



Theobroma

COCOA MARKET REPORT

Annual Report Cocoa Market 2007

The first half year prices rallied strongly, followed by a significant decline during the summer and sideways trading during the 4th quarter, finally ending with a very strong rally. Participation by non-commercial parties has been larger than ever and furthermore the weakness of the US\$ was felt strongly, of course mainly in the New York market. Also the extremely high volatility of the switches can be written in the history books.

During January the market was quite nervous, but nevertheless prices remained in a narrow range. Significant changes were seen in the structure of the London market; pressure on the nearby switches as well as tension on the July and September, anticipating on the dry weather conditions which could affect the development of the African mid crops. Also the total open position of London rose considerably, whereas in New York this position hardly changed. Furthermore the grinding figures published for the 4th quarter of 2006 evidenced the continuation of the consumption growth.

In February, the extremely strong participation of funds in cocoa, in particular on the buying side, was shown by the strong rise of the speculative long position as published for the New York market, and this time also by a significant rise of the open position.

In figures, the long position rose from 39503 lots on 26th December to 53319 lots on 27th February. While prices initially were kept under pressure by origin sales, including by Ghana even for 2007/8 crop positions, the abrupt tailing of the main crop as well as the continuing dry weather fueled the bullish sentiment.

The dry Harmattan weather continued in many production areas well into March this year, being far later than usual. This fact attracted another wave of buying, as a result of which prices broke easily the strong chart resistance around GBP 1000, being built up during previous 4 years. Positive news came from the Ivory Coast, where President Gbagbo finally concluded a peace deal with the northern leaders, of which Mr. Soro was appointed as the PM of the new government.

During April price development was extremely volatile under the influence of profit taking as well as bad estimates for the mid crop, later followed by very optimistic forecasts for the next main crop. The latter was based on excellent weather conditions and it is remarkable that these typical "silly season" conditions were influencing the market so early in the season this year. Finally the market ended with a loss of about GBP 90.

During May this weakness was quickly followed by a very strong recovery, initiated by massive buying activity on the London option market, mainly on the July. Since it was assumed that a reputed squeezer was backing these activities the ever existing fear for a technical squeeze led to the renewed buying interest. Prices rose to record highs, but at the end of the month sizeable origin sales caused a temporary setback.

In July the uptrend finally came to an end, after making a new 4 year's high at GBP 1147. The initial strength was supported by drier than normal weather, as a result of which pod counters adjusted their new crop estimates. Meanwhile the speculative long position grew to a new record of 67095 lots. However, aggressive fund selling, most likely linked with the problems in the financial markets, entered the cocoa market and this pressure led to a substantial decline. Also the return of rainfall was a contributive factor to the selling. At the end of August the market finally found support at about GBP 930 on reports of widespread presence of black pod disease in all West African producing areas. For many chocolate industries the fund liquidation was highly welcome given their strongly reduced cover after their absence to the market during the rise. Altogether, the volume of the liquidation was enormous, since at the end of August the speculative long position in New York only amounted 25500 lots, while over there the open position declined about 35.000 lots to 125.000 lots. Also in London the open position fell significantly with 20.000 lots to 190.000 lots. For a period of 8 months the funds were the leaders of the rising market and this period was finished now, albeit temporarily.

After a short period of consolidation fresh fund buying entered the market again, in line with the pattern of most commodity markets. Also more frequent reports about black pod fueled the bullish sentiment, but on the other hand arrivals of the just starting new crop substantially exceeded last year's figures. The long speculative position rose quickly again to 52.603 lots on 2nd October, while in London the open position surprisingly went down by about 10.000 lots, probably due to the expiry of the September position.

A rally of GBP 100 was followed by a strong collapse at the beginning of October. This decline was due to reports of very strong arrivals, fund liquidation in many commodity markets and a disappointing –inaccurate – grinding report of the USA. Slightly above the lows of late August/early September the market found good support and since that time prices floated in a narrow range up to early December.

Apparently without strong fundamental changes the quiet market conditions came to an abrupt end early December. Very aggressive fund buying caused a strong rally, at the same time absorbing huge quantities of Ivory Coast cocoa, which were placed on a consignment basis. After breaking chart resistance, aggressive fresh fund buying caused another rally. At the moment of writing the last published figures of the speculative position – 58602 lots - date from 11 December and thus brokers assume that the current fund long position is now larger than the record level of July.

After the successful squeeze during July 2006 participants continuously feared to be faced with this technical phenomenon again this year, the more so as a large deficit for the 2006/7 crop was expected. This resulted in premiums for the spot position against the forwards, for almost every position during any moment of its duration. Despite of this situation, all positions expired smoothly at a large discount. Below you find the highest premium against the next position and the spread at close.

Switches

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March/May	+ 25 (2 days prior to expiry)	- 15
May/July	- 8	- 45 (only 200 mt tendered)
Jul/Sep	+ 9	- 40
Sep/Dec	+ 6	- 35
Dec/Mch	+ 3	- 20

The reason of this erosion of the premium: no commercial interest or lack of financing with the companies used to squeeze the cocoa market. In New York – on which market technical squeezes are not allowed – the Dec/Mch traded turbulently at a large premium, followed by a discount and then again a huge premium and finally closing at a premium of around US\$ 100 in very small volume.

During December the London market is again, suddenly, faced with tension on the July and, to a lesser extent the September. July trades at the moment of a writing at a premium of GBP17 against the December. Another squeeze??

Cocoa products

During the greater part of the year cocoa butter prices have been steady to moderately firm, while after the summer period values were rocketing. In figures, the ratio for the second month delivery started the year at around 2,70 and gradually increased to 2,78, then slightly declining to 2,75 and from September onwards rallying to over 3. As usual, the ratio for the spot position is much more pronounced (see chart).

With a view to the expanding converting capacity, in particular in origin, it was hard to predict this significant rise of the ratio. The growth of chocolate consumption, of course, has its impact on the demand for cocoa butter, but on basis of newly installed press capacity it was generally believed, that supply would be sufficient. Why has this market analysis proved to be incorrect?

Many factories in origin countries were faced with the supply of lower than normal yielding cocoa beans and a slowly rising demand for solids. Furthermore the cost of production has generally increased due to rising energy cost, and last but not least, the

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production has generally increased due to rising energy cost, and last but not least, the bean differentials were very strong due to the lower production. As a consequence, the proceeds of the combined ratio for butter and powder did not enable them to convert on full capacity. The demand and price of solids is an important factor for the pressing industry. Many new consuming markets, where consumption growth has been extremely strong, are now feeling the weakness of the US\$, and this has a negative impact on solids in particular. Furthermore, Asian factories in the top quality segment, have to import larger quantities of West African cocoa, which is much more expensive than local cocoa.

The reduced supply of origin butter was felt during the second half of the year. Stocks, which are in cocoa butter traditionally small, were eaten up quickly and since demand lasted longer than usual, the pipeline became empty. The forthcoming trend for cocoa butter is difficult to predict, but it is hard to believe that the newly installed capacity will be used in the same way as this year. For the time being, however, the strong demand predominates and many shorts still have to be filled.

We wish all our readers a Merry Christmas and a prosperous 2008.