call your broker today to find out more about KCBT hard red winter wheat futures and options and how you can use them to hedge your risk.

## **MarketWatch**

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