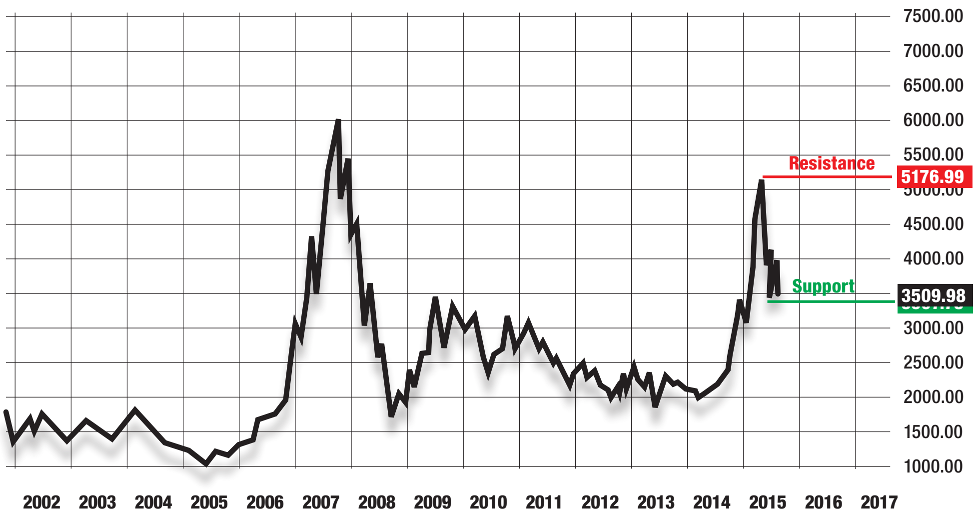
By Al Kluis

Weekly Shanghai Composite Index



The Chinese stock market soared from the low of 1,990 in May 2014 to the high of 5,200 in June 2015. The market fell about 40% from the June high to the initial low at 3,200. Major support is at 2,800 to 3,000. Look for a bottom between October 2015 and March 2016. A major low in the Chinese stock market will be a positive signal for world stock and commodity markets.

THE CHINA BUST WILL BE FOLLOWED BY ANOTHER BOOM

WHAT DOES THIS MEAN FOR YOUR FARM PRICES AND PROFITS?

A lot has changed in the 40 years I have been trading grain. When I first started, I kept an eagle eye on set-aside acreage, farm program loan prices, reserve payments, weather in the U.S., and USDA supply-demand reports.

Then came 2005. That year, with the new Freedom to Farm policy, U.S. farmers were able to plant what they wanted, where they wanted. The new U.S. farm policy subsidized farm income rather than farm prices. Farm income was subsidized through direct payments, countercyclical payments, and in some years payment-in-kind. Prices started a decade-long rally in 2005. As crop prices went up, USDA farm program payments went down. The risks that farmers had to manage on their own went up. Many farmers began to use revenue crop insurance products to help manage that risk.

That same year delivered even more huge changes. It was the year the first ethanol plants started, the year China began importing large amounts of soybeans, and the year that Wall Street began trading commodity futures as another asset class. In other words, the grain markets went global in 2005.

Before long, I found myself starting each day by watching the U.S. dollar index, gold prices, crude oil prices, and weather around the world. By 2010, my trading "days" started the night before the trading day, when the Globex markets opened at 7 p.m.

Today, I still watch all of these outside market factors every morning. I also watch what is going on in the global stock markets. In particular, I watch China.

China is a major economic force in the world. This ancient and Communist country is now the world's largest buyer of iron ore, coal, crude oil, and soybeans to name a few. I focus a lot of time each morning on what is going on in China. I enjoy sending my morning email comments out each day by 6 a.m. This lets my customers see what is going on around the world and how the global equity and commodity markets are trading.

The strongest correlation I see in these outside market factors is between crude oil and corn. Corn prices follow the price of crude oil 85% of the time.

Another strong correlation exists between the Chinese stock market and soybean prices. My own observation is that when China sneezes, the soybean markets get sick. The U.S. soybean market followed the Chinese stock market very closely between 2005 and 2010. There was little correlation between 2010 and 2014, but now they appear to be moving in close correlation again.

The growth of the Chinese economy over the last three decades has been amazing. From 1978

CBOT Soybeans Weekly

The weekly soybean chart shows a major high at just over $15 in the second quarter of 2014. From that high, prices have dropped to the lowest level since the fall of 2009. Long-term support is at $8.40 to $8.80. A reversal in the Chinese stock market would bring more confidence back into all of the commodity markets and be especially bullish for the soybean and crude oil markets.

(when the Chinese president started to introduce economic reforms and free-market policies), the economy has grown by nearly 10% per year. The growth stalled in 2009 with the global financial crisis, but it rebounded to 8% growth by 2012. The Chinese stock market more than doubled between 2013 and the first quarter of 2015.

Then came the spring of 2015. The Chinese stock market started to fall, and then it fell faster. By summer, it was down over 35%. The government responded to the red ink. Chinese currency (the yuan) had increased in value by 15% from 2012 through 2015, so China devalued its currency and took other aggressive measures to stimulate the economy and to stabilize the stock market.

What will happen? The Western free market economies have gone through periods of expansion and correction over the last 200 years. The typical U.S. business cycle is 68 months long. We have gone through 11 of these boom-to-bust business cycles since the end of World War II.

I am confident that the Chinese government, which has deep financial reserves, will be able to manage this economic slowdown and get things turned around by 2016 and 2017. That is also when the next business cycle is due to turn higher. The government has $3.95 trillion in reserves. With short-term interest rates at 4.85%, China is the only major economy in the world that has the ability to adjust interest rates lower.

Who will be hurt the most by China's Red Spring of 2015? I would be more worried if I was managing the Mercedes franchises in China than if I was a U.S. farmer exporting meat and grain to China. The slowdown so far has dropped real estate values, taken 40% of the Chinese stock market value, and reduced the demand for luxury goods. However, the slowdown has not changed the Chinese diet or China's demand for food.

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What will signal the bottom of this long slide in commodity prices? Watch for when crude oil futures are able to close above the two previous weeks' high. Then watch for a month-to-month higher close in nearby crude oil to confirm that low. The timing signals I work with project major lows in the grain and energy markets between October 2015 and January 2016.

3 SUGGESTIONS

Here are three suggestions to help you manage lower prices this fall.

1. Meet with your crop insurance agent and your lender. Lower prices going into this fall (followed by higher prices next spring and summer) can be a good profit combination. That assumes you are able to hold off on selling when grain prices are low this fall. Review how lower prices this fall will impact your possible crop insurance claims and the impact it will have on your farm program payments.

2. Sell soybeans and store corn. If you are short of storage or need to generate cash for payments this fall, then the corn market offers a great return to storage into next spring and summer.

3. Remember that soybeans offer very limited return on storage. If you want to retain soybean ownership until next spring and summer, then holding call options (rather than cash soybeans) is your best merchandising decision. SF

NOTE: Trading of futures and options has substantial financial risk of loss and is not for all investors.

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