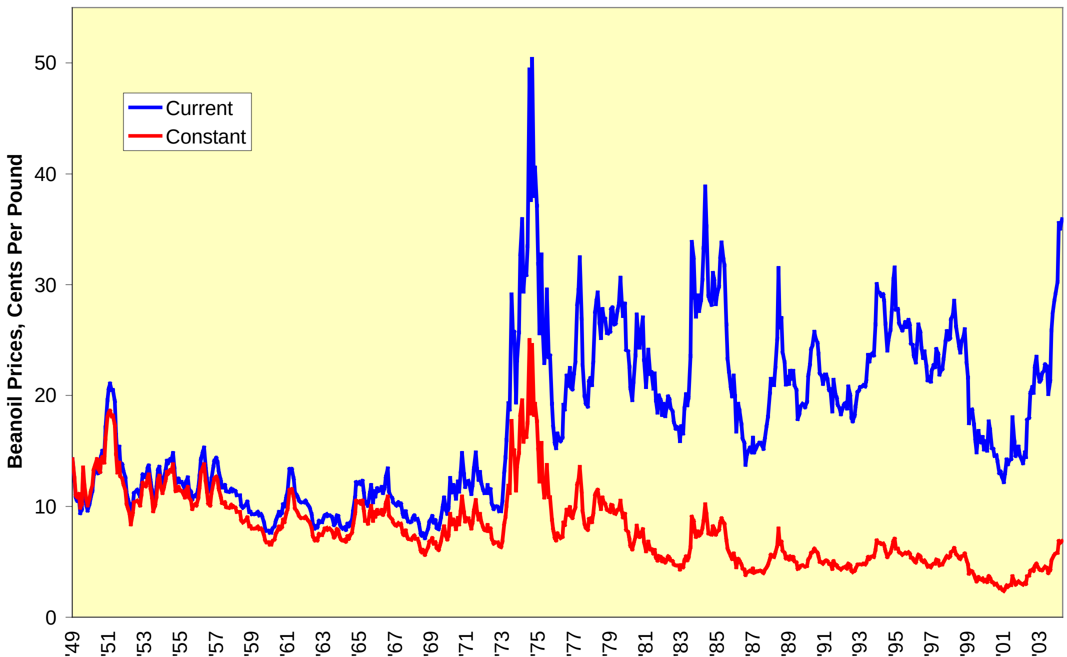
Soybeans And The Other Oil Market

With all of the economic and political stresses loose upon the land, do we really need to devote the firepower of a neuron or two to what is being described as an impending shortage of soybean oil, the basis for such staples as mayonnaise, salad dressing and vitamin E supplements? Yes: This commodity affects the cost structure of a remarkable number of foodstuffs, Brazil and Argentina's export earnings and import prices for China, Japan and Korea. Its price is headed higher, although it is a long way from reaching its levels of thirty years ago on either a constant (inflation-adjusted) or a current dollar basis.

A Long Way To 1974



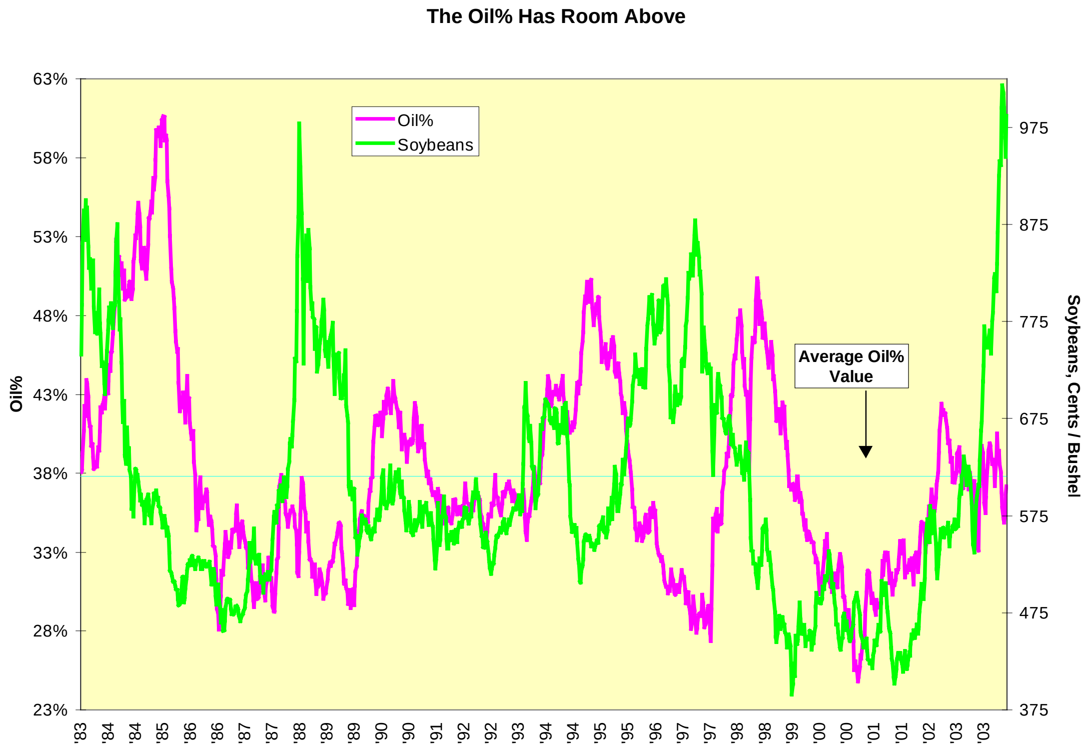
Beanoil, on which futures contracts are traded on the Chicago Board of Trade, is but one of the marker grades in the cash fats and oils market. Others with futures contracts are palm oil, traded on the Malaysia Derivatives Exchange, and canola, traded on the Winnipeg Commodity Exchange. Cash markets include corn oil, sunflower seed oil, peanut oil, cottonseed oil, palm kernel oil, tallow and lard. And let us not forget grease, which is added to livestock feed to boost its caloric content: Commodities are not pretty.

Crushing News

These various oils are substitutes for each other in some applications, subject to engineering and recipe mix constraints, but not in others. As a result of this imperfect substitution and of the different seasonal cycles involved in their production, it is quite common to see the price of one oil rise or fall significantly before the others react, as we shall see below.

Compounding these problems is the derivative nature of beanoil's production economics. Beanoil is refined from crushed soybeans and accounts for only a varying percentage of the total crush value of soybeans, to be referred to as the Oil% as shorthand. Soymeal, the high-protein residue, accounts for the remainder of the crush value. Its primary use is in livestock feed, where it competes with corn, fishmeal and high-protein grades of wheat.

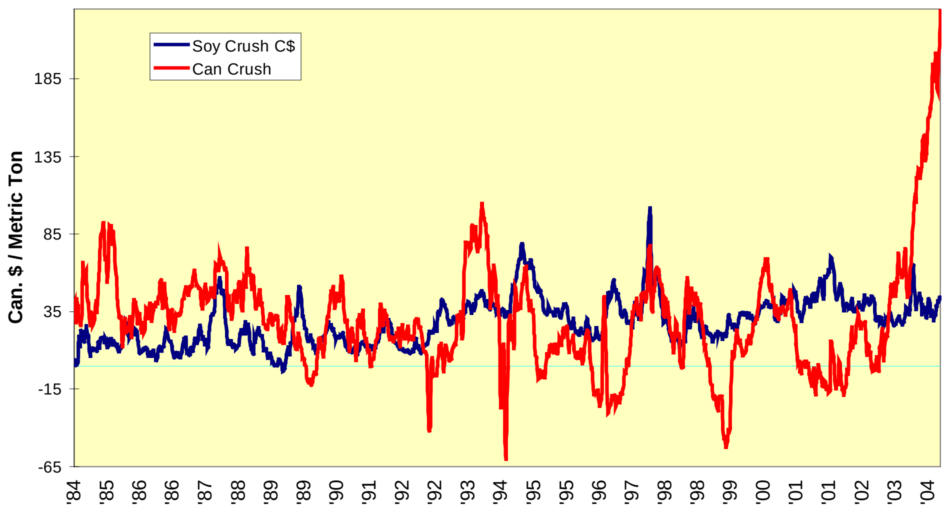
Soymeal generally accounts for more than 60% of the crush value, and thus defines the profitability of soybeans more than beanoil. Periods of high soybean prices, such as the present, have low Oil% numbers. However, high soybean prices lead to higher plantings and substitution on the demand side, which in turn lead to lower soymeal prices and sharply rising Oil% numbers.



Canadian Competition

Beanoil competes with canola in both the North American and in the Asian export markets. As many contracts for the current cash markets were fixed months ago, the relative spot market margins for crushing soybeans and for crushing canola have widened out to historic levels; the crush for canola is determined by the currency-adjusted spread between canola seed and Chicago beanoil and soymeal prices.

Spot Soybean And Canola Crush Margins

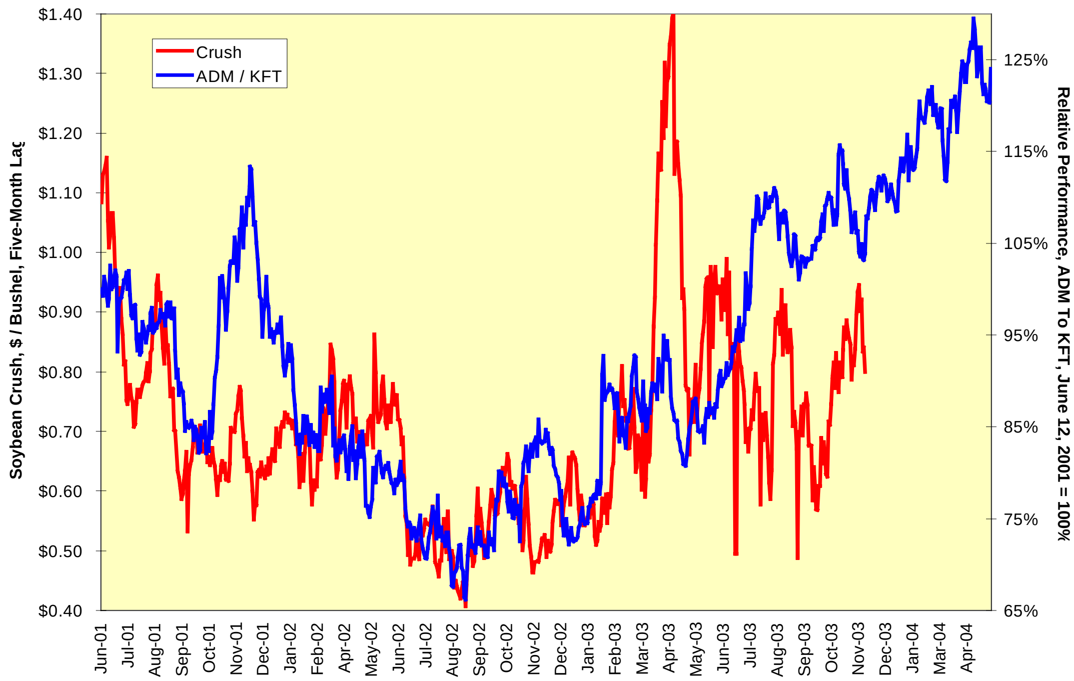


Before any of you spit out your coffee in order to scream "arbitrage opportunity," consider that these are current spot market prices. Planting and future purchase commitments are established by looking at the so-called new crop prices, those available at the end of the current harvest season. Here the story is quite different. A Canadian producer can establish a margin of C$59.76 per metric ton today, far higher than the soybean crush margin of C$31.74 per metric tonne. This should encourage maximum production of canola by our neighbor to the north this year.

Better A Crusher Than A Crushee?
Regardless of the source of the edible vegetable oil, this strong price environment has benefited firms such as Archer-Daniels-Midland, a leading soybean and canola crusher, as opposed to food processing firms such as Kraft Foods. When it rains, it pours: In their other business segments discussed here recently, ADM has benefited from the recent strong ethanol market, while Kraft has seen its margins crimped by rising dairy prices.

Although both firms are highly diverse, their relative performance over the past three years has been led by approximately five months by the spot market soybean crush.

Crushing The Customer



Given the prospects for strong spot market crush margins driven higher by beanoil prices between now and the end of the harvest, we should expect the stocks of agricultural suppliers such as ADM to continue to firm relative to those of their food processor customers such as Kraft Foods. This cycle should continue well into early 2005.