

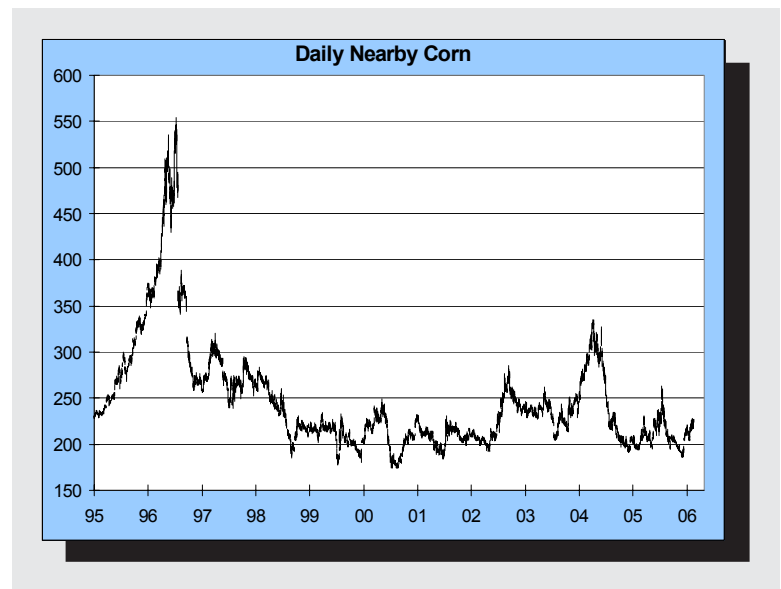
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Special Report

CORN AT THE CROSSROADS: OUTLOOK FOR 2006

February 22, 2006

The corn market is building a tremendous demand base and could be in a position to see higher prices in the year ahead if there is any threat of a tightening of supply on the world or US market. The development of industrial and energy uses for corn combined with relatively cheap prices for the past few years has helped build this demand base. The corn market appears to have a better chance for stronger prices for the coming year, as normal yield and a steady rise in demand are factors which should allow for a slight production deficit for the US and the world.



USDA Forecasts US Corn Deficit

After the surge higher in prices over the past few weeks, the trade is currently seeing corn as an "overbought" commodity, meaning

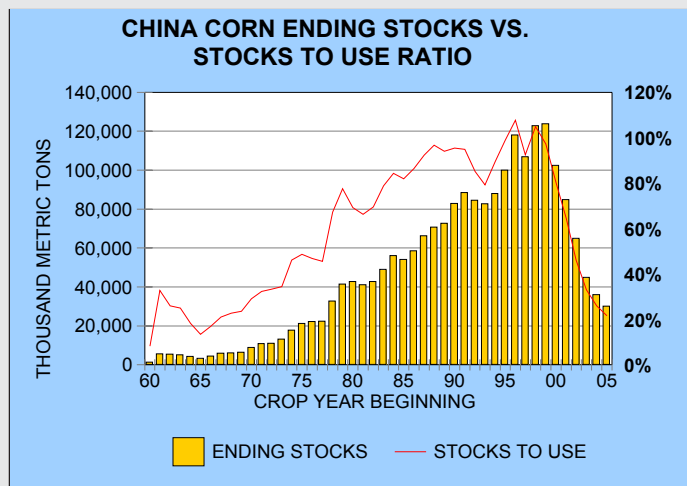
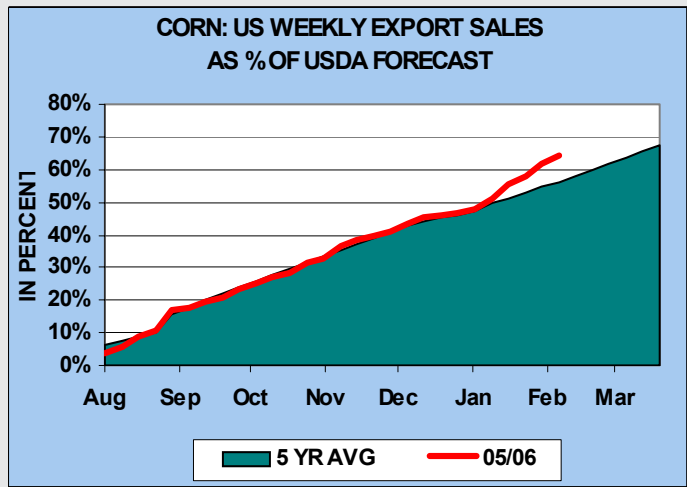
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that prices may have risen too far too fast, especially with troubles in the poultry industry in the US and abroad. However, if the bird flu crisis passes without a major impact on the world poultry situation, the price uptrend in corn, established off of the December, 2005 lows, looks to continue. The USDA Outlook Conference numbers released last week could have some impact on the trade over the near term. For the 2006/2007 season, the USDA projected planted acreage at 80.5 million acres, which was down 1.3 million from last year. This was in line with trade expectations, as corn variable costs are up significantly when compared with soybeans or wheat. Part of the anticipated decline in planted acreage has already been seen in the form of an increase in soft red winter wheat planted acreage in the southeastern US Corn Belt, where producers shifted from corn to wheat after the 2005 harvest. The USDA Conference pegged US corn production for 2006/2007 at 10.810 billion bushels as compared with projected usage at 11.495 billion, a deficit of 0.685 billion. This would leave ending stocks at 1.726 billion bushels, down from 2.401 billion this year.

The USDA is showing a slight decline in their usage of corn for feed in 2006/2007, as profitability in the poultry and pork sectors is down and the market is expected to see greater availability of distillers' grain or the left over from the ethanol process. Ethanol usage is up to 2.150 billion bushels from 1.575 billion bushels this year. Poultry producers in countries which have been hit with the bird flu virus are seeing steep financial losses, at least for the short term, as consumers shift to other protein sources, and many poultry producing and/or exporting countries could see at least a temporary drop in feed orders. The longer term impact is still very uncertain, but the declining demand could cause world prices to ease in the mean time.



US Corn Export Prospects Improving

Export demand is expected to increase to 2.0 billion bushels for the coming year, and this may be seen as a conservative number if China's exports continue to slow and they move from a being major exporter to a major importer of corn in the next few years. For the 2005/2006 season the USDA projects US corn exports at 1.850 billion bushels, but this forecast may be too low given the recent

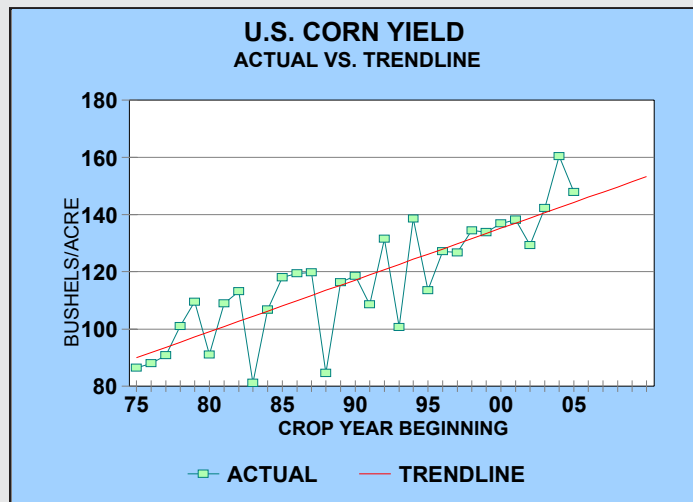
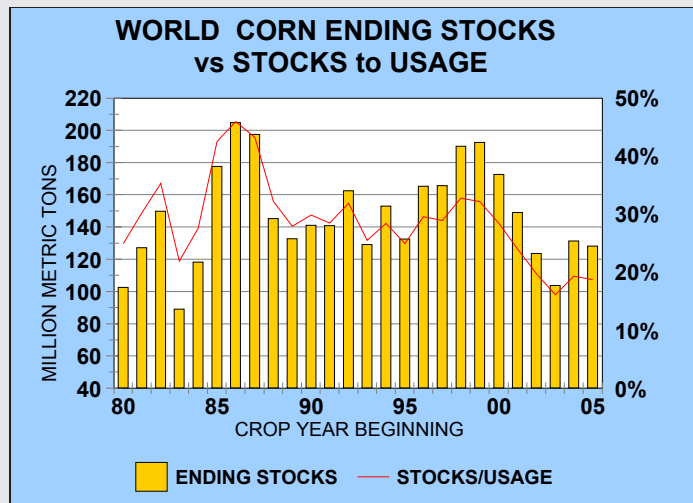
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export pace. Weekly US export sales for corn for the week ending February 9th came in at 1.249 million metric tonnes as compared to trade expectations between 1.0-1.2 million. Cumulative sales have reached 64.2% of the USDA forecast as compared to 56.2% on average over the last five years (see chart). Sales of 577,100 metric tonnes per week are needed to reach the USDA estimate.

In addition, Argentina production was down sharply due to drought conditions into the pollination period this year. Traders currently estimate Argentina corn production (for the harvest which begins in March of 2006) to come in near 14 million tonnes as compared with 20 million tonnes last year. With less corn for export out of Argentina and heavy losses in the winter wheat crop in Ukraine and Russia, which is the primary source for feedwheat exports and competes with corn on the world market, corn exports look to improve this season and maybe next. Predicting when China might stop exporting corn and begin to import is difficult, but a look at their stocks situation at the end of the 2005/2006 season would suggest that China is close to at least halting exports (see chart). The data would suggest that China has experienced a corn production deficit for 6 years in a row. For the 2005/2006 season, ending stocks are expected to hit their lowest level since the late 1970s at 30.16 million metric tonnes.

World Corn Supplies Tightening

For the February USDA Supply/Demand reports, the USDA pegged US ending stocks for the 2005/2006 season at 2.401 billion bushels as compared with 2.426 billion estimated the previous month. Ethanol usage was boosted by 25 million bushels. World ending stocks for the 2005/2006 season were revised slightly lower to 128.16 million tones, down from 128.26 million tonnes from the January report and down from 131.4 million



tonnes this past year. A look at the history of the world corn ending stocks shows that they are near the low end of the range for the past 25 years (see chart). In addition, the world ending stocks to usage ratio is projected at its second lowest level in history. As a result, a poor crop in the US or China or both could trigger a significant drop in world ending stocks for the coming year and leave the market in a supply sensitive situation.

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USDA SUPPLY/DEMAND US CORN	-- RECENT USDA REPORT --									2006-07 Crop Outlook		
	97-98	98-99	99-00	00-01	01-02	02-03	Feb USDA 03-04	Feb USDA 04-05	Feb USDA 05-06	10% Lower Yield	USDA Trendline Yield	10% Higher Yield
Area (M Acres)												
Planted	79.5	80.2	77.4	79.6	75.8	78.9	78.6	80.9	81.8	80.5	80.5	80.5
Harvested	72.7	72.6	70.5	72.4	68.8	69.3	70.9	73.6	75.1	73.2	73.2	73.2
Yield (Bu/Acre)	126.7	134.4	133.8	136.9	138.2	129.3	142.2	160.4	147.9	132.9	147.7	162.5
Beginning Stocks (M Bu)	883	1,308	1,787	1,718	1,899	1,596	1,087	958	2,114	2,401	2,401	2,401
Production	9,207	9,759	9,431	9,915	9,507	8,967	10,089	11,807	11,112	9,730	10,810	11,893
Imports	9	19	15	7	10	14	14	11	10	10	10	10
Supply, Total	10,099	11,085	11,232	11,639	11,416	10,578	11,190	12,776	13,236	12,141	13,221	14,304
Feed & Residual	5,482	5,472	5,665	5,842	5,868	5,563	5,795	6,162	6,000	5,950	5,950	5,950
Food, Seed & Industry	1,805	1,846	1,913	1,957	2,046	2,340	2,537	2,686	2,985	3,545	3,545	3,545
Ethanol for Fuel						996	1,168	1,323	1,600	2,150	2,150	2,150
Domestic Total	7,287	7,318	7,578	7,799	7,915	7,903	8,332	8,848	8,985	9,495	9,495	9,495
Exports	1,504	1,981	1,937	1,941	1,905	1,588	1,900	1,814	1,850	2,000	2,000	2,000
Use, Total	8,791	9,298	9,515	9,740	9,820	9,491	10,232	10,662	10,835	11,495	11,495	11,495
Ending Stocks	1,308	1,787	1,718	1,899	1,596	1,087	958	2,114	2,401	646	1,726	2,809
Stocks/Use Ratio	14.9%	19.2%	18.1%	19.5%	16.3%	11.5%	9.4%	19.8%	22.2%	5.6%	15.0%	24.4%

US Supply/Demand Scenarios for the 2006/2007 Season

A review of the “what ifs” for the coming year for the corn US supply/demand situation may be helpful in determining the price trend ahead for the corn market. The enclosed supply/demand table shows the USDA projections for the 2006/2007 season in the column labeled “trendline yield.” The USDA is using a trendline yield of 147.7 bushels/acre as a starting point for the coming season. Our research suggests the trendline yield should actually be closer to 146 bushels/acre. Assuming normal weather and a demand base of 11.495 billion bushels, ending stocks would come in near 1.728 billion bushels. The USDA believes this ending stock level would result in an average farm price of near \$2.15/bu as compared with \$1.90 for the 2005/2006 season and \$2.06 for the 2004/2005 season.

The presence of a La Nina pattern is a warning of possible poor weather for the grain producing areas of the US for the coming year, and drought

conditions are expanding in the southwestern plains. The Midwest is also showing low subsoil moisture in the northern half of Illinois and parts of Iowa, and these factors suggest that yield may come in below expectations (see chart). In addition, the high cost of fertilizer has many producers looking to use less fertilizer for the coming season, which could also be a drag on the eventual yield. If actual yield comes in 10% under trend at 132.9 bushels per acre and the demand base stays the same, ending stocks would come in at the lowest since 1995/96 and the second lowest since 1975/76 at just 646 million bushels. This would result in a stocks/usage of just 5.6%, which would be the second lowest in history.

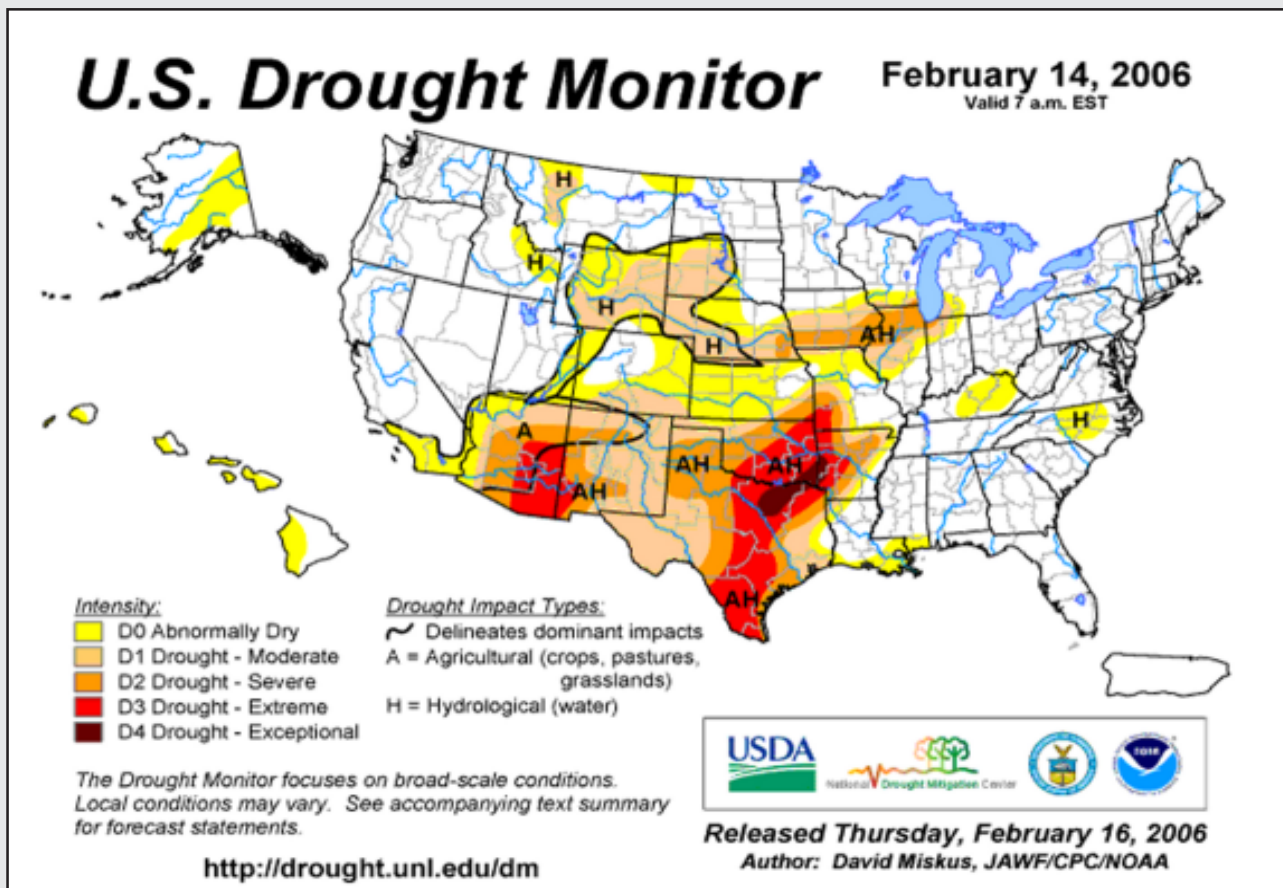
While we are not predicting a 10% drop in yield, we would believe that the yield has a better chance of coming in below trend for the coming season. Keep in mind, as recently as four years ago the average corn yield was just 129.3 bushels per acre. A repeat of that yield would leave ending stocks at just 381 million bushels and a stocks/usage ratio of just 3.3%.

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We use the “what if” scenarios as a tool to determine the sensitivity of corn to weather developments for the coming season. As you can see, a minor yield problem in the US for the coming year could spark a major move higher in prices due to the tremendous demand base established over the past few years. If yield were to come in at 129.3 bushels per acre, futures would be set up to move to new all-time highs for the coming season. If yield were down 10%, we could expect \$4.50-\$5.00 highs for nearby futures. A 5% below trend yield would suggest highs of \$2.90-\$3.25. At trendline yield, we would expect highs near \$2.70-\$2.90. At 5% higher than trendline yield, we would expect prices similar to this past year, and a 10% jump in yield above trendline could result in slightly lower prices for the coming season.

Energy and Industrial Usage Provides Demand Growth Potential

With the corn market shifting from being a feed and food market to a feed, food, energy, plastics and sweetener market, the general price trend for the next few years is likely to be higher off of the lows posted in December of 2005. With normal weather, look for nearby corn futures to continue on a slow but steady uptrend for the next few years as the market adjusts to a tighter situation for stocks in the US and a potentially extremely tight world ending stocks scenario for the world. Increased ethanol demand (if energy prices remain high) could accelerate the uptrend, and so could poor weather developments for the 2006 crops.



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Technical Outlook Bullish

The technical action remains bullish with the trend up and open interest near a record high. The Commitment of Traders report with options showed the market in a classic bullish setup with non-commercial traders (trend following funds) net long (131,388 contracts) and non-reportable traders (small) net short nearly 101,000 contracts. The record net short position for small traders occurred for the week ending February 7th at 103,745 contracts which leaves the market vulnerable to a short covering trend if resistance levels are violated.

Suggested Trading Strategies:

1) Buy December corn at 254 1/4 with an objective of 273 3/4. Risk the trade to a close under 249.

2) Sell the September corn 230 put near 12 1/2 cents and buy the September corn 260 call near 14 1/2. Risk 6 cents from entry and plan to hold the spread until September corn reaches the first upside objective at 267. The September 260 call should be near 24 cents and the 230 put near 5 1/2 cents if the objective is met in the next month.

