The Ghost In The Machine

ADM

ADM Investor Services
International Limited

EDITORS NOTE

Q3 EDITION

Q3

Pandemic, Agriculture, Sugar, Gold, Brexit, Hydrogen, Mental Health, Asset Price Bubbles, Uncertainty

Welcome to October 2020 edition of the Ghost In The Machine, which is again unsurprisingly dominated by the Covid-19 pandemic and its impact on markets and the global economy.

As the biannual London Sugar Week approaches, there are in-depth looks at the prospects for demand and supply in the sugar market for the new season.

Mental health issues in the Agricultural sector have been something of a taboo subject for decades, but nevertheless a lived reality, but finally there are some initiatives at a national level in a number of countries to create support communities to discuss the many challenges such as safety, work life balance and persistent financial uncertainty.

As the Federal Reserve shifts to Average Inflation Targeting, an obvious question is why a traditional 'inflation hedge' such as Gold should be outperforming so many other asset classes, we take a look at some of the other factors behind the rally.

Ultra easy central bank monetary policy in the developed world is clearly here to stay for a number of, if not many years to come, but are the sharp rallies in equity markets really a bubble that is close to bursting, and what is the evidence from models?

Brexit related deadlines are fast approaching, and this will have consequences for the UK and EU financial sectors, what are the key issues, above all in operational terms from a regulatory / legal perspective, and will cool heads prevail?

The EU has put environmental and climate change related issues front and centre of its recovery plans, above all establishing the EU as a world leader in hydrogen technology, we take a look at its strategy outline, and offer some introductory background on the various forms of hydrogen energy.

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THE GHOST IN THE MACHINE

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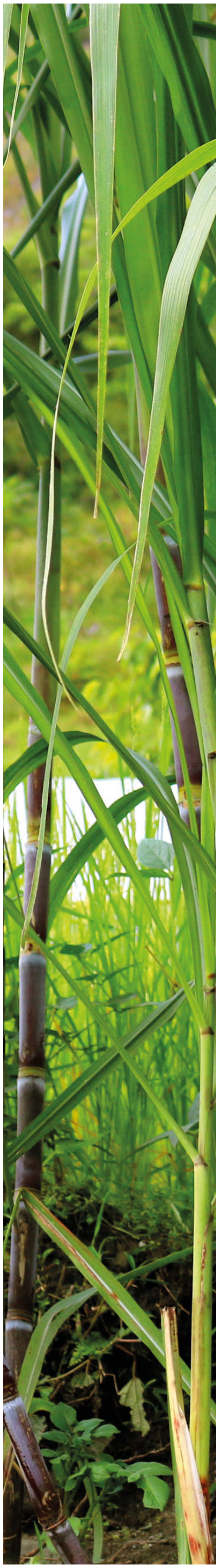

SUGAR, FROM PANIC TO HOPE.

We are 6 months from the start of the Coronavirus pandemic and for many commodities, the ongoing question is 'what are the consequences to demand?'

We had massive price drops in March and not just for Sugar, as the panic spread out with fear of recession, higher unemployment and consequently lower demand.

We saw the OPEC+ producers addressing the fall in prices by cutting demand. Crude prices plummeted, causing companies to implode and banks to cut working capital to Trading Companies. Surely the worst must be over for now?

Since March we have seen a general support to economies with quantitative easing (printing money), lower interest rates (some negative) and lower taxes (directly or indirectly), all aiming to contain the panic and support economies, therefore avoid higher unemployment.

We can say that in the short term all these measures helped a great deal and as a result the markets are behaving in a positive mood highlighting "investor's" beliefs, at least on the short term, that the worse was avoided, at least for now. For Demand, we can say that the worst fears of massive drop in consumption, especially in Agri products, was also avoided.

In terms of Sugar, we estimate that during **April/March 2019/20 demand may have risen 0,65% and for April/March 2020/21 the drop in demand may be limited to 1,1%**.

It's early days, but based on the strong export flow, even if some stock re-building is taking pace (which it is), the flow supports the "theory" that demand wasn't largely affected. Time will tell and we shall stay on the case.

What about the Supply side? Well, we started the year with expectations of a small Sugar surplus, then the numbers got bigger with expected large drop in consumption. The weather hasn't been too kind to some European/CIS Nations (Beet growers) and Thailand had a large acreage reduction. Australia was expected to have a better crop but is yet to put a good performance.

The EU crop area is expected to shrink 3% and the expectation for Beet yields are for a drop of 2% vs. the average for the last 5 years, marginally better than last year. The current EU crop is estimated at 16,7 mln m/t give or take a few.

The CIS is also going to disappoint with lower acreage (Russia seeing a 15% reduction) and total CIS Sugar production may end lower than 8 mln m/t dropping over 2 mln m/t.

WE ESTIMATE THAT DURING APRIL/ MARCH 2019/20 DEMAND MAY HAVE RISEN 0,65% AND FOR APRIL/MARCH 2020/21 THE DROP IN DEMAND MAY BE LIMITED TO 1,1%.

Thailand acreage is expected to be 32% lower and total cane crop may not reach 65 mln m/t as the weather slowly improves but is yet to be better than last year. The lower crop in 2019/20 and similar exports is allowing Thailand to clean up their stocks, starting 2021 with hardly any sugars in the warehouse and a likely lower sugar production.

The cane crop in **Vietnam** is also not expected to recover from the drop of this year, which resulted in over 900k m/t of imports.

The good news, for consumers is that **India** is on track to have a decent crop, perhaps close to 32 mln m/t an increase of 7 mln m/t, as Maharashtra should rise from 6 to at least 9,5 mln m/t. The market is waiting for Cabinet approval of the 2020/21 export program. At this stage is expected a repeat of last year i.e. 6 mln m/t with "incentives" close to US$ 145 per m/t.

In the West the **USA** is expected to have a much large Beet crop and a better Cane crop resulting in an increase of 1,1 mln m/t and **Mexico** should be back to 6 mln m/t.

Brazil is having to deal with a lower economy and therefore higher unemployment which is also causing a weaker Real and lower fuel demand. We have seen an improvement from March but we are yet to recover lost ground. Brazilian CS Millers are still maximizing Sugar vs Ethanol, given the better returns (**Hydrous worth around UScts/lb 10,50 basis 96 pol**) therefore we are heading to a large Sugar production, likely above 37 mln m/t an increase of 10 mln m/t from last year. The Northeast Sugar production is also expected to improve with a better cane crop, higher ATR and stronger Sugar Mix.

At this stage we estimated the **Sugar S&D for April/March 2019/20 in 11,5 mln m/t deficit and Oct/Sept 2019/20 a deficit of 2 mln m/t**. We had a strong start of the Brazilian harvest, with strong Sugar Mix and higher ATR, allowing for the crop to be 7,9 mln m/t higher YoY by end of Aug.

The 2019/20 deficit allowed for many sugar producers and some consumers to reduce stocks.

So, we have lower expectations for the EU, CIS and Thailand, with no great improvements, if any at all for Australia, Central and South America and most growth limited to Brazil, India, USA and Mexico.

Based on the current scenario, we expect the **Sugar S&D for April/March 2020/21 at 4 mln m/t surplus and potentially a 1 mln m/t surplus for Oct20/Sept21, all going well**.

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MENTAL HEALTH IN AGRICULTURE… IT'S TIME TO TALK ABOUT IT!

Poor mental health in Agriculture is an issue for all of us!

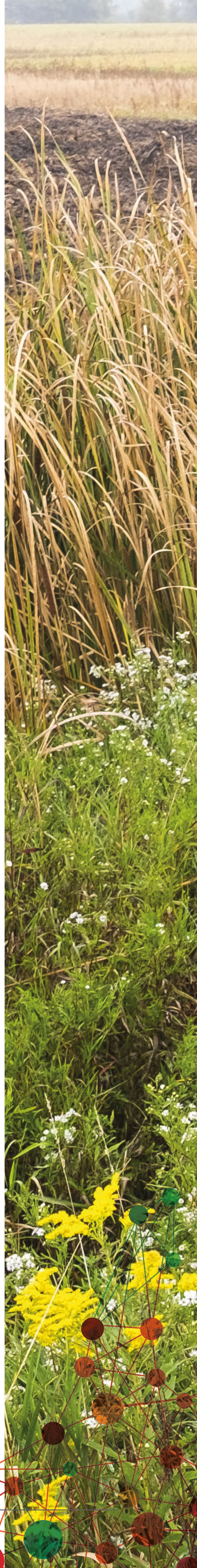
It was 2017…in Saskatoon…in Canada. A meeting was underway of APAS (Agricultural Producers of Saskatchewan Association). The panel session, which contained eminent members of Farm Credit Canada and senior members of the farming community had finished their discussion. They had now an open mic session…anyone from the audience, an audience with an average age of 65+, could come and speak and ask questions of the panel. They waited in some trepidation. It was hard to know what to expect and what would be publicly said. A farmer…in his 70's approached the microphone…members of the panel looked worried. The first thing out of his mouth was…'It's about damn time we started talking about mental health in Ag. This has been a problem, it's been around my entire life, it's always been here. If I count the number of friends and neighbours I've lost to suicide, I'd run out of fingers.'.

That was the moment many in farming in that part of Canada really started to see the need for mental health awareness. From this one event various Ag industry stakeholders launched an organisation to help farmers and to extend the conversation. This example of one part of the industry, in faraway Canada, facing up to this fear that has largely remained unspoken…is noteworthy.

"'IT'S ABOUT DAMN TIME WE STARTED TALKING ABOUT MENTAL HEALTH IN AGRICULTURE…'"

Farmers and their families…because this does include their families, face a set of challenges to their mental health that are unique, whether they be in Canada, the UK, the EU, the USA…or elsewhere. What many outside the industry see as a somewhat bucolic lifestyle may disguise a business being kept afloat… sometimes barely, which may have been in their family for generations. It is constantly being challenged by changing crop prices, rising farm costs, obtuse government policies, questions over direct payments/ support programmes…and of course natural disasters. Add to this a proud and stubborn reluctance to seek help and a lack of rural mental health support and structures in the first place…and you can see that the hardest thing to do is the simplest…to ask for help! On top of this, it was of course…before all the global effects of COVID-19 hit the world and added that to the list of pressures.

In a February 2020 issue of Farmers Weekly in the UK, the Farm Safety Foundation noted some 84% of farmers under 40, please note – a different demographic to the one in Canada, believed mental health was the biggest danger facing the industry, up from 81% in 2018. Farming has some of the poorest safety records and 85% of young farmers believe mental health is linked to the overall safety of their farms. They noted the continued masking of symptoms such as 'smiling depression', PTSD, loneliness and rural isolation. The stress factors, not dissimilar to those mentioned in Canada, of long extended time working in isolation, a blurring between work life and home plus financial uncertainty all contribute to stress factors affecting mental health.



> '...THE HARDEST THING TO DO IS THE SIMPLEST... TO ASK FOR HELP!'

The beginnings of a way to combat these has already been started. In Canada they started by rallying round the community to talk about this issue. In the UK, as Stephanie Berkeley – manager of the Farm Safety Foundation put it 'It is encouraging to see more discussions about mental health, more awareness of the mental health conditions and more emphasis on the support available to the farming community. However, more still needs to be done'. She continued... and it seems it is an echo of how farmers are the world over 'While farmers are often culturally ill-equipped to discuss mental health issues, one of the most effective methods in combating stigma is talking about it'.

Poor mental health in Ag is an issue for all of us, it is not the responsibility of someone else. It is up to each of us to watch out for those we know in the industry... friends, colleagues, neighbours, families...and even ourselves...in these challenging times.

If you would like to know more on how to tackle poor mental health in the UK then you can visit the Farm Safety Foundation at www.yellowellies.org. In Canada you can visit Do More Ag at www.domore.ag . There are other organisations elsewhere which support the mental health of the Ag industry. A first step seems always be...'It's Time to Talk About It'.

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A GREEN RECOVERY?

In the June edition, I noted that there was ever increasing debate about a 'green recovery' and how the economic costs of an abrupt shift have always been patently obvious, but how the lockdowns in many countries have nevertheless set a precedent for more decisive action.

Prior objections based on the cost of a 'green transition' fall sharply down the list of key considerations, at least from a government spending perspective, as this is the type of focussed and forward-looking infrastructure investment which will be needed to 'give wings' to the post Covid19 recovery phase. It was also noted that there would be numerous and differentiated challenges, in both developed and developing economies, be they related to the migration of energy resources, or prioritisation of other infrastructure needs, which have been often woefully exposed by the pandemic.

So called 'Green' energy has something of a chequered history, with the rise and fall of solar PV cell manufacturing industry in Europe in the early party of this century, offering a series of point lessons on the many potential pitfalls in planning and developing such 'holy grail' type initiatives. As was the case with solar, the EU with Germany very much in the vanguard, is looking to put 'hydrogen' at the forefront of its efforts to become 'climate-neutral' by 2050, and the EU is more than well aware that its primary competitor will be China, though Asia will also be in the vanguard. I make no pretence of having any expertise in this area, so this article is primarily a short introduction for other laypeople based on what I have learnt from initial investigations.

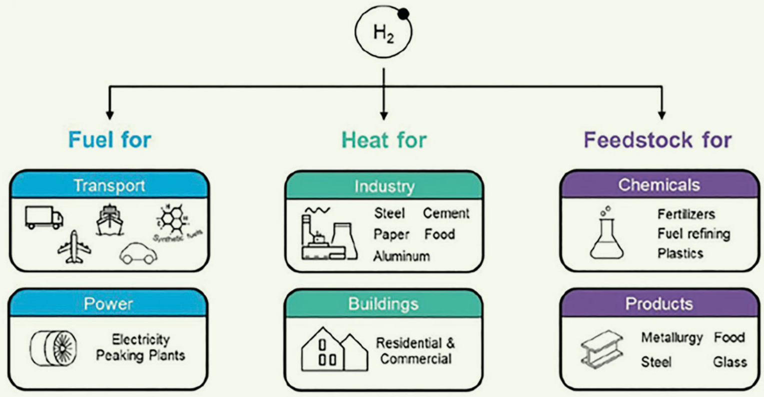
For Germany, there is a strong element of self-interest to help transition some of very large engineering companies that have been at the forefront of hydrocarbon energy production into a new era, for example gas turbines are reckoned to be easily converted to hydrogen. As German Economy Minister Altmaier noted earlier in the year "We want Germany to be the global No. 1 in hydrogen technology"; while the EU's 'hydrogen strategy' has the stated aim of create an industry that 'supports' up to 1 million jobs, and a multi (tens of) billion Euro market. One might well ask 'why now', given that hydrogen fuel cell technology has been around for a number of decades.

The simple answer would be the confluence of necessity (both due to pandemic economic 'scarring' and climate change targets), technological evolution and, the fact that it plays into a hunger for investment into the 'next big idea', particularly in an environment of a protracted period of ultra-low interest rates and financial repression. That said, there should be no illusions that this is going to be some form of instant success in commercial terms, or in climate terms. The EU strategy paper underlines this, setting targets from a current installed base of just 0.1 gigawatts (GW), of 6.0 GW by 2024, 40.0 GW by 2030 and 500.0 GW by 2050.

As with so many innovations in energy and transport, the key to unlocking hydrogen as a cornerstone of energy production is to fund the investment in the technology that will ultimately bring the sort of scale, which reduces the cost of making renewable hydrogen dramatically. Standardising manufacturing processes will also be a key part of this.

By way of some additional background, there are four type of hydrogen: brown which has been around for hundreds of years, and is a product of coal 'gasification', which produces syngas from which hydrogen can be distilled. The only problem is this process also generates large volumes of Carbon Monoxide and Dioxide, and indeed methane, in other words it is very heavy on pollutants, even if quite cheap to produce. Grey hydrogen comes from natural gas and is currently the most common sources, but the catalytic process (also known as SMR 'steam methane reformation') that breaks the hydrogen from the hydrocarbons produces a lot of CO2, though it is currently the cheapest thanks to the low price of natural gas. Blue Hydrogen is in principle a variation on Grey, but also use Carbon Capture and Storage (CCS) to eliminate the carbon emissions. The problem is that while CCS does obviate the floating costs of Carbon Tariffs, the vast majority of CCS 'projects' are centred around older oil and gas fields. The hydrogen that is produced can help to 'decarbonise' the gas, but above all in Europe, there is a lack of common standards. The holy grail of Hydrogen is Green, which by using renewable energy eliminates polluting chemicals completely, by creating hydrogen from water and electricity by electrolysis; but at the current juncture the electrolysis is very costly. The other downside of this currently is that it diverts renewable energy away from the main electricity grids, per se resulting in higher usage of polluting hydrocarbons. This is above all where upscaling is needed on all fronts, initially for the production of electrolysers on a much broader scale, which in turn can be used in so called 'hydrogen valleys' to produce Green Hydrogen initially for heavy energy usage industries (such as steel, and oil and chemical refineries), before widening the supply to other industries.

Figure 1: The many uses of hydrogen



Source: BloombergNEF

In other words, the critical initial step is to create the infrastructure for production. The natural train of thought is how this might be applied to the auto sector, in which it will like play a potentially critical role, with the battle between traditional battery EVs and those utilising hydrogen fuel cells likely to be a brutal one, above all in terms of providing the refuelling infrastructure. However it is the transportation sector, be that haulage, buses or aeroplanes, where the impact may be largest, and again where the impact may be most substantial in terms of emissions reductions.

As I do more research into the sector, there will be further articles, but as a summary of where hydrogen can and will likely be deployed, this graphic from Bloomberg's New Energy Forum (NEF) is a good point at which to conclude.

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GOLD AND THE FEDERAL RESERVE'S "AVERAGE INFLATION TARGETING"

One of the historic drivers of the price of gold has been the fear of inflation. So, with the lack of any serious inflation threat on the near-term horizon, why has gold put in such a stellar performance?

There are a variety of short-term bullish influences that have taken December gold futures to the record high of 2089.20 on August 7, 2020. One thing to keep in mind is that while traditional thinking is that gold is a hedge against inflation, it is also an excellent hedge against uncertainty and adversity in light of the global political uncertainties, especially the U.S. November elections, the ongoing tensions between the U.S. and China, the U.K. Brexit negotiations with the E.U., recent U.S. dollar weakness and the cloudy global economic outlook. When have times been more uncertain than they are now?

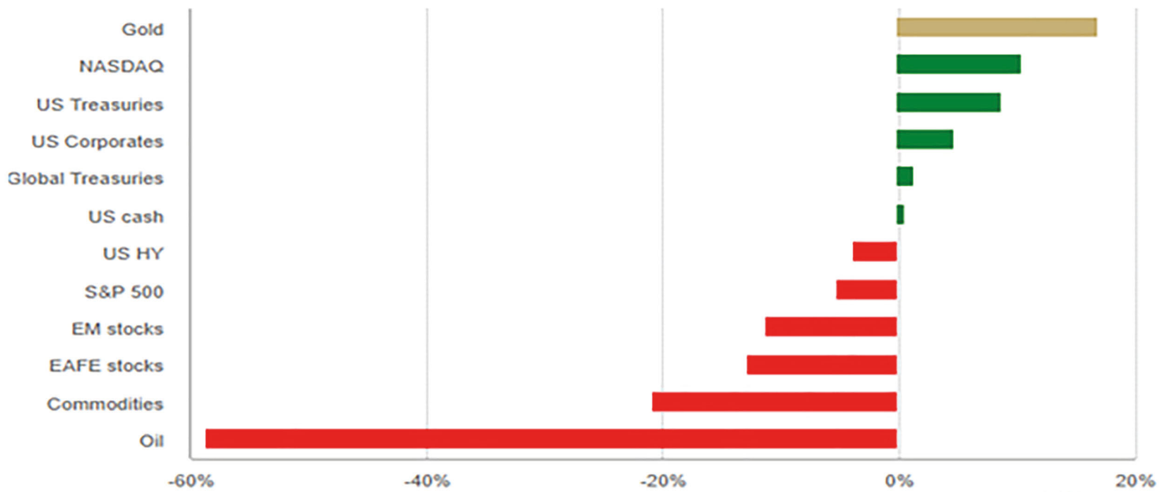
CENTRAL BANKS ADD TO THEIR GOLD RESERVES

In addition, gold has been supported by aggressive central bank buying in recent years. Central bank demand came in at 650.3 tons in 2019. That was the second-highest level of annual purchases for 50 years, just slightly below the 2018 net purchases of 656.2 tons. According to the World Gold Council, 2018 marked the highest level of annual net central bank gold purchases since the suspension of dollar convertibility into gold in 1971, and the second-highest annual total on record. Before the 2007-2009 financial crisis, central banks were net sellers of gold worldwide for decades. Central banks started out 2020 buying more gold, although the rate of purchases slowed somewhat recently as central bankers focused on economic stimulus efforts. In spite of this, the World Gold Council expects central bank demand to continue over the next 12 months.

So, what do central banks know and why have they collectively bought so much gold in recent years? Are they anticipating inflationary pressures eventually? Whatever their reasoning is to acquire gold there is one rule of thumb to keep in mind. That rule is that often it can be financially advantageous to follow what the strong hands are doing in any market, and currently that would include gold.

"BEFORE THE 2007-2009 FINANCIAL CRISIS, CENTRAL BANKS WERE NET SELLERS OF GOLD WORLDWIDE FOR DECADES."

Chart 1: Gold outperformed all major assets in H1, Y-t-d perfromance of global assets*



Source: Bloomberg, ICE Benchmark Administration, World Gold Council; Disclaimer
*As of 30 June 2020. Returns based on the LBMA Gold Price PM, Nasdaq Composite, Bloomberg Barclays US Treasury Index and Global Treasury Index ex US, ICE BAML US 3-month T-bill Index, Bloomberg Barclays US Corporate and High Yield Indices, MSCI EM Index, Bloomberg Commodity TR Index, MSCI EAFE Index, S&P 500 Indices, and Bloomberg Oil TR Index.

"POSITIVE YIELD" FOR NONINTEREST BEARING GOLD

Another reason for gold's spectacular rise could be its newly acquired status of providing a "positive yield" when compared to negatively yielding sovereign debt in parts of the world. One of the major criticisms of gold ownership in the past is that it produces no income except for central banks that have been able to loan it out. Recently, for the first time ever, gold does provide a "positive return" of zero when compared to the negative yielding debt that exists in parts of Europe and in Japan, which may become even more negative. Some investors are becoming so risk adverse that they are actually willing to pay to hold some bonds.

UNPRECEDENTED FISCAL AND MONETARY STIMULUS EFFORTS

The gold market has benefited from the potential inflationary ramifications of massive new stimulus programs from major industrialized countries that include in the U.S., the U.K., the E.U. and Japan, along with extremely accommodative monetary policies almost everywhere in the world.

A NEW LONG TERM BULLISH FUNDAMENTAL; "AVERAGE INFLATION TARGETING"

In addition to the ongoing bullish short-term fundamentals, a new long-term fundamental has emerged and that is the "average inflation targeting" policy that was formalized by Federal Reserve Chairman Jerome Powell at the Kansas City Federal Reserve's 44th Annual Economic Policy Symposium on August 27 and 28. Chairman Powell called for a "robust updating" of Federal Reserve policy and signaled looser monetary policy for longer.

The central bank has formally agreed to a policy of "average inflation targeting," which means it will allow inflation levels to run "moderately" above the Fed's 2.0% goal "for some time" following periods when the rate of inflation has run below that objective. The Fed said it would seek to achieve its 2.0% inflation goal on average, in what Mr. Powell referred to as a system of flexible inflation targeting. He explained this new policy codified how the Federal Reserve had already been operating, allowing for inflation to go above its target.

Some analysts believe the policy is vague in that the central bank has left undefined how it will find this "average" of inflation, in part because there is no equation. Mr. Powell said, "In seeking to achieve inflation that averages 2.0% over time, we are not tying ourselves to a particular mathematical formula that defines the average." In addition, the Federal Reserve also left undefined how much of an overshoot of its inflation target would be acceptable. Inflation on an annualized basis is well below the central bank's official target, and if this current low inflation rate is sustained, it could argue for a large overshoot to make up for the long period of below target inflation.

Chart 2: Gold Futures - Weekly

Source: Chart from QST

In an attempt to soothe investors' fears of potential excessive inflation as a result of the policy, Mr. Powell said tolerance for inflation over 2.0% would be modest. In addition, Dallas Federal Reserve President Robert Kaplan said he could live with an overshoot of 2.25% to 2.50%. St. Louis Fed leader James Bullard said he could see a sustained 2.5% inflation path to make up for what has been lost by past inflation shortfalls. In spite of these assurances, traders believe there is a much greater long-term inflation risk in the U.S. now than before the Jackson Hole Symposium. Rather than get lost in the math, the Fed's new policy suggests that the central bank will probably be very dovish for a really long time. The inability for the Federal Reserve and other major central banks to hike interest rates possibly for years has major inflationary long-term implications for gold.

The shorter-term fundamentals in recent years took gold futures to new highs and now there is a much longer-term bullish fundamental, the Fed's "average inflation targeting" policy. For a variety of reasons, it appears that the flow of funds into gold may just be getting started.

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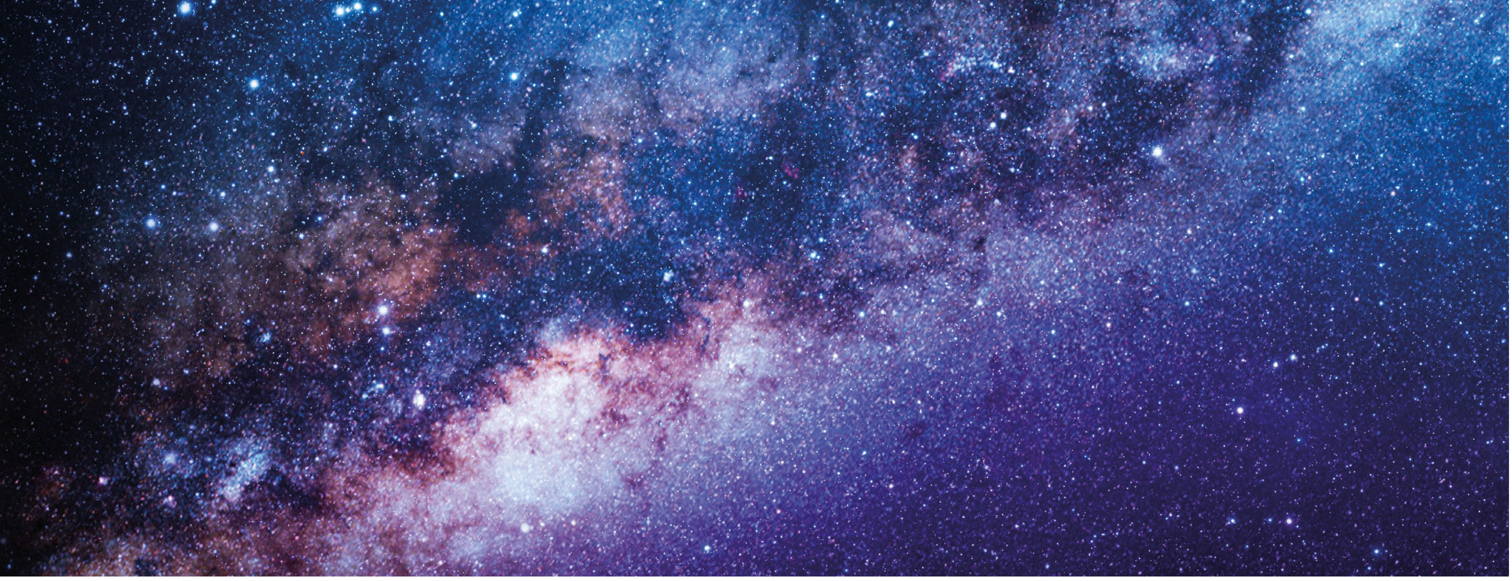


SONOLUMINESCENCE

Sonoluminescence - when a bubble bursts the energy turns into light...

Markets wobbled in the first week of September. The sharpest falls have occurred in the tech sector and other pods of excess such as TSLA and the new "gold rush" mania surrounding the biotech space. Those that espouse the theory that these stocks are or were in a bubble, that would soon pop, will be convinced that the recent weakness suggests that investors are finally starting to see the light. Is this a correction or the start of a structural reassessment of valuations in some areas of the market – basically is the market another bubble bursting and another crash?

The problem is that defining bubbles is perennially difficult. A good starting point or a hint that the market has overshot is investors, who have missed the move, bleating. But let's get a little more scientific. I am indebted to the analysts at CLSA for a more rigorous attempt at a definition. Their checklist is based on 7 criteria that need to be met to meet the requirements of a bubble based on observations over the past 43 years. Namely;

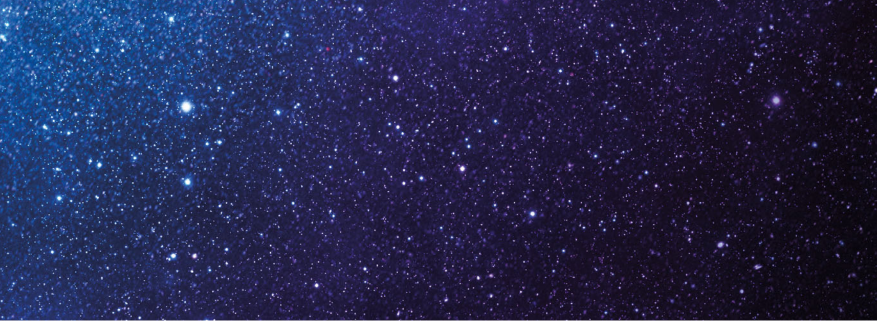
> *A GOOD STARTING POINT OR A HINT THAT THE MARKET HAS OVERSHOT IS INVESTORS, WHO HAVE MISSED THE MOVE, BLEATING*

1. price gain of 555 percent over a 52-month period,
2. rising trend for four years or more,
3. gains of over 119 percent over the past 12 months,
4. 55.7 percent premium to its 200-day moving average,
5. 10-day average true range (ATR) of over 2.4 percent (volatility),
6. prime momentum divergence and
7. churning price action or a V-shaped reversal pattern.

CLSA declared that the current performance of the NASDAQ 100 does not meet the requirements... "yet" (my emphasis). The index chart reveals that it is failing on at least three of the criteria and by quite some way, and although I gave it a pass on the momentum divergence argument, that remains a little too flaky to be taken as conclusive.

Chart 1

Source: Bloomberg



However it appears that the criteria outlined by CLSA is not met in many cases at all.

Thus, this is not a bubble...

Chart 2

Source: Bloomberg

Nor this...

Chart 3

Source: Bloomberg

Or this...**the NIKKEI surge of the 1980s'**

Chart 4

Source: Bloomberg

or indeed, controversially ....this!

Chart 5

Source: Bloomberg

The reasons given for the first week sell off in some of the more expensive stocks seemed to swirl around but never actually pointed to that old fashioned trading technique of someone actually selling. You can wrap it up in the Tesla shareholder rebalancing story and the SoftBank rumours (which if true creates a real credibility deficit for this company) but it all amounted to someone selling in an illiquid market (ahead of a US holiday) and it caught investors off guard.

However this is not a bubble bursting. It wasn't in 2000 either, according to CLSA, but that's where the similarity ends and why the Nasdaq 2020 version will recover quickly. The Nasdaq of 2020 has become a safe haven in troubled times. The balance sheets of the index's major stocks are fortress like. AAPL now has market cap that is bigger than the value wiped off the whole market in November 2000 when the market was down 75%. Many companies now enjoy a position that is very close to monopoly status. The pandemic has brought in to sharp focus how businesses operate. New working and indeed shopping practices have benefited many tech stocks. I know I'm flying very close to the sun here ... "it's different this time" is a phrase that I have often derided. However I haven't even mentioned the biggest difference of all and that is the Fed. In February 2000, having talked up stock valuations the year before, Alan Greenspan (was he really a "great' Central Banker?) announced plans to aggressively raise interest rates. The Fed of 2020 has just announced that it will not be raising rates for at least five years, will not raise rates even if inflation rises and will not create unemployment as a quid pro quo to keeping inflation in check. This is the promised land for growth stocks.

"THE NASDAQ OF 2020 HAS BECOME A SAFE HAVEN IN TROUBLED TIMES. THE BALANCE SHEETS OF THE INDEX'S MAJOR STOCKS ARE FORTRESS LIKE."

"THE RISK THAT MR TRUMP REFUSES TO CONCEDE AND THE RISK FOR WIDESPREAD CIVIL UNREST IS VERY REAL. THE ECONOMY IS ALSO PROBABLY STALLING - THE LOW HANGING FRUIT OF ACTIVITY STARTING UP AGAIN IS BEHIND US."

But this is not a comparison between now and 20 years ago and the real question is do we get back on the horse? At this point probably not. Headwinds are increasing. Event risk is on the horizon. September is always a tricky month but especially so when there is an election in the year. Election analysts can't agree on what's a good outcome. A clean sweep for either side is good but then again the market has done well under a gridlocked political scenario. The pandemic has changed the methodology of voting. Postal votes will dominate. We may not get the result for days after election day. A repeat of the previous contested election result in 2000 on a much bigger scale, without the magnanimous gestures of the rivals, is a huge risk. The risk that Mr Trump refuses to concede and the risk for widespread civil unrest is very real. The economy is also probably stalling- the low hanging fruit of activity starting up again is behind us. US Consumer confidence has started to soften again with mortgage delinquencies at highs and loan defaults rising. Euro PMIs' have moved lower. A no trade deal between the U.K. and Europe now appears something the U.K. government is actually targeting. The five minutes before midnight scenario is wearing thin. Positioning is no longer a positive and short interest is historically low at this time. So it could be a tricky end of the year for investors to negotiate but let's have no more talk of bubbles bursting. They are like hen's teeth. I concede that we are seeing some blind speculation – how many other SoftBanks are out there nursing losses? I would not touch TSLA, and the Biotechs also look an area where there is more hope than substance in some stock prices. But if the Fed- the most important game in town- continues do whatever it takes then the selloff in growth stocks should act as a buying opportunity. The game changer will be the production of an effective vaccine that will throw sector rotation in to a tailspin and test the Fed's new policy on inflation.

Remember, the last thing that can kill a rally is valuation.

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"A NO TRADE DEAL BETWEEN THE U.K. AND EUROPE NOW APPEARS SOMETHING THE U.K. GOVERNMENT IS ACTUALLY TARGETING. THE FIVE MINUTES BEFORE MIDNIGHT SCENARIO IS WEARING THIN."

SUGAR TREAT

Every two years in October the good and great of the sugar industry meet for the London Sugar dinner held at the iconic Guildhall in the heart of the City of London. In the days before the dinner, attendees enjoy drinks receptions held by brokers and trade houses and discuss the markets and the future.

This year it would have been 10 years since our first ADMISI 'Sugar Treat' event which comprises of presentations and drinks. Sadly, the global Covid-19 pandemic has put paid to the dinner and our reception with both being cancelled. It has been a great disappointment as we were looking forward to showing off our new office which we moved into mid-September.

At past ADMISI Sugar Treat events, I dust off my crystal ball to look into the future trying to predict production, consumption and, of course prices. While there is no London Sugar dinner this year I thought it is an opportunity to do the same in this article.

Back in the middle of October 2018 sugar prices were higher than current levels. They had just started to improve from a 10 year low after a two-year decline from over 23 cents. Raws were trading at 13.40 and whites at 371.00 so the nearby white premium was valued around 75.00. However, elsewhere it was a different world. WTI was close to $70 per barrel and the Brazilian real was at around 3.75. The funds were around 48k lots short. The decline in prices had been triggered by massive global production in the 2017/18 season. The season was extraordinary in many ways. Unprecedented perfect weather for growing sugar cane and beet was seen right across the globe. Virtually all the world's major producers; Brazil, India, Thailand, the EU and the United States, produced record amounts of sugar resulting in a massive surplus of over 10 million tonnes.

However, the 2018/19 season saw a drop in global production as low prices began to bite despite another record Indian production. A global deficit of around 1 million tonnes was seen. However, stocks from the previous season weighed on prices which remained in a very narrow range.

Fast forward to the present day and the world is a very different place. The Covid-19 pandemic has caused unprecedented change. The world economy has been hit very hard. Stocks markets crashed, crude prices collapsed and commodity prices followed as the world went into lock-down. While the situation has improved from the dark days of March and April it is still a very uncertain world. Sugar has, of course, not been immune, hit by a double whammy of the unexpected increase in Brazilian production and a drop in global consumption. At the beginning of the year analysts were predicting a sizable global deficit in production for 2019/20. Price responded by rallying to their highest level in two years in February only to sink to a ten year low as the pandemic took hold. A deficit of just over 2 million tonnes is still predicted for the current season but analysts expected the 2020/19 season, which starts in October to move back to a global surplus.

So how large a surplus? Global production is likely to increase with Brazil and India leading the way. We are getting well into the second half of the 2020/21 Brazilian CS harvest and sugar production, as at the end of August is over 43% higher than at the same time last season. This is due to two factors. Firstly, the huge drop in ethanol demand due to low crude prices and the impact of the lock-down on fuel usage in Brazil. Secondly, the weakening of the Brazilian real which has dropped from 4.00 to 5.35 against the USD this year.

The combination of these two factors has meant sugar production has become much more profitable than ethanol. For the past two seasons Brazil has struggled to get sugar production above 30 million tonnes. This season their total production could breach 40 million tonnes. India's production is likely to return to close to the record levels seen in 2018/19 of just over 33 million tonnes after dry and then very wet weather hit their cane crop last season when total production barely reached 27 million tonnes. EU production is likely to drop to around 16.2 million tonnes from 17 million tonnes with dry weather and disease causing issues with the banning of neonicotinoid pesticides in many EU states. The biggest decline is likely to be in Thailand. Back in 2017/18 the country produced a record 14 million tonnes of sugar. Next season some analysts believe production could halve to just over 7 million tonnes due to a prolonged drought and competition from other crops primarily Cassava. It is likely Chinese and Russian production will drop next season due to weather issues but in no meaningful way. Currently, most other producers will see similar production levels to the current season. Therefore, total global production is likely to hit around 181 million tonnes in 2020/21.

Consumption is much harder to predict. Never easy in the first place but add in the pandemic impact and it becomes even more difficult. Most analyst see consumption having taken a hit because of the global lock-down. Therefore, total consumption has probably dropped this season for the first time in living memory year on year. The big question is whether it recovers next season. Despite the on-going pandemic consumption could start to creep back to levels seen before the pandemic as the world begins to live with the virus. However, a possible global economic recession could also impact on demand. The usual increase because of population growth will also help. But, it is a very uncertain situation especially as sugar consumption has been targeted as being unhealthy with sugar taxes being introduced across the world. The debate on whether it is necessary to get people to limit their intake of sugar and whether taxing sugar products has the desired effect on obesity levels will continue. The historic linear increase of 2% a year in consumption is unlikely to be resumed for the time being.

Therefore, for 2020/21 season global production is likely to rise and consumption static at best. This suggests a production surplus of 3-4 million tonnes. This means global stocks are likely to increase. India has struggled to export its surplus over the past three years and has had to resort to giving 'incentives' to farmers much to the anger of other major producers.

Assuming a meaningful surplus for next season prices are unlikely to improve considerable from their current levels. Indeed, they could slip lower but it would seem unlikely to see a collapse to the levels of April. A recent Reuters poll had 12 cents as the expected level by the end of the year.

All the above is based on the current fundamental and macro picture. In these exceptionally uncertain times much can change. The world economy is very fragile and no one knows the course the pandemic will take. Will the USD continue to weaken? A weather issue could change the fundamental picture. The 'La Nina' weather phenomenon has recently developed. Could that bring drought conditions to the CS regions of Brazil? Will the Indian monsoon end with flooding of the cane crop as happened last year?

Let us hope that by the time traders do congregate again in London for the 2022 dinner the world is back on its feet and sugar prices are much closer to 20 than 10 cents.

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"WTI WAS CLOSE TO $70 PER BARREL AND THE BRAZILIAN REAL WAS AT AROUND 3.75. THE FUNDS WERE AROUND 48K LOTS SHORT. THE DECLINE IN PRICES HAD BEEN TRIGGERED BY MASSIVE GLOBAL PRODUCTION IN THE 2017/18 SEASON."

COUNTDOWN TO BREXIT

I love deadlines. I like the whooshing sound they make as they fly by.
-Douglas Adams

As news outlets have been dominated by Covid-19 during 2020, Britain's former topic-of-choice polemic – Brexit – has taken something of a back seat. One scenario, in which doomsday was predicted, has in effect been superseded by a more real and serious one.

For financial services, the key milestone during this year of Brexit transition was June: the date on which assessments for "equivalence", hailed by both sides as the central basis for the future relationship, were due to have been completed. Despite a flurry of activity and assertions of commitment at the beginning of the year, inevitably this deadline came and went. As of September 2020, there is still is no deal and not even this interim step – envisaged under the Withdrawal Agreement signed earlier this year – has taken place.

To many, the odds of getting any deal, let alone one that addresses the failings in the current EU equivalence regime that were identified early in the process[1], are looking increasingly unlikely. Financial services firms and market participants on both sides of the Channel must now finalise their preparations and implementation measures for a "no-deal" Brexit.

The solution to Brexit planning has been sector-specific and business-specific, because relevant exemptions and regulatory sensitivities vary considerably. Some UK firms have large numbers of EU customers; others have few. For activities such as banking, EU member states are loathe to require their citizens to close down accounts at UK banks. For activities such as clearing, any Brexit without mutual access to infrastructure could lead to adverse events of a systemic nature. However, brokerage businesses (and others regulated under the MiFID II regime) have been rather "hung out to dry" by both the EU and UK. They have been used somewhat as a bargaining chip. Such firms are neither retail-y enough to attain political attention like the banks, nor apparently systemically important enough to warrant mutual recognition. For EU firms accessing the UK, a generous temporary recognition regime was announced years ago, and there is no issue, at least in the short term. For UK firms accessing EU customers, no accommodation has been offered of any kind.

Brokerages have therefore faced difficult choices – to invest in costly overheads of a new EU customer-facing business, to muddle through using applicable exemptions, or to wait around and hope for the best. For UK firms, their options have included taking the following steps:

1. A Template for Enhanced Equivalence: Creating a Lasting Relationship in Financial Services between the EU and the UK, Barnabas Reynolds, Politeia¸ 2017.

1. HOW MANY CUSTOMERS AND HOW MANY COUNTRIES?

A key to understanding exposure is to work out how many EU customers the brokerage has, and where they are located. Many EU clients will have UK affiliates that can be pressed into service, removing the risk of services being seen as taking place cross-border in law. Relatively straightforward back-to-back group arrangements can be established to allow services to be provided to the client within the UK, and then shared within the corporate group of the client.

In addition, it is key for UK brokers to understand which countries they are dealing with and where their exposure lies. For example, Luxembourg has announced its own national equivalency regime for MiFID II; the UK will doubtless be added to this upon Brexit, allowing frictionless provision of clients to the important fund and other customer bases in that country. Italy has also announced (but not yet enacted) a temporary regime. Other countries have been less inviting. For example, Belgium has announced a temporary regime for UK firms, but the compliance costs and overhead involved would be akin to setting up a national brokerage in the country. And the likes of France have offered little more than a disowning of exemptions at EU level, such as reverse solicitation, extending even to threats of prosecution for UK firms wishing to deal with their local customers.

"IT IS KEY FOR UK BROKERS TO UNDERSTAND WHICH COUNTRIES THEY ARE DEALING WITH AND WHERE THEIR EXPOSURE LIES."

2. REVERSE SOLICITATION

EU law provides for a regime called "reverse solicitation".[2] This allows UK firms to service existing clients and continue to perform regulated activities with an EU counterparty, solely under UK law and regulation, provided that the provision of the service was initiated exclusively by the client.

It has long been established that a non-EU firm that informs its clients about available products within existing business relationships falls under the scope of the freedom to provide requested services, and does not require a licence. The most recent iteration of the "reverse solicitation" wording- in MiFID II- does not affect this analysis, and protects contractual provisions such as these established with a client in advance of the end of the implementation period for both existing and future service offerings.

Providing information about existing and new services in accordance with a contractual provision would not jeopardise the original (legitimate) basis for the underlying business relationship. The client has simply, and of its own initiative, contractually obliged the firm to inform it of new opportunities that may be of interest.

There is, however, something of a game to be played out. Firms hoping to rely on reverse solicitation need clients to agree, and many clients will need to be repapered to ensure that the most robust documentation of the relationship premised on a reverse solicitation is in place. One option being considered by several firms is to inform the client that, without more, the relationship would have to be terminated, but if they wish to continue receiving services into 2021 and beyond, then the client would have to solicit the firm in writing. Some firms are providing a template letter to effect that solicitation, providing all the representations and warranties that would be needed for both sides to have maximum confidence in the new arrangements.

2. For much more detail on reverse solicitation and how it work, see: On the Existence of a Pan-European Reverse Solicitation, Shearman & Sterling Client Perspective, 19 February 2019; The Art of the No Deal: How Best to Navigate Brexit for Financial Services, Barnabas Reynolds, Politeia¸ 2017.

3. ESTABLISH AN EU PRESENCE

If Mohammed will not come to the mountain, then the mountain must at least consider establishing foothills near Mohammed. Some local EU presences for firms, (including local directors, local compliance and so on) will certainly be required initially, as will a certain amount of regulatory capital and operational capability. There will also be embedded costs and legal and operational risks (for clients) associated with double-intermediating clients with two entities, as they access the vast liquidity available in London through the new intermediation of an EU financial entity. As a result, such structures have proven unpopular with EU clients. Finally, ESMA has acted politically and has made clear that it wishes risk to be located locally. There is therefore some risk that this structure is made even more unattractive and that ESMA will use its position to apply pressure on national regulators to require firms to ramp up activities within the EU.

However, it is possible to do better than simply establishing an EU presence and incurring the significant costs of splitting a trading book between EU and non-EU clients.

These costs can be avoided by adopting some form of back-to-back, agency or give-up booking model. There are various variations on these models. The basic premise for them all is that, where EU clients are unable to trade with the UK entity and are instead required to trade with the EU affiliate of the UK investment firm, the EU affiliate enters into some form of reciprocal arrangement (either novation, or back-to-back, or trading as agent for the UK entity). This should reduce regulatory capital and operational and risk-management capacity requirements, as all of the EU affiliates' exposures should be hedged by the back-to-back arrangements.

> *"PROVIDING INFORMATION ABOUT EXISTING AND NEW SERVICES IN ACCORDANCE WITH A CONTRACTUAL PROVISION WOULD NOT JEOPARDISE THE ORIGINAL (LEGITIMATE) BASIS FOR THE UNDERLYING BUSINESS RELATIONSHIP."*

4. CARRY ON WAITING FOR EQUIVALENCE?

There is still hope. It continues to be the case, objectively, that a deal is in both sides' best interests. There remains some optimism that we are seeing the final throes of an exhausting game of bluff, and that a deal (or at least sufficient agreement to allow for mutual equivalency) will materialise after all.

Slightly more grounded are those that note that a grand deal is not really necessary in many cases. Early myths about a "cliff-edge" resulting in reams of contracts suddenly becoming unenforceable have now been largely dispelled.[3] Moreover, although most often deemed a failing in the EU's approach, the fact that the current equivalence regimes constitute a plethora of different standards providing for different access, means that, even in the absence of a grand Deal (with a capital D), individual equivalence determinations may be made, on a unilateral basis, where this is clearly in everyone's best interests.

Concerns about certainty – that one side might suddenly withdraw equivalence on little or no notice – seem overblown. Derivatives clearing between the US and the EU takes place on the basis of this kind of unilateral equivalence declaration, without any real fear that the determination will be capriciously revoked. That said, the recent non-renewal by the EU of its equivalence arrangement for the Swiss stock markets demonstrates how politically fraught these decisions can be, and certainly adds weight to the view that long-term stability probably requires some kind of mechanism around revocation in due course.

3. See the dismissal of some of that alarmist analysis in Continuity of Contracts and Business on a Hard Brexit: Human Rights and Reverse Solicitation to the Rescue!, Shearman & Sterling Client Perspective, 31 October 2017.

"THE EU HAS JUST ANNOUNCED – ON 21 SEPTEMBER – THAT IT WILL ALLOW THE UK TO CONTINUE CLEARING EURO DERIVATIVES UNTIL JUNE 2022."

Yet given that, on 1 January 2021, the UK's laws will still be identical to the EU's, it is not implausible to think that enough of these equivalence determinations will be in place – on a regime-by-regime basis – to make life easy enough. The question then arising – namely, how far can the UK and EU, once they are independent legal entities, diverge from one another without jeopardising equivalence status – is a political one for down further the line.

Already, there are signs that cooler heads are prevailing. The EU has just announced – on 21 September – that it will allow the UK to continue clearing euro derivatives until June 2022. This means that EU banks will continue to be able to clear through UK CCPs, such as LCH Clearnet and ICE Clear Europe, which are part of the City of London's offering as the biggest global centre for derivatives trading. This looks like a win for the UK but, in fact, a proper analysis shows that the EU itself stands to lose the most by cutting itself off from the liquid markets of London. The better analysis is that this is evidence that there are grown-ups somewhere, presumably meeting quietly over Zoom calls, to make sure that when it comes to the really important decisions, politics gives way to reality, and the necessary steps are taken to prevent any serious damage.

In other words, as printed in large friendly letters on the front of Douglas Adams' Hitchhiker's Guide to the Galaxy: *DON'T PANIC.*

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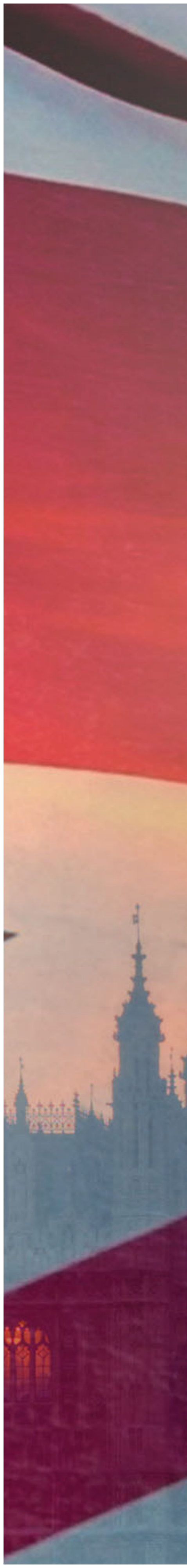
21 September 2020

4. Senior Associate, Shearman & Sterling. The author is grateful to Barnabas Reynolds and Thomas Donegan for their comments on an earlier draft of this article. All faults that remain are his own.



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13/10/20 | 11.00AM

SPEAKER:
Diarmuid O'Hegarty, Compliance Director at ADMISI is joining a panel session on 'Understanding the regulatory landscape for commodity trading to avoid issues down the line' .

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15TH ASIA PACIFIC ETHANOL CHAIN SUMMIT

21/10/20 - 23/10/20

PRESENTATION:
Eddie Tofpik presenting 'Global Sugar, Grains & Ethanol Markets Currency Risk under the 'New Normal''.

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13TH BIOFUELS INTERNATIONAL CONFERENCE & EXPO

23/03/21 | 02.15PM

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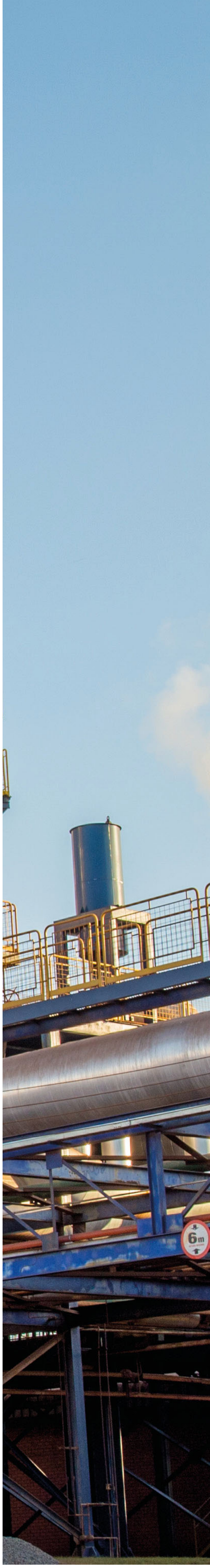
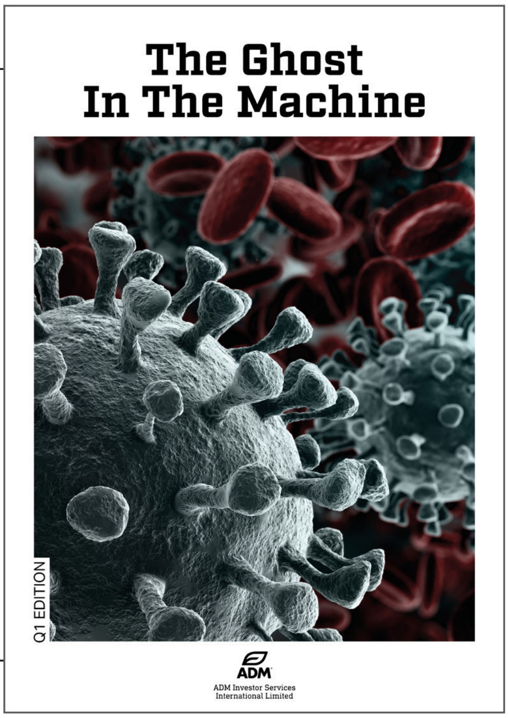


2020 EDITIONS

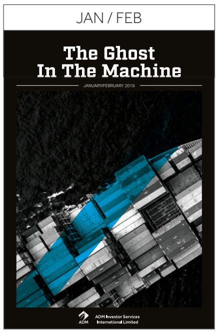
Q2 EDITION

Q1 EDITION



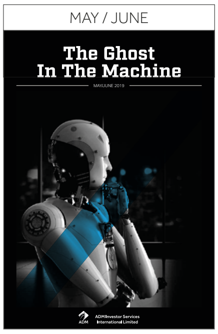
2019 EDITIONS

JAN / FEB

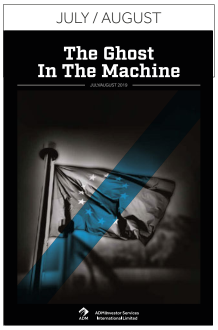


MARCH / APRIL

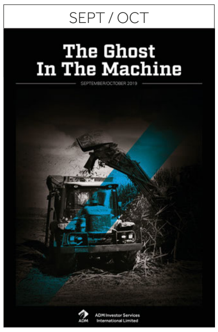
MAY / JUNE



JULY / AUGUST



SEPT / OCT



NOV / DEC

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Q3 EDITION

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