

## ***SPECIAL REPORT*** **FROM THE DESK OF PHILIP GOTTHELF**

### **Have Grains Overcome Resistance?**

After being stopped out of our corn position, technical patterns suggested a trading range between 2.40 and  $\pm$  .20. Interim volatility boosted premium values and it seemed reasonable to take 11¢ out of a short July strangle since we would remain profitable from 2.51 down to 2.09 on an expiration basis. Judging from last weeks chart, it did not appear likely that corn would breach either of these limits.



In fact, I was more concerned about the bust below 2.34 support as indicative of a further decline. As Murphy's law would have it, my technical anticipation was thwarted by fundamentals that I had previously mentioned that included dry spring conditions and the lack of planting incentives, i.e. low prices.

As the chart illustrates, July corn blasted off on March 31<sup>st</sup> with a 10¢ gap opening above the 20-day average. A switch by China back to American purchases helped put the squeeze on shorts that were forced to cover on April Fool's day after prices breached the 40-day average

and touched off stop-loss orders. According to newswires, corn's impressive follow through yesterday resulted from fund liquidation. A review of the tape points to a contraction with total open interest declining by 8,492 contracts. This means there is less participation and less money to extract from the market. Further, my commercial sources tell me corn's export potential remains tenuous... a reason funds may have spread long beans against short corn.

Understand that the pop above our 2.40 strike is, by no means, a negation. In fact, it would provide incentive to roll the strangle up, but for today's weaker action. My take is that we remain safe for another two weeks and, ideally, corn will trade within the 2.20-2.40 envelope as time and volatility premiums decline. South American weather reports have been favorable for the remaining harvest and I expect Argentinean supplies to weigh upon global pricing over the next month. It will be important to see how briskly South America unloads this year's crop because I suspect rising world demand through 2003.

Yesterday, I heard commentary that corn prices must rise (along with wheat and soybeans) as the U.S. provides increasing food aid to Iraq and Afghanistan. However, reports on the relief packages do not show a heavy grain content... for now. Bulk grain shipments are coming as Iraq's processing infrastructure is

reactivated. Will rebuilding pressure grains? It is as much a political question as it is economic.

With the U.S. and U.K. in control, we will dictate Iraq's spending over the next several years, if not decades. Already, we have had Secretaries Rumsfeld and Powell stated that Iraq is a "very rich nation" with the second largest oil reserves behind Saudi Arabia. "They will have no trouble rebuilding" after the American/British occupation. Rest assured that the U.S. and U.K. fully intend to tap oil revenue to pay for Operation Iraqi Freedom and a massive rebuilding effort. In addition, I expect to see considerable grain and other exports reaching out to Iraq... at a price.

Thus, the U.S. stands to gain from an "oil for food" relationship regardless of whether it is direct or indirect. Speaking of indirect, China is pumping up its capacity as a Pacific Rim grain hub. In the past, China has acted as a middleman by purchasing and storing ultra-bulk grain and redistributing in smaller quantities at a premium to the original price. The pattern of China's recent purchases hints of increasing activity.

A more definitive bullish complexion appears in May soybeans with the breakout thrusting above the 20-day and 40-day averages.



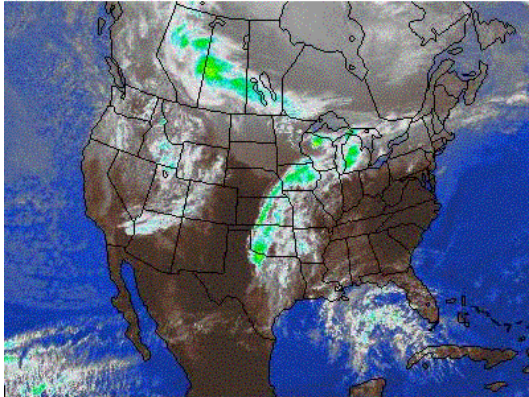
The upward channel slope has an obvious bullish hue with rising tops and bottoms. As the range narrows we can expect to see the rally diminished. Essentially, buyers and sellers are agreeing on the "right price" as the slope of the incline decreases. Fundamentally, beans above 5.65 represent a better profit margin and create an incentive to plant. Low interest rates make financing this summer's crop less expensive, however, energy, fertilizer, and chemicals are all up in the air and could easily offset any interest rate savings.

Yesterday's action challenged the September 11, 2002 5.88 high that is poised to offer near term resistance. If this spring remains relatively dry, it will ignite drought concerns and push beans over \$6. The failure of the Southern Hemisphere to appreciably add to global inventories for the 2003 season sets the stage for a big summer squeeze if weather becomes uncooperative. A dry spring doesn't necessarily lead to a dry summer. In fact, the wet springs have shown a propensity to leave July and August high and dry.

The past eight to ten months have experienced a jet stream trough that has carried moisture down from north central growing regions that include Montana, northern Indiana and northern Illinois. Historically, this pattern shifts by April and our northern tier begins receiving ample precipitation through June. Suddenly, the problem can become too much rain too late which delays planting and raises concerns about late tasseling for corn or delayed podding for beans. Of course, the later you plant, the more likely you'll have a freeze before or during harvest. All of these prospective events will impact prices down the road.

For now, we see considerable ns about the prolonged northern tier dry spell as a new series of storms begins to materialize.

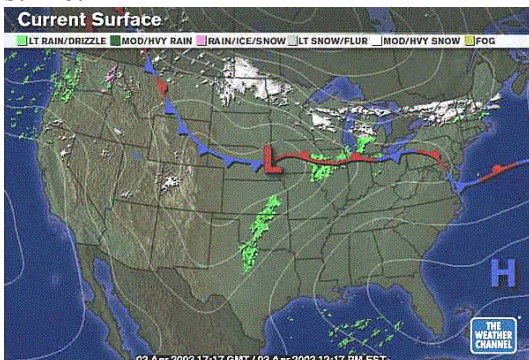
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The current satellite picture shows a rain band stretching above the Finger Lakes into southern Canada and another swatch of rain descending from British Columbia that can combine with weaker low sweeping in from the Pacific Northwest. The tracks appear to be combining right where they are needed from Montana down through Kansas.

Two years ago, farmers faced the same pattern and we saw record crops. Thus, it is not time to jump on the bull wagon just yet. In fact, this week’s weather can take corn back towards our 2.20 July put strike!



As we see, there is a band of low pressure stretching just below the Canadian border while high pressure dominates off the southeastern coast. The high is likely to dissipate, but raises questions about the

potential for a summer “Bermuda High” that can develop through July and August to bring drought to the southeastern and even south central corn belts.

One thing is certain every year. Weather is uncertain. After hearing various climatologists, I anticipate a break in the northern drought and, perhaps, too much moisture through May. I don’t anticipate remarkable deviations from a “normal spring” and, thus, I still like strangles.

Unfortunately, I tried to tap into the bullish soybean propensity by taking the long July/short November bull spread. I moved protection too tight and we were bumped out with a 10¢ profit. Although not bad, the spread has widened to more than 60¢! I still like the spread, but would rather see this week’s storm take beans down a few notches before jumping in. After all, 60¢ is a lot for an inverted (“backwardation”) market.

### Silver and Gold

Well, “they” raised April gold to 33750, just above our 33710 stop. At the time, 33710 looked safe because it represented a breach of the 20-day average which gold has been responsive to over the last several weeks. Immediately after take us out with a bunch of other stops, April gold plunged and is following through.

We managed to hold on to our short silver, but it is frustrating to get bumped out of gold after making such an effort to time a short-side entry. The chart has a bearish hue and our rising Dollar will probably erode gold parity further. The war is going well and most traders expect to see Baghdad succumb to allied forces within the next few days.

Of course, anything can happen. A chemical attack or heavy U.S./U.K. casualties can stall stocks and re-stoke gold, but the technical pattern does not look particularly encouraging.



Last week, I identified the upward consolidation flag as a downside continuation pattern as illustrated above. Under this assumption, April gold should have been constrained by 33200 resistance. Instead, gold raced toward the 20-day average, touched, and plunged back to confirm that the consolidation was, indeed, a bear flag.

Based upon the ratios, the flag projects to a test of 31800 support. This means gold has more downside, but the question is whether gold carries enough volatility to boost premiums for a short strangle. June 340 calls are fetching 4.30 as of today's close while 315 puts yield 4.50. This makes the June short strangle safe to 34880 and 31020. It is a wide enough range, but the 340 call could become dangerous under more circumstances than the 315 put.

### **Saddam – Dead or Alive?**

A great deal of mental energy has been expended on the question of Saddam's status. Is he dead or alive? Military analysts and Defense Secretary Rumsfeld have emphasized that we have not seen a confirmed live picture of Saddam since

we dropped bunker busters on his alleged meeting place before the official air campaign began.

The pertinence to gold is the possibility Saddam was foreclosed from converting his paper into gold as he was doing last month because he's post mortem. Subscribers should recall that the buying frenzy seen in February was, to some extent, linked to Middle Eastern accumulation. We traced movement from various depositories into Malaysia and Indonesia. To me, this was a sign of unpatriotic accumulation that had the potential to push gold well above \$500.

Saddam's death would cut any conversion and/or accumulation effort short. In the meantime, other Arab nations like Saudi Arabia, Egypt, Jordan, Kuwait, Qatar, United Arab Emirates, and neighbors are less inclined to risk liquidation risks and exposures to convert from paper into gold. They are not the targets of allied aggression.

Between now and June, the war effort is bound to have successes and setbacks. Since these events seem to be driving gold and silver as well as several financial instruments, I feel the strangle can offer the best strategy for the current environment. If Saddam is dead, gold will probably reflect optimism with a test of 2002 lows. Absent news until June, gold will responded to day-by-day events to stall in a trading range. Of course, that's just my opinion. I could be wrong!

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