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WORLD PERSPECTIVES: AG REVIEW

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How can WPI's consulting services help your business succeed?

Consumer Research: WPI produces low-cost, non-probability consumer surveys around the world. When overlaid with conventional market research data, the result is insights into where and how markets for agrifood products can be expanded – and we have the results to prove it.

Market Identification: Conventional use of macroeconomic and demographic data has correlative value in identifying new markets, but WPI digs deeper. The result has been unique recommendations with some netting a return ratio of 6:1 for increased exports and promotional investment.

Investment Analysis: WPI has provided due diligence on agrifood investments in disparate parts of the world from dairy and juice packaging in Cameroon to soybean crushing in Ukraine and biotech corn planting in Canada. In other instances, the company has used its decades of risk management experience to caution enthusiastic but new-to-agriculture investors to be prudent.

What do our clients say about our services?

- *Any company that follows up like WPI deserves our business.*
- *WPI does an excellent job of working to assess the client's needs and tailoring their methodologies accordingly.*
- *WPI is very responsive in addressing any questions we have; they are helping the association gauge how to move forward with effective strategies in international markets. This year they have increased the level of their services and continue to help us find ways to be effective with our strategies.*
- *WPI has been responsive and cooperative under every challenge and circumstance presented in their work for us.*
- *WPI really provides us with a life-blood service.*

Please contact David Gregg, Consulting Projects Manager, at (503) 467-8668 or dgregg@agrilink.com for more information about how WPI's consulting services can work for you.

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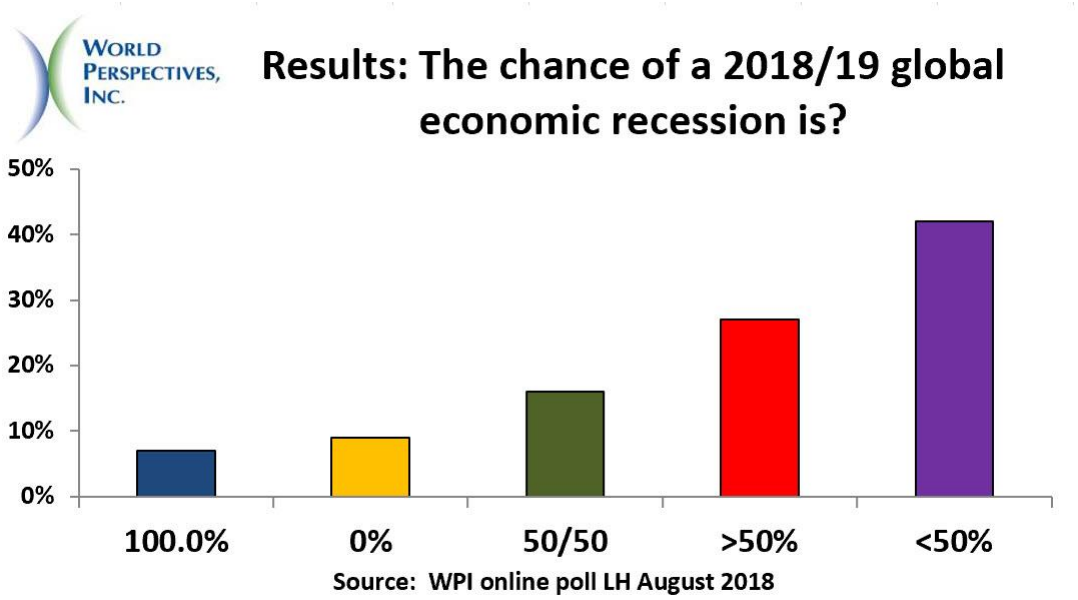
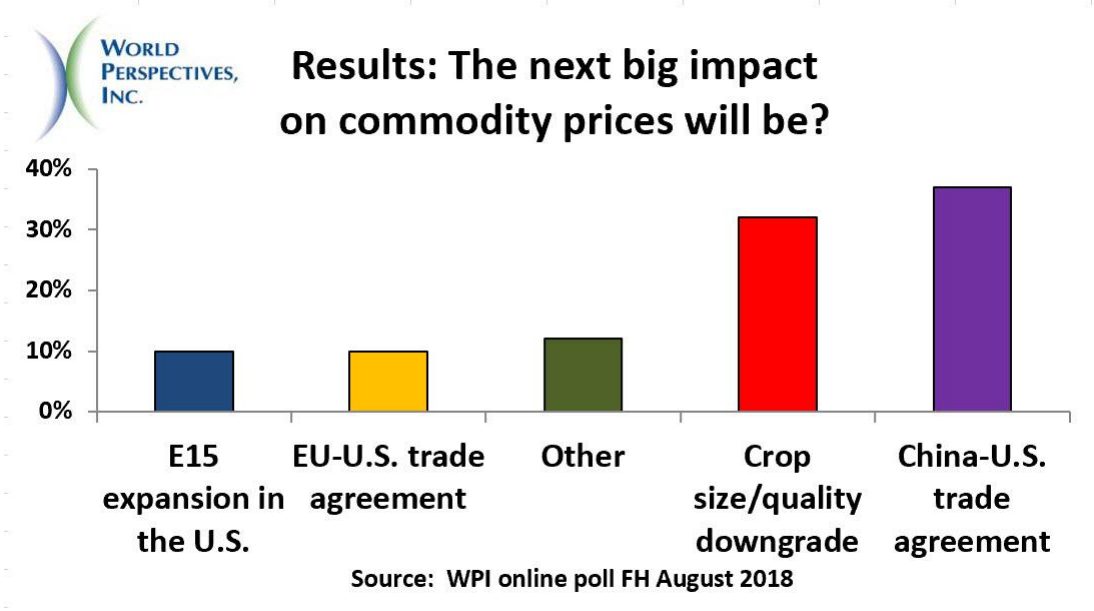
WPI POLLING

Below are the results of two recent WPI polls. Visit www.worldperspectives.com to cast your vote in our current survey.





WPI AGRIBUSINESS SUBSECTOR OUTLOOK

By Matt Herrington

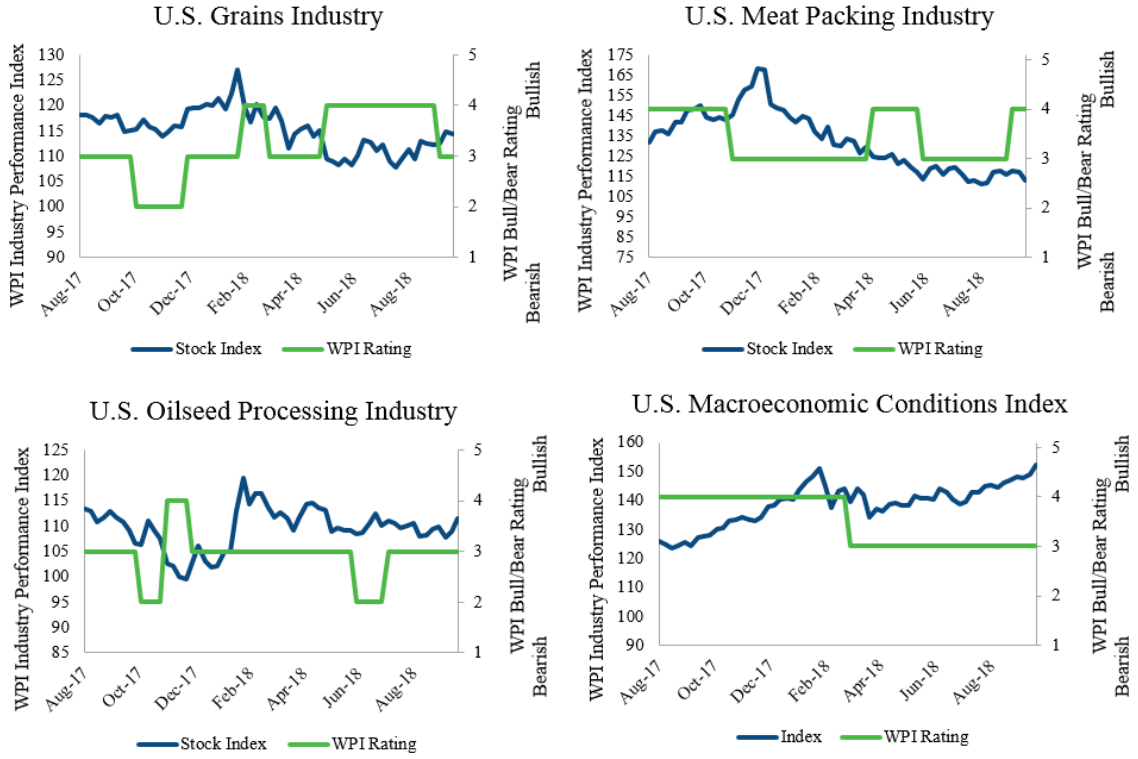
U.S. equity markets have moved up since the July issue of *Ag Review* with the S&P 500 and Dow Jones indexes reaching new lifetime highs. While trade dynamics and geopolitical uncertainties continue to cloud the economic outlook, the lack of impact thus far is at least temporarily boosting investor sentiment.

Agribusiness stocks have generally improved over the past two months with the Grains and Oilseeds Indexes up 5.0 and 0.9 percent, respectively, while the Farm Inputs Index gained 7.8 percent and the Farm Machinery Index rose 9.1 percent.

Disappointing performance from Tyson Foods continues to weigh on WPI's Meat Packing Industry Index despite a bullish outlook reaffirmed by large slaughter margins, especially for beef and pork. WPI's Macroeconomic Conditions Index is up 6.6 percent, thanks to equity appreciation and (relatively) low, steady crude oil prices.

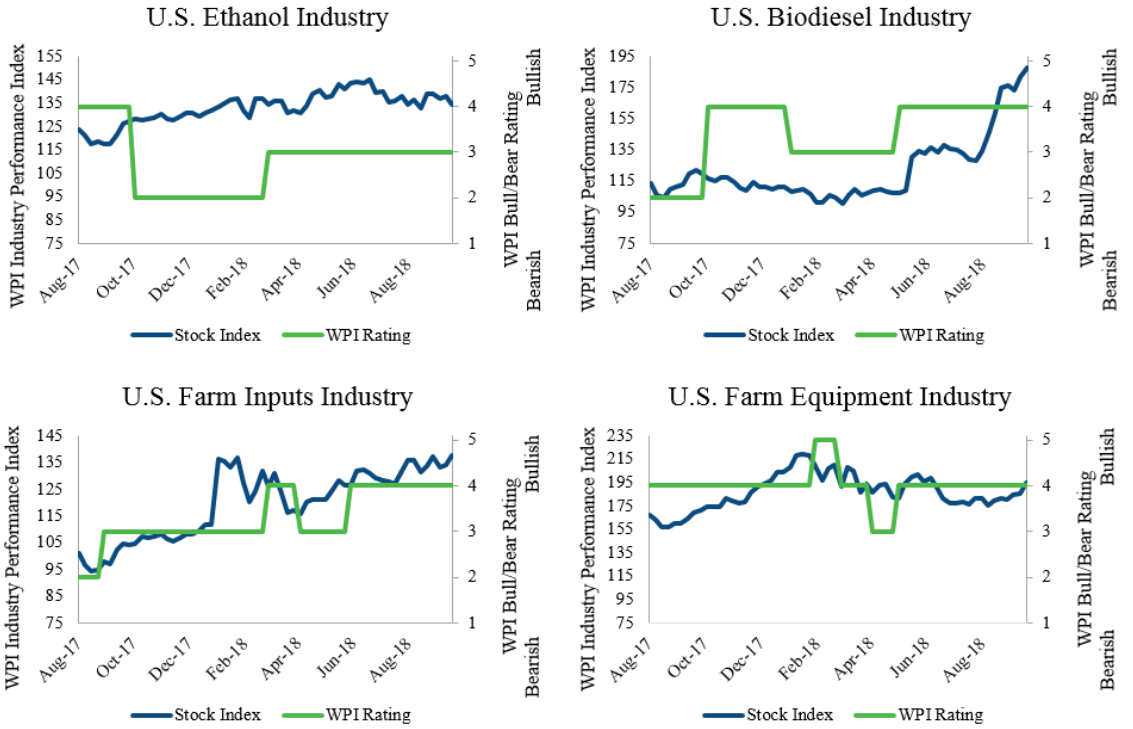
WPI maintains a favorable outlook going forward, although low crop prices and continued trade tariffs remain a threat.

WPI Agribusiness Sectors Stock Price Indexes and Monthly WPI Bull/Bear Ratings



Source: WPI
Indexes are constructed with 1 January 2016 as the base period (index = 100)

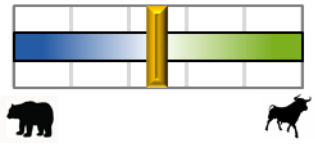
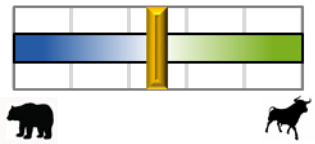
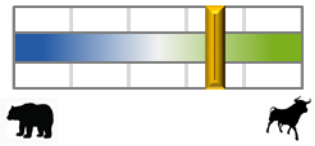
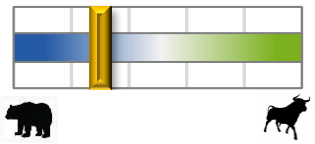
WPI Agribusiness Sectors Stock Price Indexes and Monthly WPI Bull/Bear Ratings, Continued



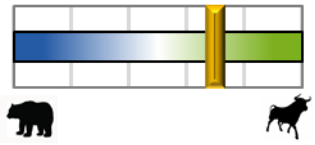
Source: WPI
Indexes are constructed with 1 January 2016 as the base period (index = 100)

WPI BULL/BEAR LEANINGS FOR AGRIBUSINESS

By WPI Staff

Industry	WPI Industry Bull/Bear Rating	Predominant Influencing Factors
U.S. Agribusiness Industry		1. Low crop prices are disadvantageous for farmers but provide upstream processors cheap inputs, which have improved corporate profits in the last quarter. 2. The U.S. trade outlook for soybeans is bleak but steadily improving for wheat. 3. The current crop cycle may provide opportunities from increased market volatility and an environment where demand for grain and oilseeds continues to grow.
Oilseed Processing		1. As long as record stocks hang over the market, potential improvement in soybean prices is poor. 2. Low soybean prices and comparatively firmer product prices have kept U.S. soy crushing margins well above historic norms. 3. The outlook for the U.S. soybean industry can only improve if one of two factors emerge: a poor production year in a major soybean exporter or an end to the U.S.-China trade war.
U.S. Meat and Livestock ***Beef*** ***Pork*** ***Poultry***	  	1. Although domestic demand remains strong, there is a huge supply of red meat and poultry on the domestic market. 2. Production for all species is projected to continue to grow. 3. Despite record red meat exports for the first half of 2018, the outlook for the second half remains volatile and uncertain.

Farm Inputs



1. WPI maintains the neutral-bullish view.
2. Supply and demand fundamentals for fertilizers are generally supportive.
3. Outside support from grains and crude is neutral. Global grain fundamentals are strong, but prices have yet to reflect that. The crude outlook is mostly neutral.
4. Macro factors are starting to weigh more directly on the industry through weakening (emerging) currencies (e.g., India) and punitive U.S.-Chinese trade tariffs (fertilizers ex China).
5. If fertilizers prices are considered the key driver for industry share price performance, they need another move higher to further improve the latter overall.

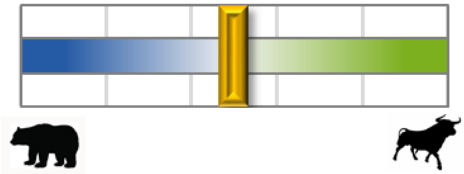
Source: World Perspectives, Inc.

Policy Factor

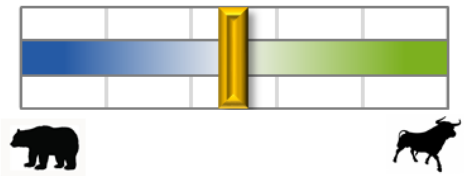
The Trump trade war is on a trend line for peak intensity in early 2019.

WPI Bull/Bear Ratings for Policy Factors Influencing Agribusinesses

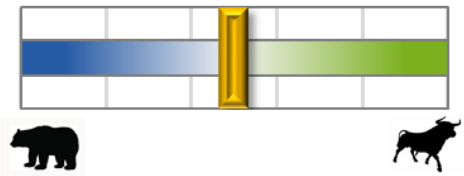
Macroeconomics



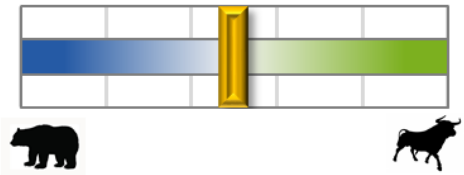
Trade Policy



Agricultural Policy



Food Policy



Geopolitics

Source: World Perspectives, Inc.

U.S. AGRIBUSINESS UPDATE

By Robert W. Kohlmeyer

Top Three Reasons WPI is Neutral the U.S. Agribusiness Industry

- Low crop prices are disadvantageous for farmers but provide upstream processors cheap inputs, which have improved corporate profits in the last quarter.
- The U.S. trade outlook for soybeans is bleak but steadily improving for wheat.
- The current crop cycle may provide opportunities from increased market volatility and an environment where demand for grain and oilseeds continues to grow.

U.S. grain and soy markets have been dominated by three factors over the past six weeks. First, there is growing recognition that the U.S. is about to harvest massively large crops of corn and soybeans. Weather during the Midwestern summer growing season has been varied with some areas experiencing periods of dryness while other areas received too much rain. Overall, however, weather has been generally favorable for the bulk of the major producing areas.

The expectations for very large crops have been fueled by USDA's weekly crop condition ratings. From early June when they first began until now, those weekly reports have shown a historically high percentage of the U.S. corn and soybean crops to be in good or excellent condition. This year's weekly condition ratings have consistently been well above those during the 2017 growing season. They are mainly based on visual appearances that can sometimes be misleading. For many traders and market analysts, though, they are an important measure of the corn and soybean crops' development each year. Some analysts use the weekly crop condition ratings to construct economic models that project national average crop yields with mixed success.

USDA's August WASDE report always contains the first survey-based estimates of the national average corn and soybean yields/production volumes compiled by USDA's National Agricultural Statistical Service (NASS). In the August WASDE, NASS estimated average the soybean yield at 51.6 bushels/acre and total production at 4.586 billion bushels. For corn, the agency predicted an average yield of 178.4 bushels/acre and production of 14.586 billion bushels, which would be the third-largest U.S. corn crop ever.

Since those yield and production estimates were compiled in early August, the market didn't believe those figures at first with private forecasters pointing to early harvest figures from Illinois, Indiana, and Ohio coming in less than was thought necessary for record-breaking yields. Then NASS shocked the market again in the September WASDE with record-breaking corn and soybean yields of 181.3 bushels/acre (BPA) and 52.8 BPA, respectively. Production estimates came in at 14.827 and 4.693 billion bushels for corn and soybeans, respectively. The September WASDE was significantly bearish both markets and has driven them lower since its release.

The second factor dominating the market's attention has been the fallout from the Trump administration's hard-nosed trade policies that have hit U.S. farmers particularly hard. When the U.S. imposed the first round of tariffs against goods imported from China, that country's government immediately retaliated with a 25 percent tariff on a number of items imported from the U.S., including soybeans, pork, corn, grain

sorghums and other agricultural products. This means that China, the largest soybean importer in the world and largest buyer of U.S. origin by far, has effectively closed its market to U.S. soybeans at least for now.

The combination of the loss of Chinese demand and the anticipated huge 2018 soybean crop sent soybean futures tumbling. During the final week of August, the new crop November soybean futures contract tested its low of $8.2625/bushel several times, and it may well fall below that level as the big harvest gets underway later in September. Not only is the soybean market looking at a potential record harvest this fall, it is also anticipating U.S. 2018/19 ending stocks will also be huge without much, if any, demand from China. USDA is projecting that 785 million bushels will be carried over into the 2019/20 crop cycle. That is well over twice the volume of two years ago and could still prove to be low.

As threatened, President Trump imposed tariffs on another $200 billion worth of Chinese exports to the U.S. in his efforts to force China to abandon what are considered unfair trading practices. China promised to retaliate immediately, although it is running out of imported goods from the U.S. to target with new tariffs. This will further complicate U.S.-Chinese trade relations and could indefinitely delay any resolution that might allow U.S. soybeans back into the Chinese market. As of this writing, there are no further trade negotiations scheduled between the U.S. and China, and the two sides remain far apart.

Besides the U.S.-Chinese trade dispute, the future of NAFTA remains uncertain. The U.S. and Mexico have reached agreement on revisions to the original agreement through a round of negotiations that did not include Canada. Following the U.S.-Mexican accord, Canadian trade negotiators quickly returned to Washington in an effort to ensure that NAFTA would remain a three-country trade agreement. However, some major differences remain, including Canada's supply management dairy program that virtually excludes imports of cheaper U.S. dairy products and restrictions on imports of other U.S. agricultural products such as wine. For its part, Canada wants to be exempted from the recently-imposed U.S. tariffs on imported steel and aluminum.

President Trump has threatened to turn NAFTA into a two-party U.S.-Mexican trade deal if Canada does not agree to U.S. demands. However, there is doubt that the necessary congressional approval for a revised trade arrangement can be obtained if Canada is excluded. It is reported that while some progress has been made in the U.S.-Canadian negotiations, differences remain with dairy issues still a stumbling block.

There is no question that U.S. farmers have been on the front lines of the trade disputes resulting from the Trump administration's aggressive trade policy. U.S. tariffs have been met with widespread retaliation from other countries, usually in reciprocal form on goods imported from the U.S. Many of those retaliatory tariffs have targeted U.S. agricultural products because they hit rural areas of the U.S. that largely supported Donald Trump in the 2016 presidential election. The Chinese tariff on U.S. soybeans is a prime example.

President Trump is certainly aware that this counterattack targeting a key base of his support is intended to ramp up pressure on him with the 2018 midterm elections coming up in November. He instructed USDA Secretary Sonny Perdue to devise a program to aid farmers whose incomes are being harmed by falling crop prices due to actions such as the Chinese soybean tariff. In late August, Secretary Perdue announced a $12 billion program of assistance that includes direct payments to farmers who grow soybeans, wheat, grain sorghum and corn. It also includes government purchases of certain fruit and vegetable products that will be used for food assistance programs as well funds to promote U.S. agricultural commodities in overseas markets.

The third dominating market factor has been the potential impact of declining production among most of the major wheat-exporting countries (e.g., Russia, Ukraine, the EU, Australia and Canada) due to adverse weather. It almost seems as though Mother Nature decided to target them

with droughts affecting the 2018/19 wheat crop cycle. The reduction has been particularly significant for Russia and the EU. This sharp decrease in wheat supplies available for export will inevitably force a restructuring of world wheat trade flows.

Russia is the world's largest wheat exporter, and it will no doubt remain so in 2018/19. However, its export volume will likely be 18-20 MMT less than last year. In fact, there is concern among wheat exporters there that the Russian government might decide to intervene and limit wheat exports to 25 MMT by imposing a restrictive export tax as it did in 2014. Because of those concerns, they are rushing to sell and ship as much wheat as quickly as possible. Ironically, this probably increases the chance of government intervention since at the current export pace, Russia's exportable wheat supplies are likely to be nearly exhausted by November.

Assuming world wheat consumption and trade do not undergo a big reduction in 2018/19, the numbers clearly indicate that the lower exportable supplies available from other exporting countries will force demand to go elsewhere. The U.S., being the one wheat exporter that actually saw its production rise this year, will undoubtedly boost its share of world wheat trade in 2018/19, and its wheat futures markets should become relevant again.

As we have often noted before, the last several years have been challenging for many agribusinesses. Big crops in the U.S. and around the world have depressed prices and dampened price volatility, thus limiting marketing opportunities. Fluctuating currencies among developing countries such as Brazil, Russia, India and Argentina have made it difficult to predict how easily or difficult it will be to source grain and oilseeds from producers. For many farmers, owning and holding their crops is their only hedge against inflation and changing currency values.

The large multinational agribusinesses have struggled for margins, evidenced by a few years of mediocre profits. The recently ended 2017/18 crop cycle with big crops and limited volatility was similar to the previous few years. However, the two largest multinationals recently reported their results for FY 2018, which showed excellent and near-record net earnings. Some of this was due to the diversity of their businesses, but some of it also seemed to indicate that they have learned how to better manage themselves to meet the challenges they have been facing. That is a good thing because 2018/19 promises to be another year full of challenges. It also appears likely that this crop cycle may provide some opportunities that result from an expected increase in market volatility in an environment where demand for grain and oilseeds continues to grow.

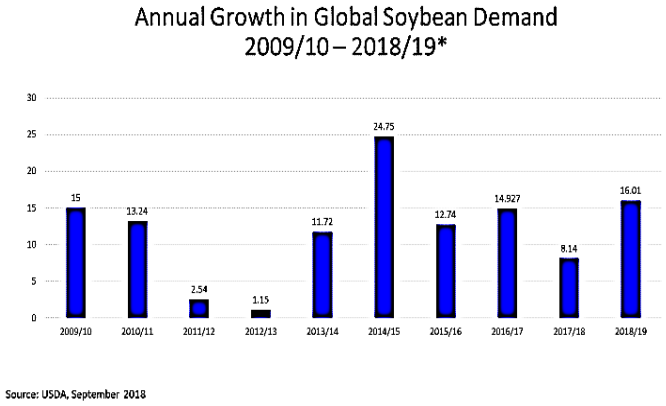
U.S. SOYBEAN INDUSTRY

By John Baize

Top Three Reasons WPI is Bearish the U.S. Soybean Industry

- As long as record stocks hang over the market, potential improvement in soybean prices is poor.
- Low soybean prices and comparatively firmer product prices have kept U.S. soy crushing margins well above historic norms.
- The outlook for the U.S. soybean industry can only improve if one of two factors emerge: a poor production year in a major soybean exporter or an end to the U.S.-China trade war.

The last decade has been one of the best for the U.S. soybean sector. During this time, farmers have seen record soybean prices, fast-growing export demand and record yields. This resulted in soybeans becoming the crop with the largest planted area in the U.S., and the soy sector became by far the largest contributor to the U.S. agricultural trade surplus. However, the year ahead promises to be one of the most challenging it has ever faced.



**2018/19 is a forecast*

Two key issues have come together to make the 2018/19 marketing year a difficult one. First and foremost is the trade war that began in late spring between the U.S. and China, which resulted in the latter imposing an additional 25 percent tariff on imports of U.S. soybeans as of 6 July that brought those shipments to a near standstill. The U.S. exported 36.119 MMT (1.327 billion bushels) there in 2016/17, 57.2 percent of the total for that year. The total in 2017/18 was 27.425 MMT (1.007 billion bushels) prior to imposition of the higher Chinese tariff, and only 0.257 MMT (9.43 million bushels) were exported there afterward.

That tariff and the loss of U.S. soybean exports to China resulted in the price of U.S. soybeans declining by over $1.60/bushel. In mid-September, they were being offered for export at a discount of over $83/MT ($2.28/bushel) to Brazilian soybeans. The trade war has been a godsend to soybean farmers in South America as they have benefitted by becoming almost the sole suppliers to China. The premium they are receiving for their soybeans is expected to encourage even more plantings in the current growing season.

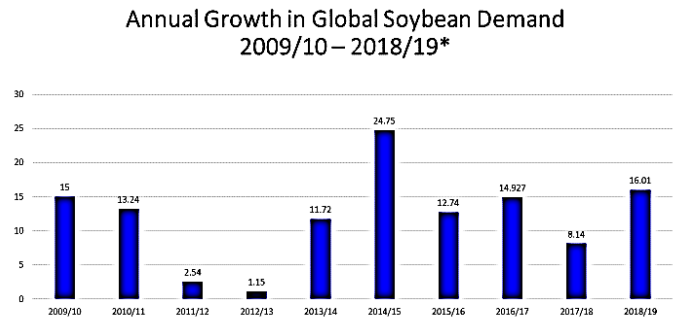
As long as the trade war continues, the U.S. is unlikely to export more than a small volume of soybeans to China. The latter's political leaders have signaled they would rather see China sharply curtail its soybean imports than buckle to U.S. demands for trade policy reforms. Some Chinese importers indicate they have been warned of penalties if they import any even if paying the higher tariff.

Under the current circumstances, the U.S. has no choice but to export as many soybeans and soy products as possible to countries other than China. That clearly will happen as those importers will be unable to source their soybeans from South America. U.S. soybean sales to these alternate markets are already well ahead of a year ago and will certainly continue to increase. However, they are unlikely to make up for the lost sales to China. To make matters worse, Russia, a major soybean importer, has banned any such stocks from the U.S. in retaliation against U.S. and European sanctions imposed after its invasion and takeover of Crimea.

The other major factor that is going to make 2018/19 a difficult marketing year for the U.S. is the record soybean crop it is forecast to produce in 2018. Based on 88.9 million harvested acres and a record average yield of 52.8 bushels/acre (3.51 MT/hectare), USDA is estimating it will reach a total 4.693 billion bushels (127.7 MMT). Some private sector analysts expect the average yield and production to be even greater.

USDA is forecasting total use of U.S. soybeans in 2018/19 at 4.268 billion bushels (116.17 MMT). This includes a forecast for exports of 2.06 billion bushels of soybeans, 12.25 MT of soymeal and 1 MMT of soyoil. Domestic use of soymeal and soyoil are both expected to reach record highs of 32.478 MMT and 9.979 MMT, respectively. However, because combined domestic and export demand are forecast to fall well below soybean production, USDA is estimating U.S. soybean ending stocks at a record high of 845 million bushels (23 MMT), which would be an ending stocks-to use-ratio of 19.85 percent or a 72.5-day supply.

The record U.S. soybean ending stocks are amplified by USDA forecasting global soybean stocks on 31 August 2019 will also reach a record 108.26 MMT (3.977 billion bushels). The buildup in stocks has been a result of the U.S. and Brazil both having six good soybean crops in a row. Even though global demand has grown by an annual average exceeding 12.3 MMT (452 million bushels) over the past six years, that has not been enough to offset the huge increase in global production that has been made possible by excellent weather and superior genetics.



Source: USDA, September 2018

**2018/19 is a forecast*

As long as the record stocks hang over the market, the potential for improvement in soybean prices is poor. This will be particularly the case for the U.S. until its trade dispute with China is resolved. The U.S. is forecast to carry the largest stocks of all soybean-exporting nations, but Brazil is expected to have only minimal ending stocks while the U.S.- China conflict continues.

For global soybean stocks to fall to reasonable levels, the key will be a drop in global soybean production because of lower plantings or reduced yields caused by poor weather. Most likely, U.S. soybean plantings will fall in 2019 due to lower prices, but that is far from certain as prices for competing crops are also down. Lower average soybean yields in the U.S. and South America are not only possible but increasingly likely. After the recent years of high yields in North America and South America, the odds favor one or both having unfavorable weather in the next few years. Poor weather outside of the Americas, however, will not have much impact on global soybean stocks and prices.

Fortunately, the Trump administration has created a Market Facilitation Program (MFP) to make payments to U.S. producers of soybeans (and other crops) to offset a sizable portion of the decline in prices caused by the U.S. -China trade dispute. The payment rate for soybeans has been set at $1.65/bushel, and farmers will be compensated for each bushel they prove was

harvested in 2018. The initial payment is set at 50 percent of $1.65/bushel (82.5 cents) multiplied by the number of bushels harvested. The maximum payment is limited to $125,000 per person or legal entity. There may be a second payment of equal size if the trade dispute with China continues and soybean prices remain depressed.

U.S. soybean farmers can only hope there is a resolution soon and China removes its tariff. Less-than-favorable weather in 2019 would also be helpful. Only then will the outlook for the U.S. soybean sector begin to improve.

THE U.S. MEAT AND LIVESTOCK INDUSTRY

By Dave Juday

Top Three Reasons WPI is Bullish Beef and Neutral Pork and Poultry

- Although domestic demand remains strong, there is a huge supply of red meat and poultry on the domestic market.
- Production for all species is projected to continue to grow.
- Despite record red meat exports for the first half of 2018, the outlook for the second half remains volatile and uncertain.

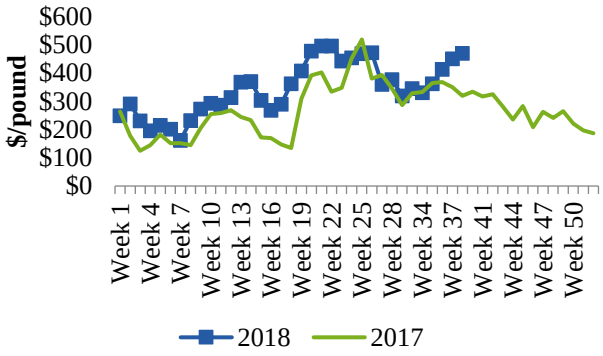
The economic outlook for livestock producers and red meat packers is heavily dependent on the export market. Red meat exports have been growing steadily for the past few years, moving greater volumes of beef and pork that resulted from growing cattle and hog herds. For the first half of 2018, they were running ahead of last year with beef setting a record for value at $7.27 billion and pork reaching record volume at 1.26 MMT. For the second half of 2018, however, the trade status is uncertain.

Pork exports in May and June were down from the earlier months of 2018 but still ahead of January-June 2017 in both volume and value. Beef exports through the period were at record levels and set a monthly record in June. They also hit $4 billion in the first six months of the year, a value that had never previously been reached before August. The July export data released in the first week of September showed continued gains for beef but major hurdles emerging for pork, particularly in the two key markets, China and Mexico.

Beef

Beef packer margins have expanded and are well above last year's levels. With cattle supplies likely to remain large, the driver of future margins will be continued domestic and export demand.

WPI-Estimated Beef Packer Gross Margins

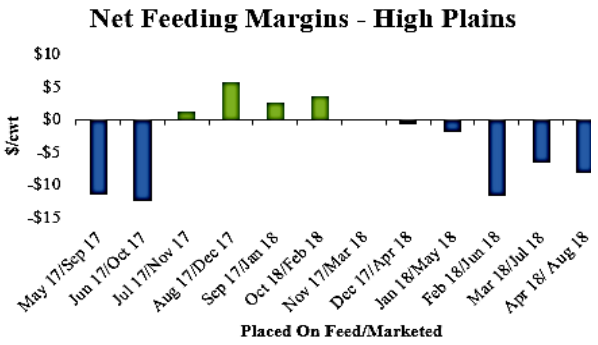


Source: USDA, WPI

The prime summer demand season for beef has passed with the Labor Day weekend holiday now behind, but consumer demand is steady. Retail prices have dropped from the previous years' levels while still remaining solid.

Both retail and cattle prices typically have a significant lag. Decreases in the latter aren't reflected in the former as retailers operate by managing a margin. Likewise, increases in cattle prices also have a lag as retailers try to avoid short-term volatility to maintain sales volumes. The record prices of 2015 certainly were a drag on U.S. consumer demand, but current prices are back at a level to stimulate that demand.

Cattle feeders, however, have been squeezed in recent months. Fortunately, feeder calf prices are usually softer in the fall and will likely follow that trend this year, especially with a large supply and drought conditions affecting grazing and forage supplies. Last fall, though, was an exception as prices remained bullish, which put cattle feeding margins in the red. Some softening in the feeder cattle market will be welcome to feeders as will be the continued softness in corn prices.

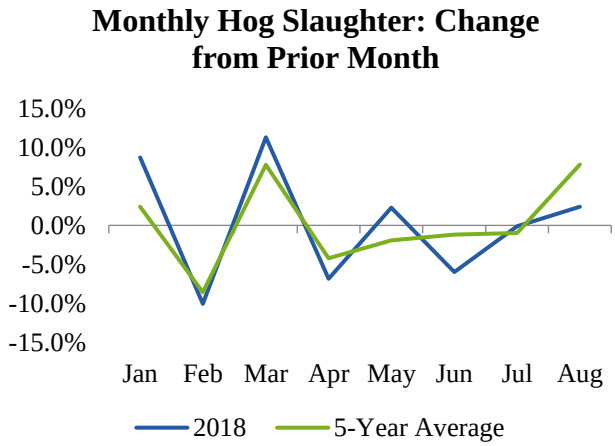


Source: USDA, WPI

On the export side, shipments to Asia have remained strong, and Korea and Taiwan have seen growth of 42 percent and 33 percent, respectively, this year. Exports to Mexico and Japan were up as well despite trade uncertainty in both countries. Shipments to Hong Kong, however, have declined since April. Drought in Australia will likely lead to increased slaughter there and could undermine some of the growth of U.S. exports to Asian markets. There will be a bow wave effect with Australian cattle, however, which will add to demand for U.S. beef in 2019. In all, packers should fare relatively well.

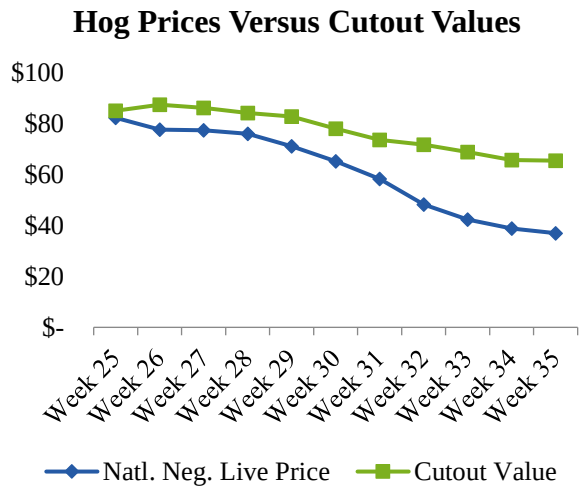
Pork

Hog prices continue to slide on large supplies. As of the first week in September, slaughter was running 2.8 percent ahead of last year. However, there were a number of packing plant interruptions this summer, and some of the slaughter capacity that was added last year has been delayed coming online. At the end of May, cumulative hog slaughter was 3.6 percent above last year.



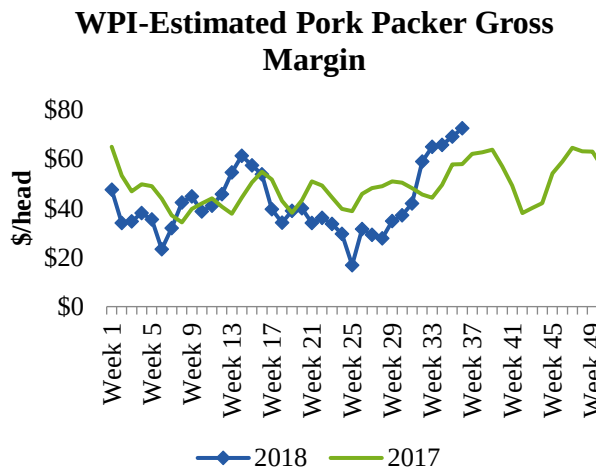
Source: USDA, WPI

Smaller kills this summer helped push hog prices down with the hog price index hitting an 18-year low. At the time of this report, those prices had stopped their three-month slide, although they only increased marginally. Some of that was due to the threat of Hurricane Florence as it headed toward North Carolina, which prompted pork packers in the region to temporarily suspend operations. Nonetheless, the net effect is that hog prices have been pushed down faster than cutout values.



Source: USDA, WPI

Tariffs by Mexico, the largest volume market, and China, the largest by-product market, have been a drag on the pork cutout, but bearish live hog prices helped those packers processing throughput see their average margins rebound from multi-year lows earlier in the summer.



Source: USDA, WPI

The rebound could be short-lived. Typically, pork prices hit their seasonal low in the fourth quarter on slack demand, and production reaches its peak during that season in the lead-up to higher demand around the Christmas holiday. Add to that the overall trade situation, and the outlook is bearish.

There have been spots of welcome news for packers too, however. First, the reports of a NAFTA deal with Mexico in late August helped rally the pork cutout value. Second, uncertainty over the impact of African swine fever (ASF) in China and the potential for culling of the world's largest swine herd have buoyed pork prices, providing at least speculative support for packer margins.

A third factor to consider in the pork market outlook is the additional uncertainty offered by the recent trade mitigation package. Producers will get an $8/head Market Facilitation Payment (MFP) for hogs owned on 1 August (total payments are capped at $125,000 per producer or 15,625 hogs). While the cash flow to producers could be further bearish pressure on the live hog market with additional income reducing economic signals to slow production, the impact could be muted. At an average price of around $40/hundredweight, those hogs earning payments would otherwise generate about $1.75 million in marketings, so the payment rate amounts to an additional 7 percent expected to be earned from the market.

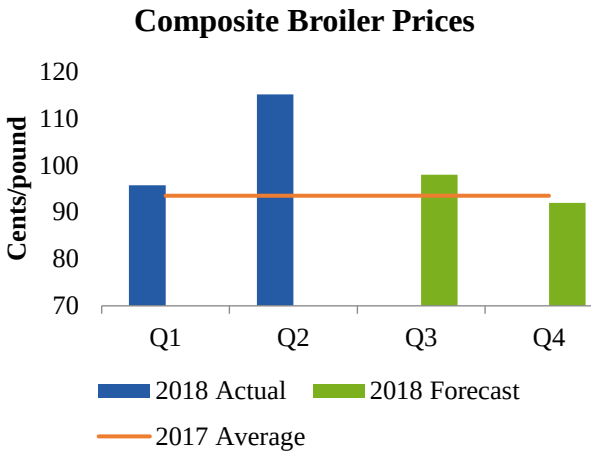
There is also a planned purchase of $558 million of pork from the USDA trade relief package's Market Facilitation Payments (MFP) fund – that's compared to a $14.8 million purchase of beef with a weighted cutout value (70 percent Choice and 30 percent Select) of $209/hundredweight for the week ending 1 September. **That planned pork purchase amounts to more than a week's average kill**, which could help packers. With these many factors at play, it will be interesting to watch the hog and pork market but challenging to trade.

Broilers

Broiler production increased this summer on more birds and heavier weights. Based on July chick placements, September slaughter should be 2 percent higher than the same month last year. However, those placements of August show production in October will be down slightly from a year ago. Given the current market for meat and poultry, there won't be any incentives to expand the breeding flock moving forward, although low

feed costs could be a reason to keep broiler weights high.

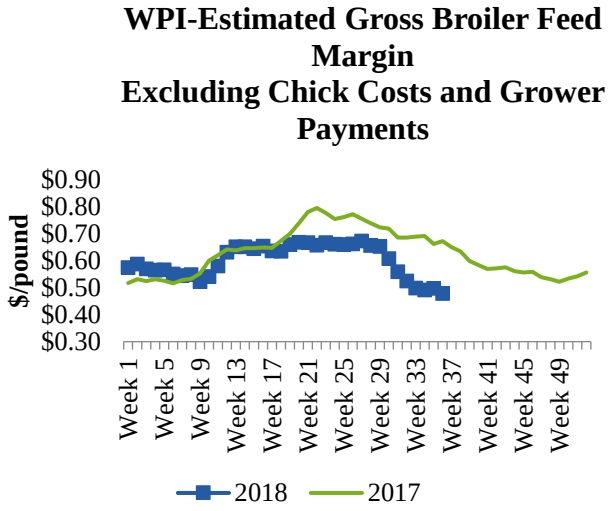
Summer prices followed their typical seasonal patterns but dropped more than anticipated. For the first half of the year, the national average broiler/fryer price held above last year as well as the record levels of June and July 2014. In August, though, the price hit its lowest level since December 2016 in the face of competing beef and pork supplies. Additionally, the large federal purchase of pork has a high likelihood of undermining chicken in federal feeding programs and food donations.



Source: USDA, WPI

Exports of broiler meat were up 2 percent for the first half of the year versus a year ago but below expectations. However, the silver lining to the cloud over the export market is that Mexican tariffs on pork seemingly helped chicken exports by leading to more substitution. Mexico already accounts for about 20 percent of all U.S. broiler exports and was 1.8 percent ahead of last year through the first six months of 2018.

Overall, broiler production is forecast to end 2018 up 2.3 percent with domestic consumption 2 percent higher and exports lagging at a 1.5 percent increase, an equation that will weigh on margins despite lower feed costs.



Source: USDA, WPI

FARM INPUTS

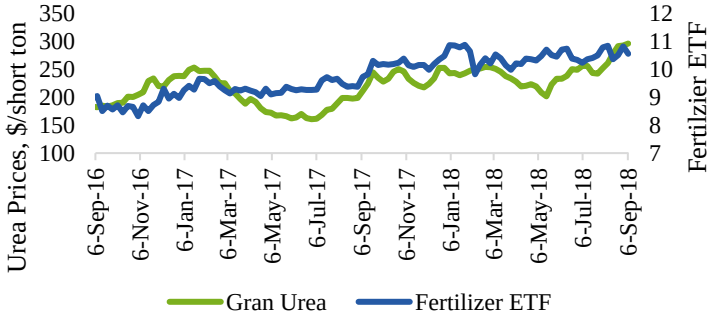
By Joost Hazlehoff

Top Five Reasons WPI Is Neutral-Bullish the Farm Inputs Industry

- WPI maintains the neutral-bullish view of June 2018.
- Supply and demand fundamentals for fertilizers are generally supportive.
- Outside support from grains and crude is neutral. Global grain fundamentals are strong, but prices have yet to reflect that. The crude outlook is mostly neutral.
- Macro factors are starting to weigh more directly on the industry through weakening (emerging) currencies (e.g., India) and punitive U.S.-Chinese trade tariffs (fertilizers ex China).
- If fertilizers prices are considered the key driver for industry share price performance, they need another move higher to further improve the latter overall.

The strong fertilizer price environment is a likely catalyst for stronger industry share price and WPI maintains our neutral-bullish outlook from the July issue of *Ag Review*. In line with that outlook, fertilizer prices have further strengthened moderately, and share price performance improved accordingly.

Nitrogen versus Industry Performance



Source: NYSE ARCA, WPI analysis.

Getting close to the final quarter of the year, the overall sentiment remains positive. This fundamentally supportive outlook for fertilizer share prices may be mitigated by an uncertain macro/geo-political outlook affecting overall equity markets. Consider the following:

- Downward price risk in nitrogen continues to be limited. Prices have been moving up in Europe with demand generally supportive, and prices in Latin America will likely follow suit as demand for the safrinha crop is gearing up. In the U.S., demand is steady while there are only limited import volumes lined up. In India, discussions are ongoing about the timing of the next tender as well as Iran's ability to participate.
- Besides Iran's participation in export markets, there are other issues on the (urea) supply side. Ukrainian supply is struggling with escalating gas costs, which are limiting export volumes. In China, operating rates have improved but are still at low sub-60 percent levels.
- The global phosphates market has improved further since our noting in the July *Ag Review* that we did not anticipate short-term price declines. Strong demand

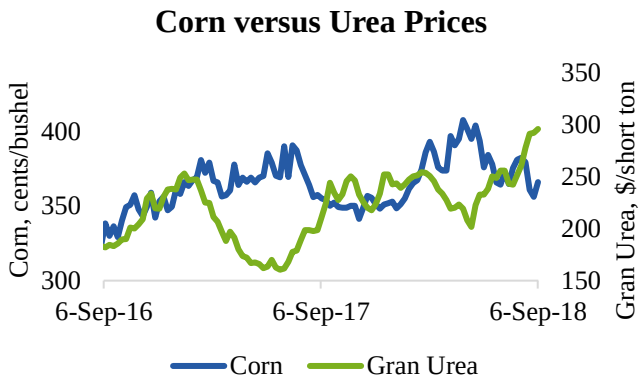
continues to outweigh otherwise high output rates.

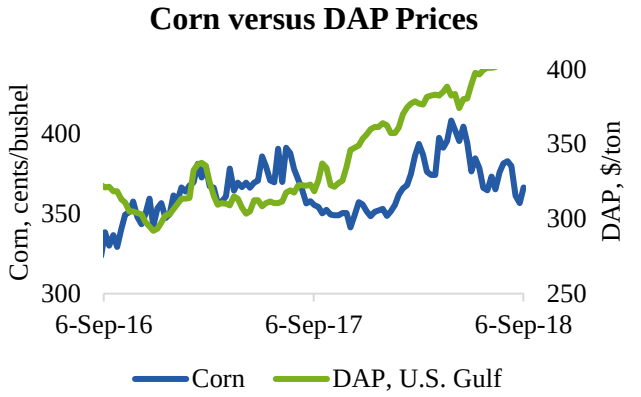
- For producers, higher prices are even more important as the production costs for both ammonia and sulfur have risen considerably.
- Geopolitical and macroeconomic factors are impacting the phosphates market. Among those are: 1) the next tranche of U.S. tariffs levied on Chinese goods that includes a 10 percent tax on fertilizers, which will likely shut Chinese DAP producers out of the U.S. market; and 2) weak emerging currencies starting to weigh on DAP affordability for major importers, most notably India. Helpful (but not enough to make imports feasible at this point) has been the recently announced increase in the maximum retail price.

Near-Term Grains versus Fertilizers

In our previous edition, we noted that despite the urea corn spread closing, a (temporary) price disconnect between the two was warranted as global corn supply and demand fundamentals continued to tighten. Nitrogen prices did indeed improve further despite the reversal in corn prices. We continue to believe that this disconnect is warranted, even now that urea has actually moved well ahead of corn.

A scenario where U.S.-China punitive tariffs remain in place for a longer period is imaginable, and we have noted before that there may be a silver lining for (U.S.) nitrogen demand. A reshuffling of soybean trade flows could push U.S. acres from soybeans to corn in the next 2019 crop cycle. In this scenario, corn prices might suffer on the back of soybean price declines, but the additional corn acreage would support nitrogen demand.

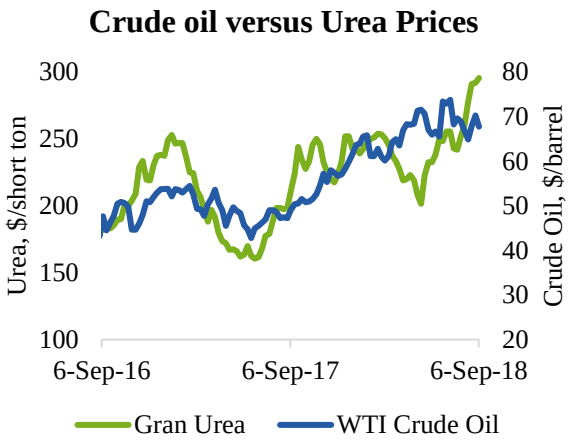




Source: CME, CSI data, WPI analysis

Near-Term Crude Oil versus Fertilizers

While fertilizer fundamentals and outside support from grain markets are both strong, crude oil is unlikely to be supportive. As urea prices have marched higher since mid-May, WTI crude oil has stabilized around $70/barrel in the same period. The historical price relationship between the two suggests further upside for urea prices is limited unless crude moves up. To that point, some observers have suggested that a combination of strong demand and supply uncertainties could bring crude oil closer to $80/barrel. It will be another two months before U.S. sanctions on Iran's oil exports will take effect, but sold volumes have reportedly already dropped considerably. However, OPEC's total output has risen, more than offsetting the lost volume from Iran.



Source: CME, CSI data, WPI analysis

POLICY TRENDS

By Gary Blumenthal

Top Reason Why WPI is Neutral Global Trade Policy

The Trump trade war is on a trend line for peak intensity in early 2019.

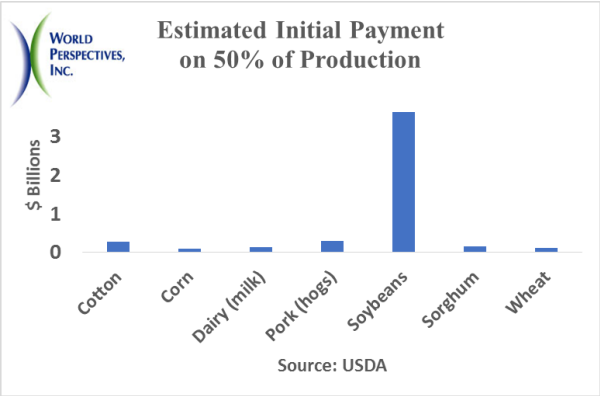
Whether Donald Trump's trade war approach to achieving better terms of trade for the U.S. from China is wise and successful or not, it is being rolled out slowly and methodically. As documented by *Bloomberg*, the two countries collectively have made over 60 announcements over the past nine months, indicating their intentions and parsing out actions. In fact, the latest round of U.S. tariffs was announced at an initial 10 percent, which will not rise to 25 percent until the start of 2019 to allow American companies to adjust.

The tariffs have barely helped some U.S. companies and likely hurt many others, especially the agrifood sector. With Wall Street up from a year ago and the Shanghai Stock Exchange down more than 20 percent, Mr. Trump believes he is winning. Torsten Slok of Deutsche Bank explains that one factor favoring U.S. aggression is that the country has less to lose given that trade is a small component of the American economy. For comparison, exports contribute 10 percent to U.S. gross domestic product (GDP) and 20 percent to China's. Meanwhile, Germany depends on exporting for 40 percent its economic fortunes.

Allianz Group chief economist Mohamed El-Erian gave a 75 percent probability that the trade war would result in better terms of trade for the U.S. Others are not so sure, and most question the ethics of the approach even while acknowledging the need to change China's practices.

Agriculture Impacts

The Trump trade war has been gestating for nine months, and while its impacts have been relatively benign for the larger U.S. economy, the retaliatory focus of other countries against an already bearish agricultural commodity market has imposed significant suffering on America's farms. Politically, the Trump administration was forced to announce a set of "Trade Mitigation Programs," which are to be operated by USDA as a compensation mechanism. USDA found soybeans to be the most damaged by the war, followed by hogs and cotton.



However, as noted by University of Illinois economist Gary Schnitkey, all of agriculture is being adversely impacted. As a result, USDA will also purchase $1.24 billion worth of specialty crops off the market, and it allocated $200 million to bolster export promotion programs. One irony is that the administration has opposed public spending on the export promotion of privately-produced crops and previously tried to cut these outlays via the budget process. **Instead, it has**

now had to nearly double government support as a result of the trade war.

Wrong Focus

Donald Trump was largely elected by focusing on the frustrations of Midwest Rust Belt citizens who had lost their previous well-paying manufacturing jobs. Even though manufacturing has risen in output and productivity gains are the larger culprit for job losses, competition from Mexico, China and elsewhere is an easier target.

At a session hosted by the Center for Strategic and International Studies, six former U.S. trade representatives (USTRs), three Democrats and three Republicans, echoed their concern that policymakers are focused on bringing back the jobs of yesteryear instead of preparing workers for the shift to a knowledge-based society. Even with the tariffs, workers need to prepare for increased automation and the introduction of artificial intelligence. As former USTR Ron Kirk noted, before it was China taking my job, and now it is a robot. Former USTR Bill Brock lamented that politics and therefore policies tend to respond to yesterday and never keep up or get ahead of problems.

WTO Out of Date

All six former USTRs agreed that the WTO's appellate body had overstepped its bounds, creating rulings that were not based on either agreed law nor on the underlying dispute settlement panel's decision. The problem is that WTO rules badly need to be updated, and this has left jurists with just creativity for solving problems. Still, there was agreement that the U.S. tactic of starving the appellate panel of new jurists is not the best tactic for solving the problem, even if the approach was developed by President Obama and simply extended by his successor.

There is a block of like-minded countries that acknowledge the WTO is out of date. Former USTR Sue Schwab says there have been no new rules since the Uruguay Round went into effect in 1995 even as much of the world has changed. She goes on to note that the construct of the NAFTA agreement completed in 1992 provided Uruguay Round negotiators with concepts that were subsequently adopted globally. Her hope is that a plurality of countries will similarly develop the 21st century trade rules that eventually get adopted by all WTO members.

There was agreement amongst these former officials that the U.S. taking on China alone was a mistake. Former USTR Carla Hills correctly contends that China is a problem for many countries and a coalition would have more influence. In fact, a coalition could use the WTO's dispute settlement procedures, arguing that Beijing has nullified and impaired its obligations to other members for national treatment and nondiscrimination.

Ms. Schwab concedes that the Trump tariffs have for the first time gotten China's attention. If the result is that they stay in place, this will have been a very large mistake. However, if Mr. Trump's trade war against China achieves progress, it will be viewed more akin to the Reagan Doctrine that brought an end to the Cold War.

Worse Case

Even before the U.S. economy hit its longest period of expansion in July, various economists were weighing the risk factors that will cause a downturn. Some stress over an interpretation that the stock market is overvalued, using former Fed Chairman Alan Greenspan's colorful description of investors' "irrational exuberance." More on point is a focus on developing country debt, particularly as a strong U.S. dollar complicates repayment. Some even fret over the debt levels of major economies like the U.S. and Japan. Nearly all cite the trade war as a risk factor for retrenchment. The one upside is that none of the soothsayers are warning of the kind of deep recession experienced last time.


WORLD PERSPECTIVES
AT THE NEXUS OF POLICY & MARKETS