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The outlooks provided herein represent the professional opinions of the PFGBEST Research analysts and should not be construed as statements of fact. There is a substantial risk of loss in trading commodity futures, options and off-exchange foreign currency products. Past performance is not indicative of future results.
During the coming months and years, the U.S. Federal Reserve Board has the responsibility to delicately maneuver monetary policy to avoid deepening our economic downturn, while gently raising interest rates to avoid inflation. The most overtly critical economic theme for 2010 will be whether the Fed will rightly judge its actions and the timing of them to achieve the desired steady growth in the economy. Too much or too little, or a timing error, could be globally cataclysmic since surprises continue to emanate from debt-ridden nations and businesses all around us. This is an historic high wire act for the Fed.

Economic reports and indicators will provide the scorecard for the Fed’s performance. Investment opportunities will be created and some will be truncated. I’ll let our PFGBEST Research analysts tell you market by market what some of the opportunities and challenges are to inflationary versus recessionary money supply moves.

Meanwhile, I travel frequently to and from Washington, in an effort to guide and educate our leaders regarding government influences in markets. I cannot overemphasize the responsibility and care that must be taken by industry leaders and government agencies to work in tandem as they balance customer protection with their mandate to implement regulatory modifications.

One key issue is a proposed trading tax from proponents in the U.S. Congress (Rep. Peter DeFazio) and Senate (Sen. Tom Harkin). This is an attempt to penalize speculators so widely blamed for causing the current economic distress. Sadly, these legislators do not adequately understand the markets, and therefore, they are dangerous to the markets.

The bursting of the mortgage bubble was not caused by rapid-fire buying and selling of family homes. Instead, the crisis was primarily a financial liquidity and credit crunch, where the major problem involved a significant decline in the value of collateralized securities which became illiquid. Any intervention that would reduce trading and make repurchase agreements more expensive would have worsened the crisis. But now such intervention is practically a foregone conclusion. As you are well aware, arbitrage and speculative trading significantly increase volumes, reduce spreads, and serve as a key source for price discovery. To tax trading, to cause liquidity to evaporate, and to cause spreads between price bids and offers to widen, will cost investors a dear price. In the end, this will destroy our nation’s financial leadership.

Together we can fearlessly speak out on this and other “reform” issues as we defend our markets and work for regulations that are fair to all and which help the markets to thrive in their intended purpose. Education is our weapon of choice.

With that, I turn the Outlook 2010 to our fact finders, research analysts and individual market specialists who will pinpoint more key themes for the year, and the opportunities inherent in constantly shifting and evolving volumes, volatilities, liquidity and strategies.

Happy New Year and thank you for being part of PFGBEST.
• Slow growth in U.S. economy with many risk factors including price inflation

• Continued expansion of China economy continuing to fuel demand for commodities, land, and a host of natural resources and companies

• How large can speculative bubbles in commodity prices become before they burst?

• Government intervention - potential regulatory changes and proposed transaction taxation of U.S. financial markets - could force more trading volume to non-U.S. exchanges.
Overarching themes for interest rates:
- Slow, choppy economic growth
- Investors are reaching for yield based on their risk appetite
- Less than 1% interest rate increases by Fed in 2010

**FOMC AND FOREIGN CENTRAL BANK POLICY:**
The main drivers of the global markets are interest rates, mainly those of the G8, but also to some extent the G20 nations. Investors have been “reaching for yield” and will continue to do so as long as they have an appetite for risk and the risk-free rate of return stays close to zero. Although many say the Federal Open Market Committee (FOMC) doesn’t have the flexibility to exit their stimulus in an effective manner, this is suspect, especially given their promise for continued transparency. Transparency is actually one of their greatest tools as investors analyze the FOMC’s commentary sentence by sentence, allowing for the FOMC to create ad-hoc policy. Actions of foreign central banks are also vitally important due to their effect on the value of the U.S. dollar.

**KEY FACTORS FOR ECONOMIC GROWTH:**
Now that we have moved through the worst of the credit crisis, economic growth sans massive stimulus will become the focus of investors. Most importantly, they will look for vast improvements in three key areas for recovery and growth to truly settle in. These are:
1. Employment levels – It will take numerous years, if not a decade, to recover from the current under- and unemployment levels in the U.S.
2. Wage increases – this is one of the more overlooked considerations coming into 2010, as many U.S. workers continue to make less, some considerably less, on a year-over-year basis.
3. Consumer spending – The economy has become 70% dependent on the spending habits of American consumers. So, until we see employment numbers improving, debt levels decreasing, and higher wages materializing, it will be very difficult for the U.S. to recover quickly.

**NON-U.S. AFTERSHOCKS FROM CREDIT CRISIS:**
The epicenter of the credit crisis has come and gone, obviously taking place in the U.S. As the aftershocks continue to roll throughout global markets, the Euro zone should be of particular focus coming into the first half of 2010. It is one the world’s largest economic regions and many governments there are struggling to recuperate from the massive real estate and construction declines/halts and the overall pullback in consumer and economic expansion. The crisis did not affect the Euro zone and its many countries in the same way, so while some economies may hold up decently, others, although unlikely, may tumble like dominoes; keep your eyes on Greece, Ireland and Spain to name a few.

As we step into 2010, interest rates will continue to be the main driver of the global markets, and growth will continue to be slow and choppy. There is concern about what the true recovery of our economy has actually been, given the unheard-of levels of government stimulus programs. Stimulus will continue to be necessary. However, it appears from the FOMC’s comments that “the great unraveling” will begin in Q1 2010.

It will take years, not months, for the U.S. and the world to recover from this crisis, although some economies that largely steered clear of the crisis will rebound much faster than others (Asia and South America). Certainly, with an underemployment number of over 17% and an unemployment level close to 10%, the U.S. will most likely need a decade to rebound to an unemployment level of 5%, given the reductions in leverage/available credit, lack of consumer spending and ominous amounts of consumer debt accumulated over the last decade.
Look for the FOMC to raise rates no earlier than Q2 2010 but most likely not until Q3; don’t look for more than a 50 to 75 basis point increase in 2010. There is greater than a 50% chance for an increase in rates in 2010. However, this rate increase is very dependent on the creation of jobs and a continued economic recovery on the domestic front. The FOMC is playing a difficult game of taming deflation in America while also spurring growth, and they are trying to do this while avoiding the creation of asset bubbles like those created by the last extended low-interest rate period below 2% (December 2001 to November 2004). Additionally, the current level of 0 to 25 basis points was only necessary in the sense banking systems almost failed, so as normalcy returns to the markets and banking systems, there will be no need for such extremely low rates.

Another aspect to consider regarding U.S. interest rates is how they affect the value of the U.S. dollar; there is a strong inverse correlation between the U.S. dollar index and 10 year T-note futures. Right now, regardless of the government saying they believe in a “strong dollar” policy, the U.S. wants a weak dollar as it allows for greater overseas profits for companies and increases the demand for exports. Low interest rates, as compared to other nations, can lead to a weaker dollar but there are market forces, such as investors’ level of risk aversion, which will continue to move the dollar, still considered a go-to safety asset. However, as with investing, nations are realizing that their reserves need to be better diversified and not so closely tied to one economy.

**DOWNWARD TREND IN TRADING FOR 2010:**

We will continue to bounce of off resistance and support levels as risk aversion ebbs and flows. As we’ve seen by the long end of the curve’s actions since the beginning of December, markets are expecting more yield to be associated with the increased debt being issued. However, this pivot point is also associated with the reversal of the “short” U.S. Dollar trade. With this and the fact interest rates will most likely rise by Q2/Q3 of 2010, 10 year T-note futures will experience lower highs and lower lows in 2010. As we begin the New Year, look for 10 year T-note futures to rebound once closer to the current 114-16 support level; the current geopolitical and economic issues within the Euro-zone and Middle East should continue to buoy the U.S. dollar and weaken 10 year T-note futures in the near term. Don’t be surprised to see resistance near 117-16 as we approach Q2 and resistance closer to 115-16 coming into Q3. The forecast is close to 113-16 in the 10 year T-note futures by the end of Q3, with a support level near 111-16 in the second half of 2010.

Likewise, 10 year T-note cash yields will average 3.65 to 3.80% in the first half of the year, then 3.90 to 4.05% in the second half.
Overarching themes for the U.S. dollar and foreign currencies:

- Potential for inflationary implications of Fed policy
- Global appetite for risk overall
- Downward pressure on the U.S. dollar from “carry trade”

The U.S. dollar (USD) broke sharply from its peak in March of 2009. The dollar index sold off 17.24% of its value, moving from its high of 8962 to a low of 7417 in November. The primary factor in the dollar’s slide was the Fed’s easing of monetary policy which included lowering interest rates to near zero and quantitative easing to increase the supply of dollars in the economy. One result of lowering U.S. interest rates was further downward pressure on the USD from investors borrowing the USD to invest in higher-yielding asset classes like commodities, including precious metals, and higher interest-rate-bearing currencies such as the Australian dollar in what is referred to as the “carry trade.”

At the end of 2009, we saw the dollar rally due to a number of factors including a decline in the global appetite for risk, and signs that the U.S. economy is improving and may be on the road to recovery. Further, we saw end-of-year profit taking by commodity and hedge fund managers locking in gains on those markets that benefited from a weaker dollar in 2009.

As the Federal Reserve’s mandate is to keep prices stable and promote economic activity consistent with rising employment, the Fed indicated their intention is to remove some of the excess reserves it has injected to stimulate economic growth. It is likely to maintain its target range for the Federal funds rate at 0 to ¼% for an “extended period” at the conclusion of its FOMC meeting in December. With most economists surveyed by Bloomberg looking for the Fed to leave interest rates unchanged through the middle of 2010, downward pressure is likely to reassert itself on the USD as worldwide investors seek potential for profits in other assets.

Since its low of 7417 in late November, the dollar index has recovered 5.6% of the 17.24% it lost from its peak of 8962.4 in March, and is approaching key resistance points highlighted in the chart below. Conversely, many of the currency markets have given back some of the gains they made against the USD in 2009. If the USD were to recover 50% of the value it lost since its peak in March, it would be at 8189. Key retracement levels for selected currency markets are below, and could be useful as potential reversal points as we begin 2010.

<table>
<thead>
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<th>Currency</th>
<th>38.2%</th>
<th>50%</th>
<th>61.8%</th>
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<tr>
<td>US Dollar</td>
<td>8008</td>
<td>8189</td>
<td>8370</td>
</tr>
<tr>
<td>Euro</td>
<td>14117</td>
<td>13800</td>
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<tr>
<td>Canadian</td>
<td>8978</td>
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<tr>
<td>Aussie</td>
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<tr>
<td>British Pound</td>
<td>15748</td>
<td>15348</td>
<td>14947</td>
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<tr>
<td>Swiss Franc</td>
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<td>9223</td>
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<tr>
<td>Japanese Yen</td>
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<td>10828</td>
<td>10601</td>
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<tr>
<td>USD/JPY</td>
<td>9967</td>
<td>10426</td>
<td>10885*</td>
</tr>
</tbody>
</table>

*USD/JPY data is based on a longer timeframe as the dollar has been losing value relative to the Japanese yen since the June of 2007.
In the table above, many of the commodity markets moved up significantly in 2009 as well, benefiting from a weaker USD. Retracement levels may prove to be good levels to buy into bull markets on a pullback in 2010. For select commodity markets, these levels are in the table below, and could be useful as potential reversal points as we begin 2010.

<table>
<thead>
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<th>Market</th>
<th>38.2%</th>
<th>50%</th>
<th>61.8%</th>
</tr>
</thead>
<tbody>
<tr>
<td>S&amp;P 500</td>
<td>946</td>
<td>892</td>
<td>839</td>
</tr>
<tr>
<td>Gold</td>
<td>1065</td>
<td>1014</td>
<td>964</td>
</tr>
<tr>
<td>Crude Oil</td>
<td>6316</td>
<td>5734</td>
<td>51</td>
</tr>
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In the table above, many of the commodity markets moved up significantly in 2009 as well, benefiting from a weaker USD. Retracement levels may prove to be good levels to buy into bull markets on a pullback in 2010. For select commodity markets, these levels are in the table below, and could be useful as potential reversal points as we begin 2010.
Overarching themes for U.S. stock indices:

• U.S. stock markets will evade a double-dip recession, maintaining a V-shaped recovery
• Modest gains with periods of retracement throughout 2010

Since the S&P 500’s intraday low of 666.79 on March 9, 2009 through the end of the year (mid December), the index was able to amass an impressive 66% gain. For that 9-month period, the U.S. has kept itself from a major backward dive, and such staggering advancements in the U.S. markets for that extended period thwart the likelihood of a double dip in the indices. There is a second influence to that end – the intense oversight by government officials who are cognizant of the impact a W-shaped recovery would have. They will go to great lengths to maintain a V-shaped revival.

The Obama administration has pumped massive amounts of nearly $700 billion in stimulus funds into the American economy serving to keep the upward move of the indices in place. Recently reappointed Fed Chairman Bernanke has done his part by taking the interest rates of the U.S. to record lows which he has declared will be for an “extended period.” It is a direct quote from President Obama on December 15 that he believes our nation must continue to “spend its way out of this recession” until more Americans are back at work.

The retail investor is one potential bright spot for the 2010 equity markets. After this year’s stellar performance, coupled with the potential for continued positive economic data and an increase in interest rates, the retail investor should continue to reallocate assets out of fixed income and back into equities. However, the pain experienced late in 2008 and into early 2009 will take many years to overcome, especially given the aging of the baby boomers.

The S&P 500’s mid-December price of 1,109.18 is still nearly 30% off its all-time high of 1,576.09 (intraday). The index achieved this pinnacle just over two years ago on October 11, 2007. December’s level is far from this major market’s peak. And, markets have the inherent tendency to continually want to attain new highs. In summary, that inherent bullish urge, a vast gap from the S&P’s all-time high and Federal intervention (stimulus package, low interest rates) warrant that U.S. stock indices will continue their advancements. There is still an abundant amount of money on the sidelines. Look for value investors to continue to take advantage of low equity pricing as the economy continues a slow march to recovery.

Gains for 2010 should be modest; we have already had a large recovery from the low of the current recession. The unpretentious progressions for the markets in 2010 are further merit by the fact that many companies are posting profits through rigid cost cutting means which is not customary in setting a bullish trend. Extremely high rates of unemployment, coupled with the fears of those who are working that they may incur job losses, will keep consumer spending in check all year. Though the indices will likely enjoy humble gains in 2010, expect periods with noteworthy pullbacks, which these indices managed to avoid for the most part in 2009.
Overarching themes for gold and silver:

- Strength fueled by a weakened U.S. dollar with gold being viewed as a safer haven
- Insatiable demand from international investors
- Limited supply

In 2009, precious metals provided investors with record breaking volumes, as gold reached its all-time high before retreating from it, and silver traded in a $19-plus price range! How much more volatility could a trader want? Yes, it truly was a great year to be a Gold Bug.

The trading ranges were phenomenal. Here are the highs and lows of the December futures contract for the year 2009:

**GOLD**

High: $1,226.40 (Dec. 3, 2009)  
Low: $810.00 (Jan. 15, 2009)

**SILVER**

High: $19.30 (Dec. 2, 2009)  
Low: $10.39 (Jan. 15, 2009)

DEMAND:

In 2010 the U.S dollar will remain under siege, especially if the FOMC continues to hold U.S. interest rates at current levels. Many economists are suggesting our economy is on the road to stability. However, demand for precious metals continues at record levels and was the cause for the Q4 2009 announcement from the U.S. Mint that its Buffalo one-ounce gold coin supply was gone. It appears the flight to quality is away from the U.S. dollar and into precious metals.

Global central banks are among those diversifying from the U.S. dollar into gold and silver bullion – to protect against the possibility that the weak dollar trend will persist.

And, if the U.S. government continues to print U.S. dollars to help us “spend our way out of recession,” as President Obama has suggested, we’ll see further demand for precious metals, as there will be more movement out of dollar-linked assets. Investors have become savvier and seek tangible assets, and their itch to buy more and more gold belies the fact that the public is losing confidence in the U.S. economy. Don’t expect to see an ease in demand – quite the contrary. Further, India’s “wedding season” is from November through January; demand from India, the world’s leading consumer of gold, remains high despite the record prices. Jewelers of India have expressed strong interest in purchasing gold around the US $1,100 level. Earlier in 2009, we learned that India’s central bank had purchased 200 metric tons of gold from the IMF.

SUPPLY:

China is the world’s largest producer of gold, responsible for 300 metric tons of newly-mined gold annually. However, they are not exporting any precious metals. Instead, the governing body of China is educating citizens to purchase gold and silver to protect newfound wealth. China and other developing countries have instituted policies geared toward building their national reserves as well. So with that and India’s consumption for jewelry and other luxury items, there is a tightening of supply leading to an upward trend in price. ☞
Overarching themes for oil and gas:

- Energy prices may plunge as the economy gets better, only to rebound in a demand-driven rally
- OPEC oil production is on the rise
- Geo-political risks: the possibility of showdowns in Iran/Russia and the Ukraine

To predict the fate of energy prices in 2010, first review what drove energy prices last year. Oil was not driven so much by supply or demand but by the largest coordinated global economic intervention in history. Central banks around the world led by Fed Chairman and Time’s ‘Man of The Year’ Ben Bernanke went to extreme measures to bring the global economy back from the brink of what was the greatest widespread economic crisis since the Great Depression. Doing so, they created a bull market in commodities. That was only the beginning.

In 2009, many oil traders had to forget everything they believed about supply and demand – and so-called wet barrels and dry barrels – to focus instead on the intricacies of currency exchange rates and global macro economics and the relationships therein. Traders had to view a barrel of oil not so much as a commodity but as pawn in this juicy economic “comeback” story. Oh sure, there were those that failed to grasp the fundamentals of the crisis and tried to blame speculation for all of the economy’s ills. Yet it is now clear to many, in retrospect, that markets acted just as they should.

Traders had to think about the price of oil in a different way. This was difficult, as many had false assumptions about what was previously driving oil prices. If you remember how the year started in oil, it was a time of great fear and uncertainty. The price of oil, like a lot of other commodities and stocks, was in the grips of a deflationary death spiral. Crude oil hit a low of $32.70 a barrel at the start of 2009, after a death defying plunge from the all-time high of $147.27 dollars per barrel in 2008. And that perilous drop was nothing compared to the demand drop. According to the U.S. Department of Energy, consumption of liquid fuels and other petroleum products in 2009 had one of the steepest declines on record, compared to prices of the previous year. Consumption fell by a stunning 1.25 million barrels a day as fear and the destruction of demand permeated the marketplace. The economy was crumbling and we were losing faith in everything. Bank failures and auto company failures, industrial production grinding to a halt – all this as the greatest economy the world has ever known started a total meltdown, and the rest of the world melted down alongside us.

Source: Future Source
But despite the dire predictions and the fear that all hope was gone, the market came back once the Fed and other central banks came to the rescue and hit the economy with massive amounts of stimulus. And the most significant factor in 2009, and what will be a major factor for the price of oil in 2010, was the day in March when the Fed printed a floor under the price of oil. Or in economic terms, the day the Fed went to “quantitative easing”.

In effect, that meant the Fed printed money. They lowered interest rates as low as possible to further stimulate the economy. Then they, and other central banks around the globe, turned to their printing presses and started printing currency by the bucket load to try to stop the deflationary spiral. Our economy was very sick, and the Fed had to go to extreme measures to try to bring it back from nearly certain death and make it well again. We exchanged deflation and hoped for a bit of commodity price inflation, because the alternative was extremely bleak. As the Fed pumped in more cash, the dollar lost value and commodities soared as oil more than doubled in price. Oil futures reflected the improving mood by rising more than 64% from a low of $32.40 a barrel at the end of 2008.

Investors seeking safe haven from the credit crisis sold the USD and bought gold and oil. The subsequent commodity price rise along with the free flow of cash helped stabilize the banks and the economy and helped put an end to our deflationary mood. Quantitative easing was the equivalent of putting the economy on a high powered drug to alleviate fear and depression and stop the deflation spiral that was making our economy suicidal.

After that major injection of fiscal laughing gas we are now starting to feel pretty good. The world is looking more like the worst is over; we are all feeling a bit woozy but better. The deterioration in the jobs market is slowing and near record productivity suggests that we may be seeing job growth return. We have returned to GDP growth and the recession may be technically over. Wow, these quantitative easing and zero interest rate drugs feel pretty good right now.

The problem is that in 2010 we will have to get off the drugs. It won’t be easy. We may have to focus on such frivolous matters as oil supply and demand.

At the beginning of 2010, the removal of stimulus will be a bearish event for crude. Any dollar rally and fear that higher interest rates will slow demand should cause a major break in the price of oil. But, after a big drop, the low price of oil should create a buying binge. We should see sizable swings and opportunities similar to what we saw in 2009. The price of oil at that point will be predominantly driven by improving demand. But this demand has to be real and inspired by low prices and not artificial demand created by fiscal stimulus. Even the International Energy Agency, an energy advisor to consuming nations, says it expects consumers globally next year to use on average 86.3 million barrels a day, representing an upward revision of 130,000 barrels a day from the IEA’s November report and growth of 1.5 million barrels a day from 2008. Still, oil could fall as low as the $40 handle as the stimulus wears off. A new bull market will be born. Expect to see oil exceeding $82 a barrel later in the year.

RBOB gasoline will fall to the $120 support before rising back to near $210, and heating oil could test $110 before going back near $212. All of these energy markets should slightly exceed 2009 highs.

As the stimulus slows and demand growth stimulus wears off, the market will have to work off a glut of supply that is high compared to historical standards. U.S. crude supply in early December was about 7.2% above the 5-year average. U.S. gasoline supply was 4.8% above the 5-year average. Distillate supply increased a whopping 24.7% against the 5-year average. Globally, oil product stocks in the Organization for Economic Cooperation and Development (OECD) reached the highest level in several years in September, despite OECD refiners reducing crude runs by 1.7 MB/D on average (in the first three quarters of 2009 vs. the same period in 2008). Even as demand improves, oil producers are anxious to meet that demand with more oil production.
At the outset of 2010, OPEC is raising production which will add to the bearish mood. Saudi Arabia, the world’s biggest oil supplier, raised crude production to as much as 8.5 million barrels a day, with an estimated 4 million barrels a day of spare production capacity on top of that. OPEC is confident that demand will grow. They are eager to gain back lost market share, so we’ll see them overproduce—until they realize that their excess added to a major break in price—and then they will again cut production to a level that will push oil upward to contract highs again.

Of course we have to look ahead to possible geo-political risks as well. Iran continues to thumb its nose at the world community, ending the year by test firing upgraded versions of an advanced missile capable of hitting Israel and parts of Europe. Russia and the Ukraine seem always to have a gas dispute for which the market must contend. But the year 2010 should be a year of the economy continuing to heal, even though that healing will not be painless, and a year of tremendous moves in energy and other commodities.
Overarching themes for grains:

- A repeat of explosive moves and fundamentals mirroring the first half of 2009
- Continued increase in global demand for corn and soybeans
- Wheat may follow price strength in tandem with corn
- The battle between corn, beans and wheat to secure acres is just as important in 2010 as it was the two prior years, because the goal of producers/government is to build inventories to levels that insure an untimely summer drought does not leave bins empty
- Approximately a third of the U.S. corn crop will be used for ethanol production

A bullish sentiment reigns over all the grain and oilseed markets. 2010 has many of the same factors as 2009. In 2009, world demand caused U.S. farmers to attempt to plant enough acres of corn and soybeans to keep supply inventories from getting depleted. This battle led to price strength in both markets, and with that underpinning, a very wet spring delayed planting from normal time frames, fuelling more “fear” buying. By early October, when an early Midwest frost brought a premature ending to the growing season, only about 26% of the domestic corn crop and 10% of the bean crop had reached full maturity. Final production numbers were well under projections and the effort to build ending stocks was unsuccessful.

The market is not sure that supplies will expand to meet world feed grain and protein demand. And then there is the ethanol factor.

Traders see corn inventory trending down for the third consecutive year, which will likely result in further narrowing of the corn:wheat price ratio. I anticipate that wheat prices will come up so that the spread does not narrow to much less than $1.00. A strong corn market means higher wheat. The supply story on wheat is a just a bit different from corn. Currently, inventories are ample, with ports around the world holding record wheat supplies for export. However, U.S. winter wheat seeding is complete, and production numbers were less than anticipated. Add to that a higher wheat ratio used in livestock feed, and you will see inventories declining not only here, but in Canada and Australia. Traders will no longer want to be short, and so they will see wheat key indicators as very similar to the drivers of beans and corn.

As for soybeans, in Q1 of 2008 and again in 2009, the market rallied because ending stocks were 205 million bushels. In the year-ending production report for 2009, inventory is seen at closer to 250 million bushels, but demand for oilseed proteins from a host of countries with strong economies will mean a likelihood of another Q1 rally in 2010.

**THE ETHANOL FACTOR:**
Currently, interest from the public sector is so great to produce ethanol from corn that the government ended subsidies for the building of ethanol refineries in mid-2009. There are currently 180 refineries and fifty under construction. The beauty of an ethanol plant is you can build it in six months and operate it with twenty people or less. An oil refinery takes almost two years to build and requires hundreds of employees. You can start up and stop an ethanol plant almost overnight. And, unlike fossil fuels, ethanol burns cleanly and does not damage the environment. In corn, there is an unlimited and renewable supply of product from which to make ethanol. So, corn is not just a food, but a renewable fuel for the future. This demand for corn to produce ethanol comes at a cost to our own grain reserves.

The USDA projects about one third of the U.S. corn crop (about 4 billion bushels) will go to ethanol production versus 1 billion five years ago. The government sees that, even at the cost of depleting grain reserves, it’s necessary to our economy and security in the long term to expand ethanol production. 2009 saw weak ethanol plants go bankrupt, as they initially launched for environmental reasons and
government subsides. They lacked agricultural hedging skills, and the market’s rally forced them to sell to the strong agricultural ethanol producers. This sets up 2010 to be ethanol’s strongest year. We expect ethanol users to be aggressive corn buyers and storage builders to insure they have enough product. The Obama administration mandate on ethanol has 20 laws and incentives to boost ethanol use, with 49 states offering additional subsides and supports. 2010 will see refiners blend almost 12 billion gallons of ethanol into gasoline, more than double two years ago.

**WEATHER AND EXPORTS:**
As with 2009, trading in 2010 could take on a wild pattern if weather has a particularly helpful or disruptive effect on the planting and growing periods. Just last year in South America, the second-largest bean producing region in the world, a drought left many of the fields parched, so importers like China tapped the U.S. market to fill gaps. Additionally, China overbooked bean purchases as insurance against world growing season problems in the future!

Meanwhile, the Obama administration has lowered trade barriers so that nations short of adequate grain supplies can more easily import grain from the U.S. Importing countries have realized it is a huge error not to enter the market early and often to buy grains before supplies dwindle and prices hit record highs. This psychology will continue in 2010, as grain importers attempt not only to fulfill near-term buying needs, but also to build more reserves to offset possible adverse, weather-related conditions in the U.S. or South America.

In grains, as well as nearly every market, economic growth in heavily populated nations of Asia is an influence. After the 2008 record run-up in grain prices, China announced they would build a strategic reserve of feed grains to help achieve a more protein rich diet for their populace; they do not want drought or wild price swings to interrupt this objective. They also have committed billions more to build warehouses for storage of grain and vegetable oils.

**PROJECTIONS FOR 2010:**
July corn futures trading to the $5.25 - $5.60 level.
July soybean futures trading to $11.75 - $12.25 level.
July wheat futures trading to $6.75 - $7.10. 🌽
Overarching themes for the livestock and meats complex:

- Supplies generally steady to tighter
- Demand linked to financial market recovery – weak but possibly improving

To understand 2009 meat markets we must go back to the fall of 2007. Fueled by low interest rates, the economy hummed along at an ever-increasing pace. In the five years from October 2002 through October 2007, the domestic stock market doubled in price. Unemployment was low at 4.7%. Mr. and Mrs. America went on a 5-year spending spree resulting in $900 billion in credit card debt by late 2008. As the good times rolled on, our nation’s bankers were finding new ways to get rich; if you had a pulse and/or knew someone that had a job, you got a home mortgage. These home mortgages were packaged and sold to investment banks. Using poorly-understood derivatives and buying insurance from AIG, our country’s bankers slept soundly, dreaming of fat bonuses.

Unfortunately, not all fairy tales have a happy ending. People without jobs started defaulting on what had become known as subprime mortgages. As the real estate bubble unraveled, stock markets took notice, breaking 55% between October 2007 and March 2009, with unemployment rising to 10.2% by October 2009. American families who found their 401K and kids’ college funds down by 30% to 40% reacted. Fearing the worst, they decided to save 3% to 5% of their income. Car and meat sales were the first to feel this effect. This is where the 2009 meat story began.

**BEEF SUPPLY/DEMAND FACTORS:**

By the third quarter of 2008, retail beef demand tanked. Food service (restaurants) saw a 30% decline in customers. (Approximately 25% of annual beef demand comes from restaurants.) With supermarkets lowering retail pricing only 6% to 8% for the first half of 2009, beef customers, not impressed, strolled inactively past grocery meat cases.

Export demand faltered 7%. Even with feed lot supplies down 5% from year-ago levels during the first six months of 2009, cash cattle traded between $80 and $85. Cash cattle could not go up with diminished domestic and export demand, but could not break with a feed lot population down 4%.

The stock market chugged up on a little-trusted rally starting in March. Cattle futures tried to follow, but H1N1 influenza – swine flu – contributed to a 25% decline in pork futures. Because retail buying of beef competes with demand for pork, and wholesale sales of pork cuts dipped some 40% off from year-ago levels in summer, beef had no choice but to mirror the weakness. Huge summer feeder cattle placements (futures hedge available) raised the prospects for the December 2009 to February 2010 feedlot supply up over 420,000 head from the same time period twelve months previous. That large increase fueled a projection of Q1 2010 cash cattle prices of $80 to $82 per cwt. Futures, which had a year earlier traded at a large premium to cash, were in the basement; February through October futures declined an average of $14,000.00 a contract from their Q3 highs of 2008. December 2009 futures made their low on December 12, 2009.

2010 looks better. Feedlot supply will probably stay 1% to 2% over last year for most of 2010, but that is still down 7% from 2007 levels.

Domestic beef demand should improve with the financial market looking better. The Asian Development Bank is forecasting a 3% to 4% increase in GDP for that country in 2010. Export sales to Japan, Vietnam, Hong Kong and South Korea will more than offset slow beef buying by Canada and Mexico. Beef exports for 2010 should increase by 6% from the 2009 forecast level of 1.825 billion pounds.
With the recent pork products rally, beef is becoming a heavy favorite for retail chains to feature. Cash cattle demand will stay strong as beef packer operating margins are running $30 per head. Last year, in December, packer operating margins were minus $40 per head.

At the end of 2009, cash cattle prices ranged from $79 to $82. The normal seasonal increase in beef demand should offset increasing late Q1 feedlot numbers, and the associated seasonal rally should take cash cattle up to $86 to $88 by Q2 in 2010. The normal second quarter to third quarter price decline will be muted as cattle placed into feedlots are likely to remain 2% to 5% below 2009. A break to $83 to $85 should be expected. World economies and domestic psychology will determine late 2010 pricing. Cattle to be harvested in Q4 will be placed during the late Q2 and early Q3 of 2010.

**PORK SUPPLY/DEMAND FACTORS:**

Our pork story differs little from beef up to August of 2009. The overall stock market decline over 16 months of 55% gave the same results. Like beef, pork demand sank quicker than the Titanic. U.S. pork exports were 4 billion pounds for 2009, off 13% from 4.7 billion pounds a year ago. The flip side is that this year’s 4 billion pounds will be 29% over 2007 and 30% over the 5-year average of 3.1 billion pounds. Pork exports are forecast to increase in 2010 to 4.3 billion pounds, making it the second highest year on record.

H1N1 influenza surfaced in April 2009. Our high month for pork exports was in March at 370 million pounds. H1N1 gave us a decline to 300 million pounds by June. Pork exports have rebounded to 378 million pounds in October, which was the last available month for USDA data. This is still 3.6% under October 2008, but it appears the H1N1 scare has gone to the back burner. Meanwhile, unsold pork found its way to cold storage warehouse stocks. In March 2009, there were 624 million pounds of pork in storage, a record for any March. The good news was that 2009 pork exports increased 30% over the 5-year average of 3.1 billion pounds. By August, with exports declining and cold storage stocks increasing to record levels, U.S. pork processors reduced wholesale pork by 40% from the year earlier. This unheard-of reduction caused a spike in consumer demand. In addition, this pricing and a declining dollar made U.S. pork quite attractive to foreign buyers. As domestic and foreign business picked up, warehouse stocks declined 17% from March’s 624 million pounds to 520 million pounds by November.

Since August, our lean hog index (combination of cash hogs and wholesale pork product) has gone from $49 to $64.12 (on Dec. 11). Demand is back and it is solid. Hog supplies point to higher prices in 2010. Hog producers have been losing $20 per head for the last 24 months. With $3.60 per bushel cash corn prices, they will need $50 per head to break even. Hog prices now at $36 to $42 leave them still in the red. The Q3 2009 quarterly pig crop (September 1) showed producers planning to breed 3% less hogs through the first six months of 2010. In addition, Canada has reduced their feeder pig exports to the U.S. by 25%. The combination of these two fundamentals will give us a 4% reduction in market hogs for the first half of 2010.

Assuming world economies and stock markets behave during 2010, a forecast for pork pricing is not hard. Our lean hog index, now at 6457, should seasonally decline to between 6000 and 6200 by the middle of January. With hog supplies down 4% and exports up 7% from last year, we can expect the index to go to 7700 to 7900 by summer. This gives us a cash hog price between $45 and $47 per head. But, that still leaves pork producers without a profit.

Like cattle, the last half of 2010 will depend on consumer psychology (will H1N1 remain a factor?) and world economic health. The price of corn should be the key to 2010 hog supply. If producers can make a profit raising hogs, second half 2010 hog supplies will increase. If cash hogs stay under $50 per head and cash corn stays over $3.50 per bushel, producers’ lack of profit will keep hog supplies 2% to 4% under last half 2009 numbers. At the present time our forecast for summer 2010 cash hog prices between $45 and $47 leaves hog producers looking for lower corn pricing if they are to make a profit and increase late 2010 hog numbers.
Overarching theme for coffee, sugar and cocoa:

- El Niño and bullish weather fundamentals in growing areas

El Niño events generally have caused or are causing the following meteorological phenomena: warm, dry conditions in Columbia, Venezuela and northern Brazil; heavy precipitation in Paraguay, sections of Uruguay and southern Brazil; severe, drought-like conditions to portions of Australia and southern Asia.

Commodities grown within 20 degrees of the equator are tropical by definition. This area is generally hard hit by the effects of El Niño events, creating reductions in crop size and firmness in prices. Along with this bullish influence there are additional circumstances that could push these three markets to much higher price levels than where they are currently trading.

COFFEE SUPPLY:
Brazil is the world’s largest producer of high-quality coffee. There is already tightness in supply of high-quality Brazilian coffee. This in and of itself has created upward price pressure and it is now coupled with a disappointing size of the Columbian crop, which is harvested late in the year (from September through about December). Brazilian growing areas have had too much precipitation for too long. This lack of a dry period to induce flowering for next season’s crop (harvested in May through about September) is one of the key reasons we’re calling for continued upward price momentum in coffee futures. Small, undeveloped flowers will affect both the quality and quantity of the new crop. As far as the coffee crop in Columbia and Indonesia, it is uncertain how much El Niño will hinder production. It will be watched carefully.

Based on the situation as it exists in coffee, one should regard coffee as being in a full-blown bull market. Additional bullish fundamentals are already in the cards for the 2010 growing season. One thing to keep in mind is that, if the market begins a run to the upside, the additional risk involved will be quite large. All long positions should include an equal amount of protection through the use of puts.

It is quite possible that coffee will trade above $2.00 in 2010. In fact, don’t be surprised to see coffee trade above $3.00!
The historical coffee chart in this report illustrates the extremely fast nature of bull runs in coffee. Visits above $2.00 and $3.00 are fleeting in nature.

**COCOA SUPPLY/DEMAND:**
Cocoa supplies arriving at ports for export have exceeded expectations. There is talk, however, that the next two months of final harvest will see lower-than-expected yields. Experience shows that a harvest that starts out good just gets better. Cocoa demand is linked to macroeconomic conditions. Chocolate is purchased as a luxury item and is not necessary in the way that coffee, sugar and cotton are necessities.

**SUGAR SUPPLY/DEMAND:**
There is a supply deficit in sugar. However, since the price of sugar now is so strong, it will spur greater planting during the next growing season. Demand is strong – India remains a large importer. The tightening supply from Brazil, due to recent heavy rains and higher ethanol prices, is supportive to sugar prices. Another demand fundamental that will shore up the price is the improving economies of Asia and South America, where demand is huge.

**COTTON SUPPLY/DEMAND:**
If the macroeconomic picture improves globally, cotton prices will rise. If not, the opposite would be true.

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