

RF Posson & Company, CTA
Also presented by Ag Financial Strategies

Annual Corn Report 1/2/06

2005 Review

- Forecast for decline of corn crop condition as reported from USDA was correct. Forecast was for a decline 2005 or 2006 with greatest probability for 2005. Condition declined from range of 68 to 75+ during 2004 to a range of 50 to 55 (percent good to excellent crop) for 2005. This forecast was generated from a technical model.
- Forecast 88% probability for peak in precipitation for the nation as of 2004. 2005 data is not yet official but reflects 2005 as lower precipitation than 2004 suggesting 2004 as a peak. (From technical model.)
- Forecast 80% probability for peak in corn production as of 2004. 2005 production (USDA) has been estimated as lower than 2004 production. (From CSA model.)
- Forecast for a major drought for 2005 was incorrect, while forecast for a decline in the RFP Chicago Precipitation index was correct and related to worst drought in 30 years for IL. Had warned that cyclical structure of drought and weather and related price movement dictates to call for drought each and every year until 2008.
- Price forecast was for an early annual peak if no crop damage and if crop damage then bull market into 2006. Price of corn peaked mid year with no major crop impact.
- Intra year model intermediate trend forecasts were near the norm of 70% accurate.
- The late 2005 violation of 1.94 and 1.91 spot corn price support levels forced revision of Adjusted Posson Disaster Price Index and revision of CSA (Cycle Series Analysis) forecast that cycle bottoms of 9 yr., 36 yr. and 72 yr. were in place at either price. Price traded to 1.86 just below major scale level of 1.87 and recovered by large amount going into yearend. It turns out that this same support level was support of trend line of spot yearly chart from the 1960s.

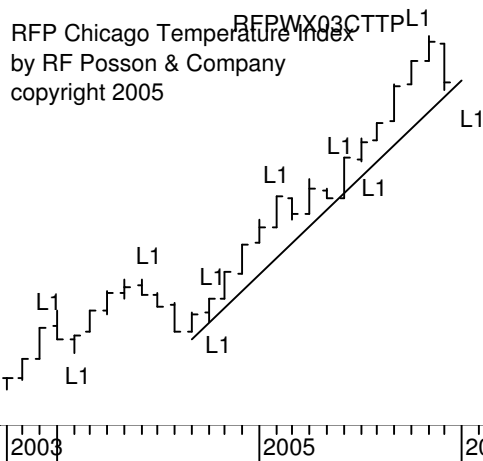
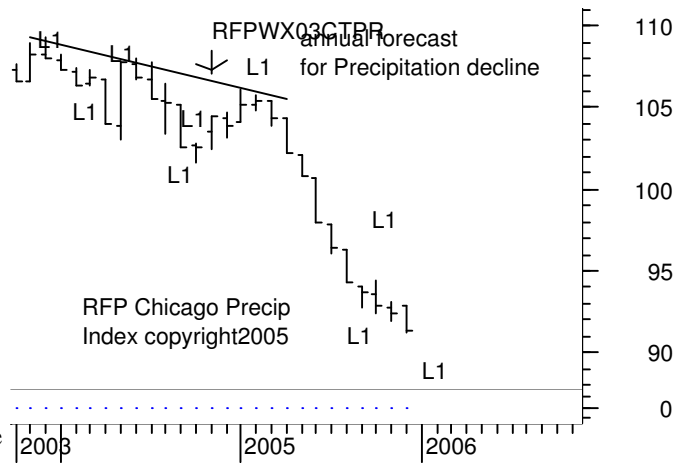
2006 Forecast

- CSA cycles up to 72 yr. bottomed at 1.86. Trend is up into 27 yr cycle top due 2006 to 2008.
- Benner drought cycle calls for up to two events by end of decade.
- Proprietary weather research calls for drought for 2006 but will do so into end of 2008 for corn and wheat production and 2009 for soybean production.
- Proprietary production research calls for a decline in corn production and significant enough to cause a major bull market for 2006-2008.
- Crop condition model for corn can allow for 2006 recovery but it can be allowed that the 2005 decline in crop condition was first phase of a trend lower. It seems condition needs to be below 50 to reflect a major impact. Trends in condition have been known to last two years.
- The 3 yr. cycle forecast is for higher corn price into a top due mid 2006 into mid or late 2007. If 2007 then it is likely that the bull market would have begun from 2006 which in turn suggests major bull market pattern and therefore suggestion of 2006 as a major crop impact year. (Major bull markets span 2 to 3 years.) If top arrives mid to late 2006 odds do not favor a major crop event and bullish forecast will be delayed from 2006-07 to 2007-08.
- Major bull market forecast offers target range of \$4.00 to \$6.00 corn, \$5.00 to \$8.00 wheat and \$10.00 to \$18.00 soybeans.
- A cash only chart from 1720 shows corn price did violate a major up trend support line from 1932 bottom and for the second time in past 10 years. Price did recover swiftly over this line to reflect technical economics are in force in the corn market place.
- A forecast is made that 2005 corn production was .5 to .75 billion bushel less than stated by USDA. None the less price can back fill early 2006 due to adequate supply.

Weather

The degree of decline in the RFP Chicago Precipitation Index supports the IL drought news of 2005 and then some. Trend of this index has been in decline since 1998 offering suggestion there has been a bit of luck in producing corn.

Applying CSA concept to national and corn belt annual precipitation offers a 3 yr. cycle pattern 80% of the time since 1900 versus 100% of the time in corn prices. There was 88% probability of a peak in 2004 for national precipitation and current estimate of 2005 offers proof that peak occurred. The question is now one of was the 2004 peak a decade based peak as since 1900 the data with use of CSA offers a decade based cycle like the 9 yr. price cycle of corn. Alternate precipitation data suggests the decade based peak occurred in 1998 and trend has been drier since then.



During the past 10 years it seems that the trend of temperature for the corn belt has offered cooler summers for the corn belt. Which implies reduced stress to corn crop. And this against global and annual warmer trend. The trend for the RFP Chicago Temperature index has increased its momentum within what is a warmer than normal trend for 2003 through 2005. Makes one wonder if summers have altered trend toward warmer which can increase drought damage.

- **Deserts expand by 20,000 square miles annually.**
- **Global temperature trend has been said to be warmest in 600 years.**

With global warming trend it would seem that if precipitation is adequate that better than expected crop production can occur. (2004) While global warming with reduced precipitation should cause historical negative impact to production. (2006-2008) My research shows 100 yr. up to 1000 yr cycles that assist in explaining the time that global warming appeared. These cycles can offer impact from now into latter part of this century. (Additional research is in need to assess the role of man within this cyclical fluctuation.) Relating these cycles to a price cycle that for now I will refer to as 170 years found in wheat pricing from 1280 to 2005 suggests a related cyclical top due in wheat and likely all grains this decade. This cyclical structure implies current price targets are not only valid but could be on the low side of possibility.

Although I do not need this influence from the mega weather and price cycles discussed above in order to be correct as for current price forecast, I will continue to offer the opinion of past two years. **“One or more countries may be dropped to their knees in terms of crop production, this decade.”**

Production

Yearly national corn production chart exhibits 3 yr. and 9 yr. cyclical fluctuation like weather and prices. The 3 yr. production cycle shows itself 80% of the time compared to same statistic for precipitation and 100% for corn price. The chart shown offers 2004 record production as a decade based cyclical top but must be considered during 2006 as with minor chance it was only a 3 yr. cycle top. Meaning production could recover for 2006.

Research had suggested 80% probability of a peak in production for 2004 and unless USDA says other wise (2005 as higher than 2004 production) the 2005 production number confirms a 3 yr. cycle top. The question to yet be answered is was 2004 a decade based top and production declines for 2006 or 2007. One pattern I consider is the two year decline pattern when a decade based top is in place. Year one of the two year pattern is of a minor reduction in corn production say 7% to 9% for most recent pattern examples. 2005 production reduction may not have been as large. Year number two of the two year pattern is a reduction of 15% to 25% although one should not place a limit as to size of reduction.

Applying a statistical study such as regression channel shows production of corn for 2004 as nearing an extreme. Applying a technical study to corn production as support and resistance lines offer a better view than the standard regression channel. (See Production chart.) Resistance line shown on the chart was near the 2004 turning point. Add a fibonacci retracement study using the 2004 peak and one can see that current retracement levels were near previous important production fluctuation. This could be viewed as offering more significance to the 2004 top in production and more so as suggestion for future targets of a future decline in production.

Economy

In 2005 I added an economic indicator to our Cycle Series Analysis list that includes price, supply/demand and weather. A forecast was made mid year that the indicator and the economy (more so the commodity sector) had bottomed following a mild recession from the 2004 top in grains. At the time of this CSA addition there were analysts forecasting the opposite and with enough negativity to forecast future lower interest rates. One month following the forecast the indicator took a sizeable jump and the analysts we were most interested in released a forecast that was 180 degree alteration. The trend for this economic indicator was positive into end of 2005. I view this as support to concept of strong demand for commodities and assume economic trend to be conducive for such trend well into 2006 if not 2007. This study will prove to be an interesting addition to our cyclical economic concept.

With the 15 to 20 year regression trend of the stock market as forecast as bearish well into next decade and the negative correlation of commodities a bullish forecast has been made for commodities well into next decade. It seems by end of this decade we will learn of two opinions of demand for commodities. One as the spot or cash demand and the other for commodity derivatives. This creates an economic debate as to what is true value. Like the saying of "beauty is in the eyes of the beholder" the decade of the aughts will be "value is in the eyes of the beholder." For the believer of alternative value the battle cry is "but what if economic valuation the past 10 to 20 years has been incorrect."

The pace of development of demand for grains has been record setting past few years. Today's grains are made into chemicals, drugs, fabric, building materials and a wider range of livestock and human food products. And the starch/sugar and oil based agriculture markets have hundreds of percent increase in production of bio energy products over the past 10 years. Ethanol production from corn is on a path to be if not already a major demand factor for corn.

China and India are forecast to carry the global economic positive trend into the 2030s to 2040s. This is a long enough trend to continue to offer demand support into the cyclical grain tops due this decade. In addition China follows the same cyclical drought structure as the United States and with a degree of correlation to cause consideration of droughts occurring at the same time or consecutive years.

Posson Disaster Price Index

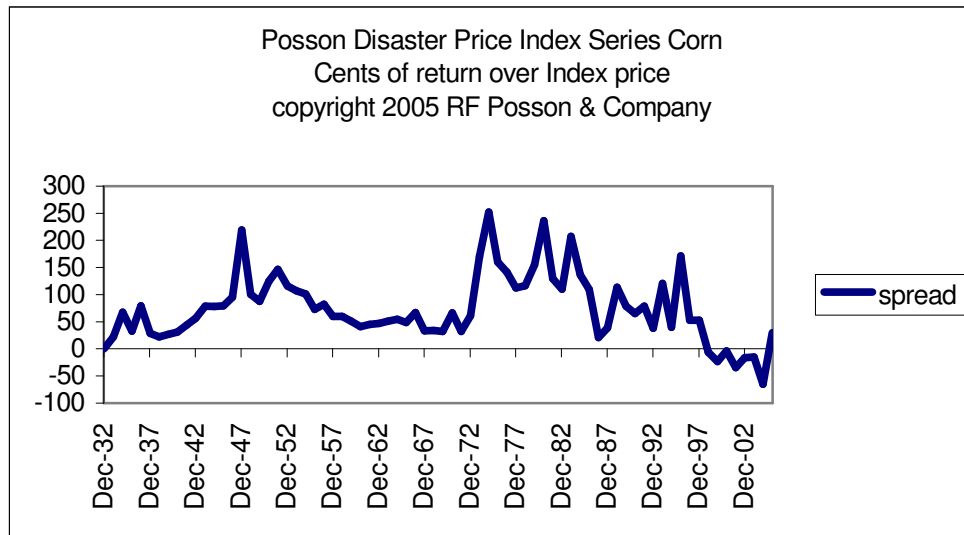
In 2004 I developed the Posson Disaster Price Index which is derived from the lowest annual price at the worst of economic conditions that being during the 1930s Great Depression. This price is then adjusted for average annual inflation. A study such as this shows corn price as far below the disaster price level. An index adjustment must be made from time to time or inflation will create a straight up price curve rendering the concept as useless. So the economic clock if you will must be reset in order to include economic supply versus demand innovation. I choose to follow cyclical economics and have learned that the stock market most dominant cycle is the 72 yr. cycle bottom. A cycle such as this has created bear markets of 4 years up to 70 years with stock index price declines as large as 89%. Such a cycle last arrived in 1932 as a turning point.

The 72 yr. cycle relates to the 36 yr. cycle I have discussed for many years now for the grain markets. It also relates to the 15 to 20 year bull or bear trends in the stock market. Commodities also follow this cycle and have bottomed in relation to this cycle. With the 2005 low price of corn of \$1.86 spot futures and \$1.54 national corn price (1 cent from a major scale level method used at our firm), by using these prices as a revised starting point I can now show the index as having turned up from its recent negative performance compared to the 1930s.

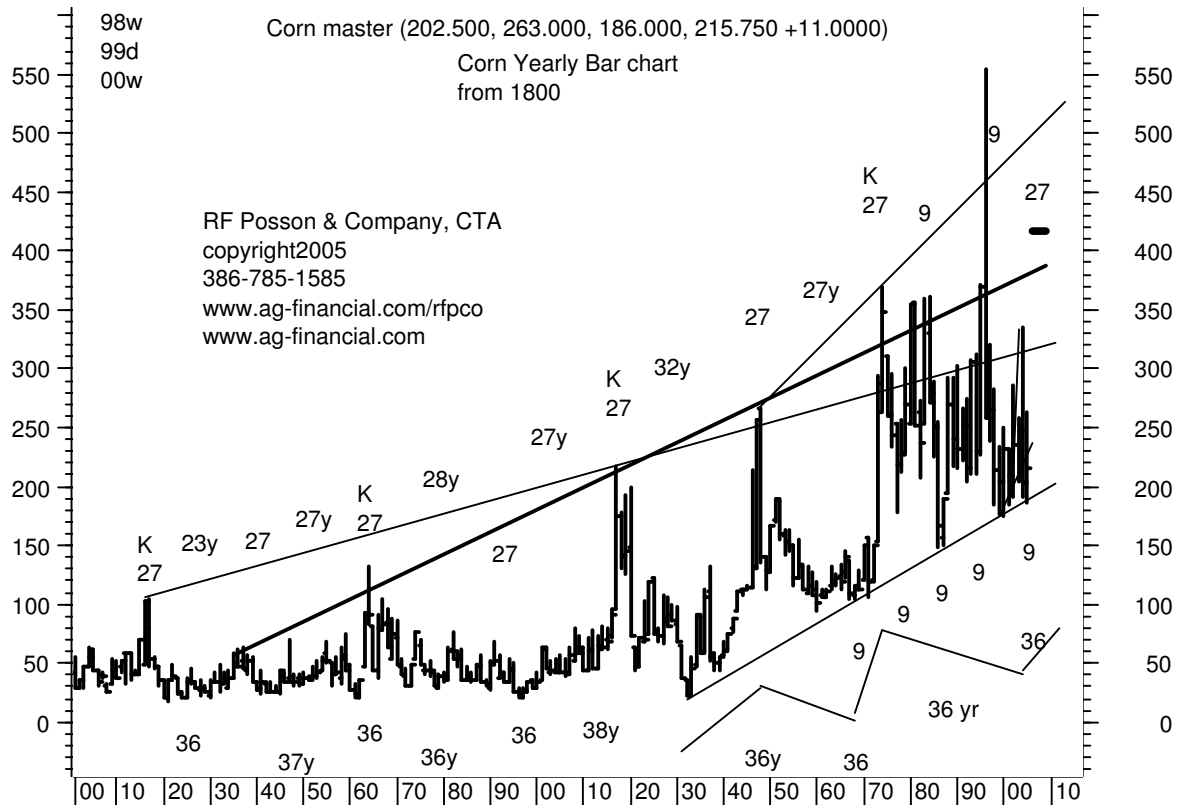
A chart of a spread of this index and cash and futures prices exhibits the 15 to 20 year bull or bear trends, the 36 yr. cycle bottom and what appears to now be a turn of the 72 yr. cycle. Average premium of this index has been around 50 cents per bushel with a high of \$2.00 plus. A study such as this arrives at the same conclusion as studies by other analysts with inflation adjusting methods that offers a commodity such as corn as long term under valued. The index study assumes inflation is built into price but masked by the negative side of production innovation and the deflation economics of the 1990s. If not since the peak of inflation since 1980. And it arrives at the same conclusion as other inflation studies in that if today's price can decline to a cyclical adjusted inflated disaster price like the lowest price of the 1930s then price is too low in historical terms.

With the long term bullish forecast for this decade for corn one can forecast that the spread of the index to cash and futures pricing will add premium. The economic or fundamental factors to add this premium can be farm subsidy change, weather impact to production, technological advancement trend toward demand rather than production, inflation and the commodity bull revolution (investors but cash seller to tag along). The name of the game for the grain seller past 20 years is who can sell the cheapest. The game next 20 years is one of who can extract the better price. Competition is a good thing in general but can become extreme with negative economic

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Note: To better follow this discussion take a pen and draw a line on the above chart that connects the prices near the labels of 27 and 36. This will exhibit the trends related to the long term cyclical fluctuation discussed. The numbers with a "y" are the actual number of years counted from top to top of the 27yr cycle and bottom to bottom of the 36 yr cycle. Note the amount of price fluctuation. Pay close attention to the statistics written on this and the following page.

Price What matters most.

In 1993 I developed a method of price analysis called Cycle Series Analysis that is based on the concept that some cycles integrate to tell a story of price and behavior of buyer and seller. And therefore impact of supply versus demand and from short term to long term. The forecast in 1993 was for commodity prices to rally into mid to late 1990s and then decline into early this decade with chance for low prices severely impacting commodity producers.

The result was the CRB commodity index rallied into 1996 and then declined while individual commodities such as corn and wheat traded to record high prices by 1996 and milk price to a record level by 1998. From 1998 into 2002 the commodity sector was riddled with major declines such as hogs at some of the lowest prices since the depression of the 1930s. In 2003 a major cyclical bottom was placed for milk and was low enough to cause farmers to work together in terms of supply management. While shortly after the bottom I received word of a farmer who shot dead all of his cattle rather than proceed in friendly terms toward bankruptcy. Indeed the CSA concept goes beyond macro economics and can relate to the condition of businesses, organizations and individuals.

The same forecast called for a peak in the stock market in 2000 with risk of a major decline if not crash by 2002. It was also forecast that losing the stock market at time that commodities were already trending lower increased the odds of a recession due 2000 to 2002 as becoming a deflation depression. The year 2001 charts show stock and commodity indexes trending lower suggesting the wave of deflation was underway and in terms of a negative economic impact.

Next phase of the forecast was for a major bull market in commodities for this decade. With the CRB index up 46% (2001-2005), crude oil up 256% (2001-2005), gold trading from \$280 to \$530 and by 2004 soybeans trading from \$4.50 to \$10.00 seems evidence enough that the 1993 forecast and related CSA models continue to be correct as for long term trends.

The CSA model for corn uses a 36 yr cycle that can be seen on a price chart dating back to 1720. A cycle of 36 years relates to a Civil war and several depressions and as of 1968 a kick off of major inflation. A 36 year cycle suggests the most important price low every 30 to 40 years. Examining the chart shown reveals that years between two 36 yr cycle bottoms price has never traded down to the 36 yr cycle bottom. This offers a statistic that the 36 yr cycle is for real and is important to price fluctuation. An additional supportive statistic is the fact that the price chart shows that there has never been a 36 yr cycle that has traded below the previous 36 yr cycle bottom.

- If statistics such as these are to remain so then the 2002 cyclical price lows for beans and wheat and the 2005 cyclical price low for corn will not be seen again until 30 years from now. Innovation in macro economics and or supply/demand could cause the first revision of these statistics in 300 years. But do you want to bet a against statistics at 100% over past 300 years?

The CSA corn model uses a 27 yr cycle top instead of a 36 yr cycle top. The number of shorter cycles within the 36 yr cycle are reduced by one quarter to create the 27 yr top. A cycle of 27 years relates to periods of inflation, high demand and most of all the reduction of supply. Weather plays an important role in creating the largest of production declines which in turn relates to the bull markets into the 27 yr cycle top. **Supply is such a major factor in the 27 yr cycle trend that there can be poor macro economic conditions and price of corn can still rally over 100%. Best example is the bull markets during the 1930s depression.**

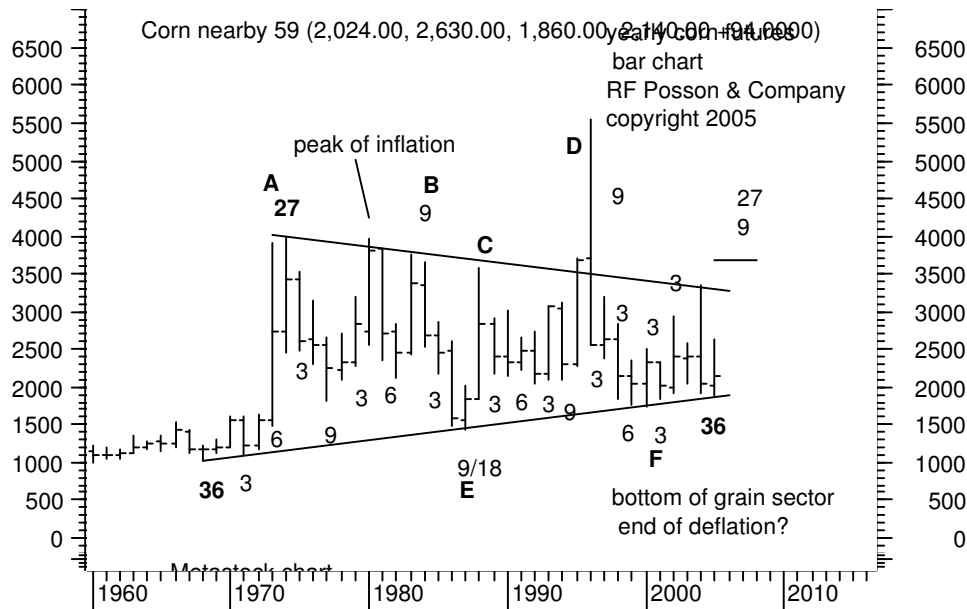
The following are statistics of the trend from a 36 yr cycle bottom to a 27 yr cycle top.

- Trend has always been up.
- Trend created price increase of 180% to as much as 1000%.
- Trend of trends has been one of higher performing bull markets.

When CSA forecasts a bottom for a specific cycle it will produce a range of time for the bottom which is referred to as a timeband. The next shorter cycle within a CSA model is then used to reduce the range of time of the timeband as an effort to time the desired cyclical bottom. So depending upon the cycle(s) in question timebands can range years, months, weeks, days and minutes. The timeband for the 36 yr cycle bottom due this decade will expire before the timeband for the 27 yr cycle top. A pattern such as this implies one should forecast the 36/27 CSA bull market to occur anytime now in that the top should occur following a bottom.

- Current opinion is that corn bottomed for 3, 9, 36 and 72 yr cycles as of December 2005 at a futures price of \$1.86.

See next page.



Technical Factors

The chart shown above is of spot corn futures price in form of yearly bar chart and from 1960. Drawn on the chart are support and resistance lines that exhibit a market that is narrowing in range. A pattern such as this is often referred to as a contracting triangle and can be assumed to be a sign of a market that is building tension. Note that the support line offered a correct forecast of a price that was low enough to reflect economics as out of line and corn as under valued in that price rallied from this line by end of 2005. Note the size of the bull market from the 1968 bottom labeled "36" to the 1974 top labeled "27". Points "A,B,C and D" were all related to droughts. Point "E" was in relation to largest level of supply for years shown and at time U.S. wanted out of agriculture support-dump it. Note the respect of this line for the 2000s ("36,E,F,36"). The 36 yr bottom is shown as of 2005 with forecast future top as 27/9 suggesting potential for a market some what like the 1968-1974 bull market ("36" and "A").

With the past 7 years as spending more time on the low side of the triangle corn is a market that has fallen asleep. Corn fell asleep from over production and lack of interest. Comparing technical to fundamental it can be said that fundamental analysts have offered a higher level of corn supply while price action (technical) suggests that the increase of supply does not matter. Bottom line is market place realizes high supply equates to low price but realizes it makes no sense to allow a market place to be a bottom less pit in that such action would probably not increase demand anymore than at current price level. Such price action reflects a market that acknowledges the supply of corn will be used and there was a cost to produce the corn.

- Note that support trend line is trending up from the 1968 bottom of the 36 yr cycle suggesting there is an economic that states that there is an extreme low price that can create a bottom. And also states that this price and related economic are under the influence of inflation.

Ratio

When one compares ratio of corn with other commodities, financials and commodity indexes, corn is the poorer performer. With consideration of market rotation and contrarian thinking it seems corn should be on the list for potential catch up with other commodities which in turn may be a sign corn is the better investment.

- A corn market that traded to \$1.86 futures in December 2005 compared to \$1.91 low in December 2004 with larger supply of corn in 2005 than 2004 does not sound like a panic market. With consideration that the December 2005 closing price of spot futures was \$2.1575 versus the closing price of 2004 at \$2.0475 offers suggestion the corn market cares less of the larger supply and must be interested in the trade discus-

sion of record demand.

- History repeats. The daily trading during December 2005 spot futures was almost the same characteristic as what was seen for December 2004. Price pattern can repeat and at same time of year. (.70-.76 correlation open, high, low and close, an analog market.) Proof of cyclical behavior.

Forecast

A price CSA model forecast suggests that the current price high of this decade (2004) was not high enough to meet symmetrical standards of the model. The 1996 record price high of \$5.54 was much higher than the 1974 high and 1974 was a 27 yr cycle top. Corn's current record high price of 1996 was a 9 yr cycle top which is less important than a 27 yr top and the 9 yr is a component of the 27 yr cycle. Price action such as this suggests that the 1996 bull market was paving the way for the final 9 yr cycle bull market to create the 27 yr cycle top due this decade. So the ideal forecast is for a new record high price and by no later than year 2008 which is when the timeband will expire for the 27 yr cycle top. If there is to be failure top of this cycle then price should at least exhibit an attempt to trade over the 1996 high. A gross failure would be a price just over the 1974 high (\$4) and ideal as about \$4.75. The bottom line of the price only CSA model is that the high for this decade is not yet in place.

Adding fundamentals to the price CSA model to create a fusion CSA model it can be seen that the bull run into the 2004 top was not related to supply reduction in that crop size were large for 2003 and 2004. (The latter year was with record production.) Reason for the 2003-2004 bull market was from a strong soybean market and very tight corn stocks. Investors and consumer risk managers bought corn aggressively and from dialing in "what if" scenarios in terms of a 2004 drought. Corn was so tight that I believe had there been a drought in 2004 we would have seen the "big bang" forecast come to fruition with result of a new record high price. The fundamental driver of 9 yr (decade based) and 27 yr cycle tops is supply reduction.

With current large supply of corn if the big bang drought occurs during 2006 to impact the crops in a major way then I forecast price as higher into 2007 with a target of on the low end of the range of \$4.00 to record price. If there is no "big bang" crop impact then forecast of 2006-2007 will be delayed to 2007-2008. If price trends just to \$4 this will create a record low performance of the 36/27 bull trend but still create a 100%+ price increase from the \$1.86 bottom. Still a worthy analytical return. **Forecast \$4 to \$6 corn by 2007.**

Related markets.

Soybeans-

Soybeans placed a record high price in 1974 that to this day is intact. The true 27 yr cycle top however was a failure top a few years later and at slightly lower price. Models show this helps to explain why the 1988 drought was a "bigger deal" to soybeans than corn in that 1988 was a 9 yr cycle top for soybeans. (1988 was only a 3 yr cycle top for corn.) This also allowed for soybeans to peak in 1997 for a 9 yr cycle top and one year later than corn. Whereas the 1996 peak for corn was the latest year allowed. With the 1997 top for soybeans as with higher price than the 1970s 27 yr cycle top a forecast was created like corn to put soybean price this decade back to if not above the 1997 price. This occurred in 2004 fulfilling minimum price CSA symmetrical requirements. (This should be considered as evidence corn could fulfill the ideal forecast of trading to the 1996 high in that beans honored the same pattern.) The fusion model shows that there was a drought and major production impact during 2003 and a price bull market of 2003-2004. Therefore fundamental requirement has been met and in line with the price only CSA requirement.

The forecast for soybeans for remainder of this decade is that a new high for the decade could occur, that a new record high price could occur but neither should be viewed as required. A 27 yr cycle top may have been put in place as of 2004 but with the cycle as with remaining time for a peak into 2009 there is chance for beans to be on board with corn. It is hard for me to imagine a new record high for corn and not to see the bean market trade over the 2004 top. While a \$4 corn top this decade and less of a crop impact to beans than corn would explain why beans do not trade to a new high relative 2004. **Forecast \$10 to \$18 by 2007 to 2009.**

Wheat-

Since 1720 the wheat market has exhibited high correlation with the corn market in terms of percent price change, length of bull and bear markets and can bottom or top out near if not the same years as corn. A chart of wheat price back to year 1280 adds additional evidence of 36 and 27 year cycles. And current research seems to have uncovered a cycle of 170 years that may arrive this decade which could add additional support to the “big bang” forecast. Wheat has traded higher during the past 500 years with two bull markets lasting over 100 years. Like corn the 1996 record high price could be unfinished business. **Forecast \$5 to \$8 by 2007.**

3 yr cycle and Trading Model

The 3 yr cycle is a component of the longer term cycles used in CSA models. It may relate if not be the same as the Kitchin and 4 yr Presidential cycle discussed in cyclical circles. I tested performance of this cycle on several commodities, commodity index and stock index with a result of a price increase of 10% to 500%+ and price decline of 10% to 90%.

Clearly the performance of the 3 yr cycle can make or break a year’s performance for the business as consumer and or producer as well as for the investor. It represents great risk and great profitability. Our models track the 3 yr cycle to time the longer term cycles. A Trading model is used to time the 3 yr cycle.

The Trading model is used to track and forecast intra year price fluctuation and can relate to some fundamental information as well as some short term technical methods. Level 1 tops and bottoms occur 2 or 3 times per year for the corn market. These are the more important trends we follow on an intra year basis with price fluctuation from a few percent to over 50%. Level 2 are tops and bottoms that are less important than Level 1 but are referred to as intermediate trend related. Level 3 tops and bottoms occur once or twice per month and generally relate to the high and low of a month. Level 4 are intra week tops and bottoms.

The result of the combination of the Trading model and the CSA model is a method to provide short to long term price analysis.

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