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2010 Commodity Market Outlook: Fundamentals Will Matter

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Commodity Markets: 2010 Outlook

Fundamentals will matter: We expect correlations will weaken into and through 2010. Fundamentals will matter, more so than they did in the liquidity-induced rally of 2009. Investors, as a result, should be much more discriminating in 2010. We want to own commodities with tight balances.

We want to own commodities that are levered to the EM: Our economists are forecasting healthy global GDP growth of 4%. Importantly for the commodity space, they see EM GDP growth of roughly 6.5% against developed country growth of 2%.

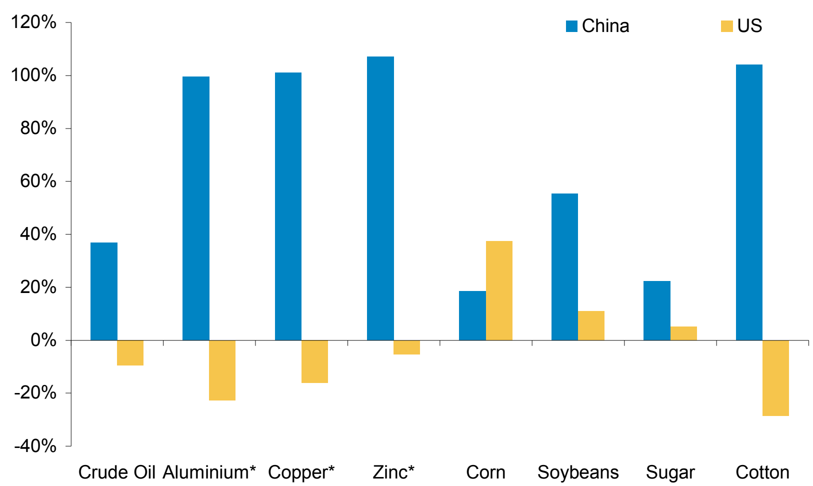
We expect inflation-risk to rise next year: The weighty public sector debt burden will pressure some central banks to continue printing. Commodities have historically outperformed equities/bonds in inflationary environments.

The USD won't weaken as much in 2010: A weaker USD provided a lift to commodities in 2009. While weakness against EM currencies is likely next year, we doubt that commodities will find the broad-based support from a weaker USD as they did in 2009.

Our Favorite Trades For 2010:

- Long gold through to the beginning of rate hikes
- Long deferred oil (Dec 2011)
- Long corn/short beans into US planting intentions
- Long sugar through April
- Long copper

US & China's Contribution to Demand Growth From 2003 - 2008



* From 2005 - 2008

Source: IEA, USDA, CRU, Morgan Stanley Commodity Research

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Macro Risks – What Would A USD Rally Mean?

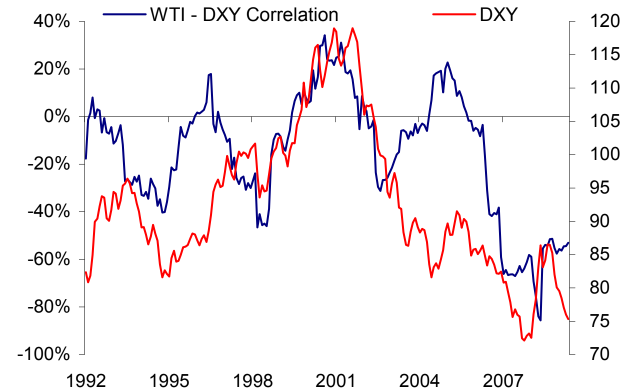
A weaker USD in 2009 provided support to the entire commodity complex. Into 2010, our FX strategy team is now calling for a stronger USD (vs. developed world currencies). A rally in the USD is not a death knell for commodities, in our view. Rather we expect the high negative correlation between most of the commodity space and the USD to fade.

The impact of a USD rally will depend on its cause. If the USD rallies because the US economy is outperforming other developed world economies, this will ultimately be supportive to commodity prices, especially for commodities where the US is a net importer. If the USD rallies because US interest rates rise owing to US government funding issues, this would be markedly less supportive. Our economics team is expecting rates to rise for both of these reasons. As long as the former is part of the story, we expect the commodity complex to do well overall.

We caution, however, that the immediate response on the part of investors to a USD rally could be to sell commodities, until the market digests the reasons behind the rally. <u>We would view a sell-off in the wake of a USD rally as a buying opportunity.</u>

USD Rallies Often Break The WTI – DXY Correlation

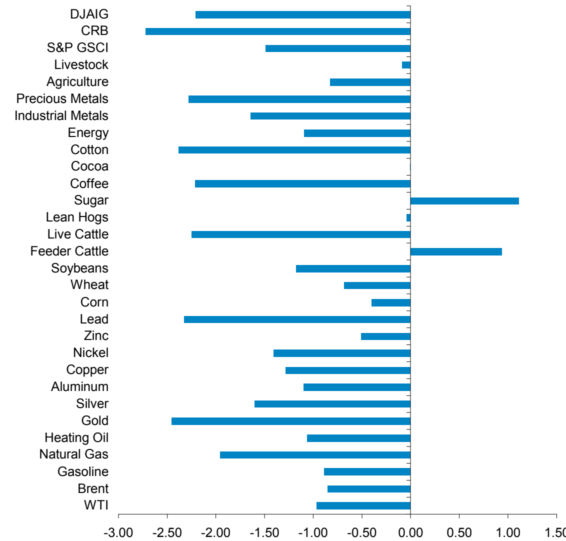
(left axis: MoM%Δ in price, 24 mo. rolling correlation; right axis: DXY index)



Source: Bloomberg, Morgan Stanley Commodity Research

Commodity Elasticity To The USD

(a 1 %Δ in the USD results in the %Δ for the commodity noted below)



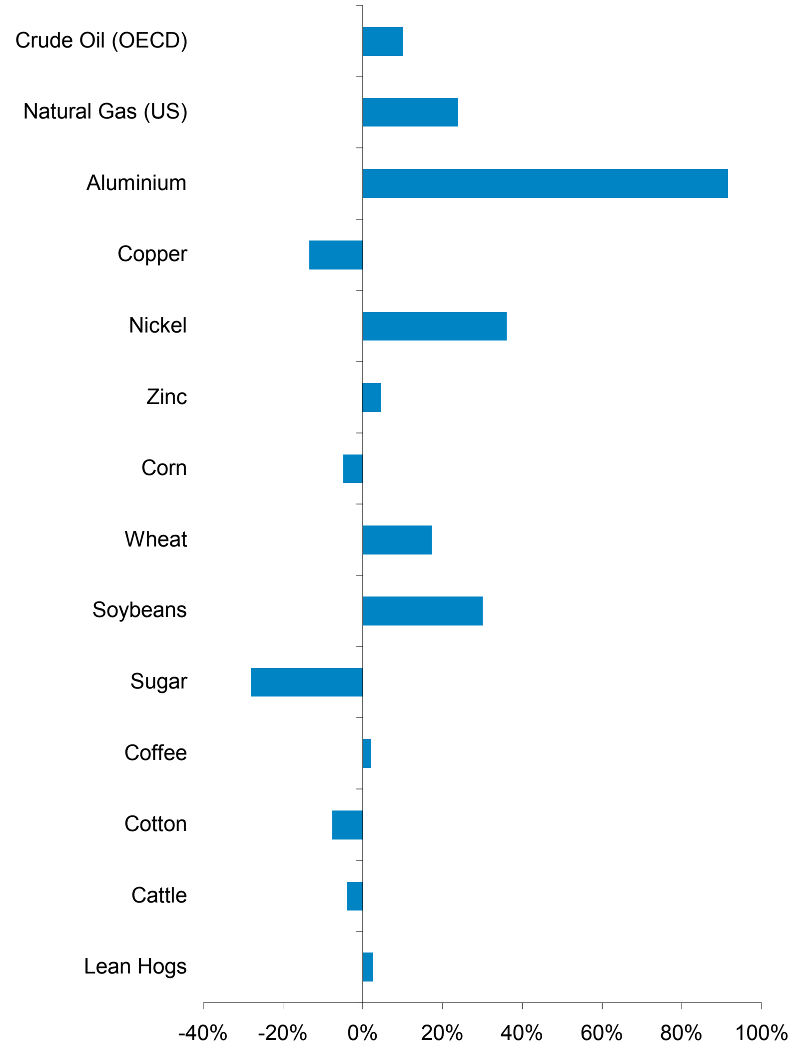
Source: Bloomberg, Morgan Stanley Commodity Research

Top Trades Into 2010

- In the commodity universe, sugar shows the best fundamental story through 1H10, and we expect prices to reflect the fact that the Indian cupboard is almost bare. We continue to see sugar prices trading to $0.30/lb prior to the arrival of Brazil's 2010 crop in April.
- We see oil prices grinding higher into 2H10 as demand rebounds and inventories start to clean up, making room for more OPEC barrels and the beginning of the end of spare global production capacity. A stronger USD and lackluster fundamentals may prove challenging in 1H10.
- Our long corn/short soybeans trade reflects relative inventories levels as well as the need to encourage an expansion of corn acreage in the US in spring 2010.
- Our long copper trade reflects our expectation of stronger demand for refined copper in the OECD and China, and persistent tightness in the scrap market.

World Inventory Levels

(2009 vs. 10 Year Average, % Δ)



Source: USDA, Morgan Stanley Commodity Research

Forecast Tables

Average Year Price

Energy		2010	2011	2012	2013	2014	2015
Crude Oil	**US$/bbl**	**85**	**95**	**105**			
Bull case		*100*	*115*	*120*			
Bear case		*55*	*65*	*70*			
Natural Gas *	**US$/mmBtu**	**6.50**	**8.00**	**8.00**	**8.00**		
Base Metals		**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Aluminum	**US$/tonne**	**1,900**	**1,900**	**2,100**	**2,500**	**2,500**	**2,500**
Copper	**US$/tonne**	**6,600**	**7,000**	**7,300**	**6,800**	**5,500**	**4,300**
Nickel	**US$/tonne**	**17,200**	**17,400**	**17,800**	**17,900**	**16,500**	**15,700**
Zinc	**US$/tonne**	**1,800**	**1,800**	**1,900**	**2,100**	**2,200**	**1,900**
Precious Metals		**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Gold	**US$/oz**	**1,200**	**1,125**	**1,075**	**1,025**	**975**	**900**
Silver	**US$/oz**	**15.77**	**16.50**	**16.89**	**16.52**	**15.10**	**13.35**
Platinum	**US$/oz**	**1,311**	**1,370**	**1,455**	**1,503**	**1,396**	**1,288**
Softs **		**2009/10**	**2010/11**	**2011/12**	**2012/13**	**2013/14**	**2014/15**
Cotton	**US¢/lb**	**64**	**72**	**81**			
Sugar	**US¢/lb**	**23.0**	**16.0**	**13.0**			
Coffee	**US¢/lb**	**141**	**150**	**150**			
Grains **		**2009/10**	**2010/11**	**2011/12**	**2012/13**	**2013/14**	**2014/15**
Corn	**US$/bu**	**4.50**	**5.50**	**6.25**			
Soybean	**US$/bu**	**9.00**	**11.00**	**12.50**			
Wheat	**US$/bu**	**5.50**	**6.50**	**7.00**			
Livestock		**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Live Cattle	**US¢/lb**	**95**	**99**	**100**			
Feeder Cattle	**US¢/lb**	**95**	**102**	**106**			
Lean Hogs	**US¢/lb**	**69**	**72**	**75**			

MS GDP Forecasts

YoY%Δ	2008	2009E	2010E	2011E
GLOBAL	**2.7**	**-1.2**	**4.0**	**3.9**
G10	**0.3**	**-3.4**	**1.9**	**2.1**
United States	0.4	-2.5	2.8	2.8
Euro Area	0.5	-4.0	1.2	1.1
Japan	-1.2	-5.7	0.4	1.4
Emerging Markets	**5.8**	**1.7**	**6.5**	**6.0**
CEEMEA	**3.5**	**-6.3**	**3.7**	**3.0**
Asia ex Japan	**7.0**	**5.7**	**8.2**	**7.6**
China	9.0	9.0	10.0	8.5
India	7.5	6.0	8.0	7.6
Latin America	**4.2**	**-2.5**	**4.1**	**3.9**
Brazil	5.1	0.0	4.8	4.0

Source: IEA, Morgan Stanley Commodity Research estimates

* Natural gas forecast is technically in US$/mcf, but virtually identical to a US$/mmBtu price
** Agriculture commodities are in US marketing years: wheat (Jun-May), cotton (Aug-Jul), corn & soybeans (Sep-Aug), sugar & coffee (Oct-Sep)
Note: Natural gas, platinum and base metals forecasts are as per Morgan Stanley Equity Research
Source: Bloomberg, Morgan Stanley Commodity Research estimates

Crude Oil: We Don't See The Market Tightening Up Until 2H10

2009 has been characterized by steep flat price rallies, even as crude timespreads have provided ample evidence of oversupply (steep contangoes). As demand globally starts to post growth for the first time since 2007, we believe the market's focus will return to oil's long-term supply issues (see our *Crude Oil Update: Balances to Tighten Again by 2012*, Sept 13, 2009).

We are bullish on demand next year — expecting 1.7 mmb/d of demand growth — but do not see the market getting tight. We expect a soft market through 1H, but in 2H, we think there will be room for OPEC to bring ≈0.5 mmb/d of offline capacity to market.

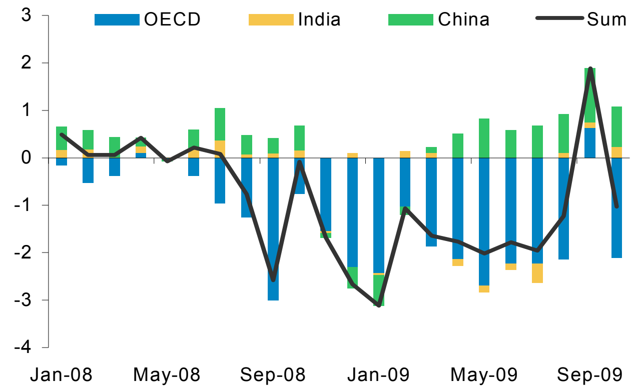
For 2010 we expect China to be the biggest contributor to oil demand growth (again) at 550 kb/d. Middle Eastern demand is forecast to grow by 300 kb/d, Latam by 200 kb/d and India by 120 kb/d. We are assuming that demand in the OECD bounces by 200 kb/d, as the economic recovery feeds through into higher distillate demand.

Our base case assumes that macro support for crude prices fades in 2010, as policymakers pull back the wave of liquidity that has been such a boon to oil bulls this year. We are sticking with our $85/bbl forecast for 2010. If prices falter — a possibility if the macro environment turns and fundamentals remain weak — we expect OPEC to keep barrels offline, which our balances indicate would be enough to cause steep inventory declines. Either way, OPEC spare capacity will remain ample — we estimate spare capacity in 4Q09 at ≈6 mmb/d.

We assume that US crude runs stay low, with refinery utilization averaging a similar level to 2009 at ≈ 83%. Combined with increasing Canadian flows this means that we expect WTI to continue to suffer periodic dislocations from the global crude market in 2010.

For Refinery Runs, OECD Weakness Is Trumping Non-OECD Growth…

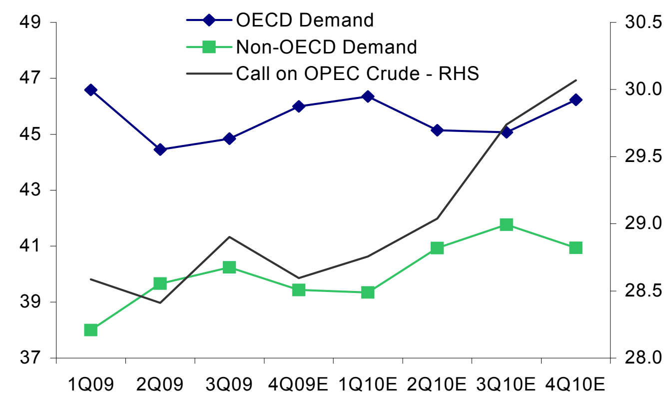
(Crude Runs YoY Δ, mmb/d)



Source: IEA, Morgan Stanley Commodity Research estimates

…But Things Should Be Tighter By 2H10

(left axis: OECD and non-OECD demand, mmb/d; right axis: Call on OPEC Crude, mmb/d)



Source: IEA, Morgan Stanley Commodity Research estimates

Products: Staying Bearish On Cracks, Especially Gasoline

We remain bearish on refining margins given the ramp-up in capacity that has accompanied the collapse in demand in 2009. We count another ≈1 mmb/d of refining capacity coming on line in 2010 — after a similar increase in 2009.

Weak margins have already caused the shuttering of 1.8 mmb/d of refining capacity. We think it will take more than this to balance the market, particularly with so much new capacity coming on line. Persistently weak margins are required to rebalance the market, and summer cracks look like a sale in this environment.

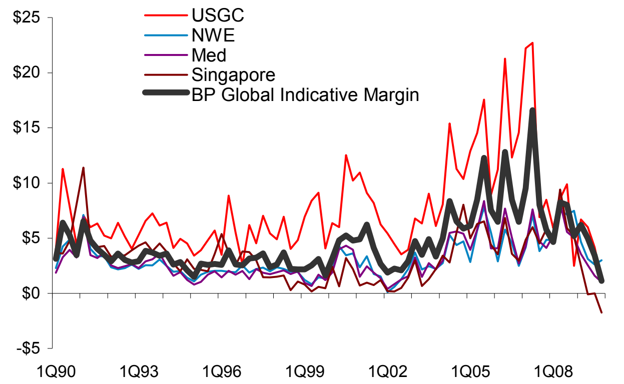
Data on EM car sales is bullish gasoline. Chinese car sales are up 73% thus far in 2H09, with Indian car sales up 27%. Assuming ½ gallon/new car/day implies demand growth in these two countries alone of 180 kb/d. Despite these stats, we are looking for distillates to be the lead product. We count 200 kb/d of new cat cracking capacity coming on line in 2010. And we expect the surging NGL production coming from new LNG start ups and increasing flows from unconventional gas plays in the US to find its way into the gasoline pool, weighing on the gasoline margin especially in winter.

Distillates continue to suffer as demand remains weak and inventories remain bloated. The weather has finally turned cold, which will help, but we continue to look for signs of a rebound in Atlantic Basin diesel demand. We expect the 1H10 retail restocking to help clean up the market.

We expect frequent and steep contangoes in WTI to continue to support cracks at surprisingly wide levels, given the poor demand and inventory backdrop.

Margins Are Weak Everywhere…

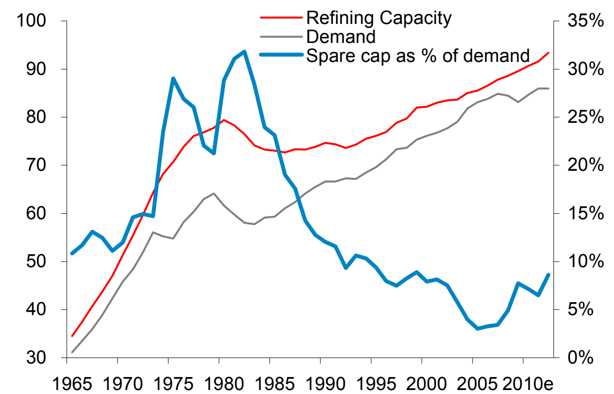
(BP regional refinery margin estimates, $/bbl)



Source: BP, Morgan Stanley Commodity Research

…As Spare Refining Capacity Weighs

(left axis: global product demand and refining capacity, mmb/d; right axis: spare refining capacity as % of global demand)



Source: IEA, Morgan Stanley Commodity Research estimates

Natural Gas: Still Waiting For Production To Roll Over

Gas was pummeled in 2009 by the combination of an economic-driven collapse in demand and a paradigm shift in the US production outlook as the full scale of unconventional gas plays became clear. Inventories are starting the winter at record levels, 16% higher than the 5-year average level. In 2010, we are modeling a slight rebound in industrial demand, but this is offset by over 1 bcf/d of gas demand getting backed out by the start-up of incremental coal and nuclear power capacity. US onshore production is the wildcard in our forecast: bulls have been waiting for US production to roll over in line with the rig count, but have so far been disappointed.

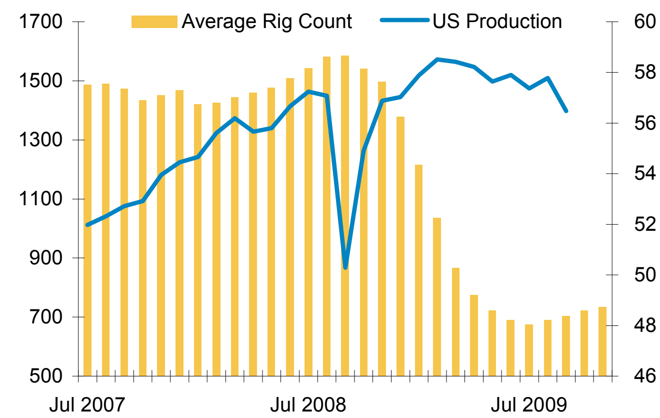
US production in 2010 will be a function of price (in Sept & Oct 2009 we saw ≈1 bcf/d of economic shut-ins), decline rates and rig counts. The rig count remains down 47% YoY, but the parabolic decline rates associated with shale gas plays have yet to show up in onshore production declines. We are currently modeling US onshore production down 2 bcf/d in 1H10, but the absence of any material rollover in production in the monthly data through September justifies caution. Our conversations with companies reinforces our concern, with most expecting growth next year, with hedges already in place to protect cashflow.

Total demand in 2009 is down ≈1 bcf/d, or 2% YoY. For 2010 we are modeling a rebound in industrial demand of 0.4 bcf/d (in line with our economics team's bullish view on US IP), but this is neutered by an incremental 0.8 bcf/d of coal-powered generation capacity, and another 0.4 bcf/d of nuclear and wind generation capacity.

LNG is another thorn in the side of the bulls, with 9.8 bcf/d of new liquefaction capacity coming on line. European storage is near capacity heading in 2010; barring a frigid European winter the US may have to cope with significant LNG supplies next year.

US Production Just Won't Quit

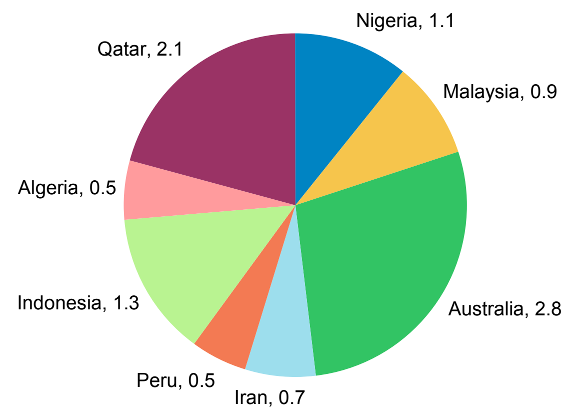
(left axis: US Rig Count; right axis: US Production (Bcf/d))



Source: EIA, Morgan Stanley Commodity Research

9.8 Bcf/d of New Liquefaction Capacity in 2010

(Bcf/d)



Source: Norwegian Energy, Morgan Stanley Commodity Research estimates

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We would like to thank Stephen Richardson for his contributions to this work

Aluminium: Rising Production And Capacity A New Challenge

Relative price performance for aluminium in 2009, which was the poorest for all of the LME metals, reflected a continuing market surplus and concerns about the high level of exchange stocks, despite the existence of a large number of financing deals that have effectively tied up an estimated 75% of LME inventories.

We are expecting further improvements in primary aluminium consumption in 2010 as the residential construction and automotive markets in the US start to recover, albeit from a low base. Consumption of aluminium in the Chinese residential and retail construction sectors and in the automotive industry is also expected to be very robust, resulting in a global increase in aluminium usage of 13% YoY.

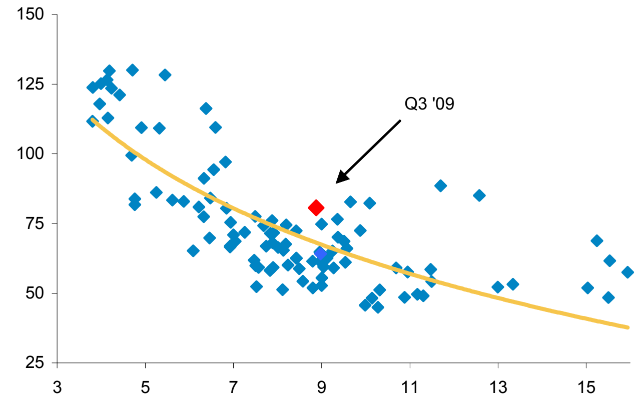
With a healthy recovery in demand in 2010, it is the supply side of the aluminium market that will continue to present the greatest challenges in 2010, just as it has done in 2009.

There are several elements to this supply-side challenge. First, the continued ramp-up in Chinese production and increased capacity raises the possibility of net exports adding to global supply. Second, while much of the closed capacity in the western world is expected to remain idle during 2010, new capacity growth in the Middle East and India will also lift output.

Third, the market still has to face the reality of high inventories, despite buoyant investor sentiment reflecting the persuasive influence of financing deals. Some warehouse deals are unlikely to be renewed in 2010, with the result that prompt availability will increase, making a sustained rally in aluminium prices difficult.

Aluminium Stock to Use, 1984-2009

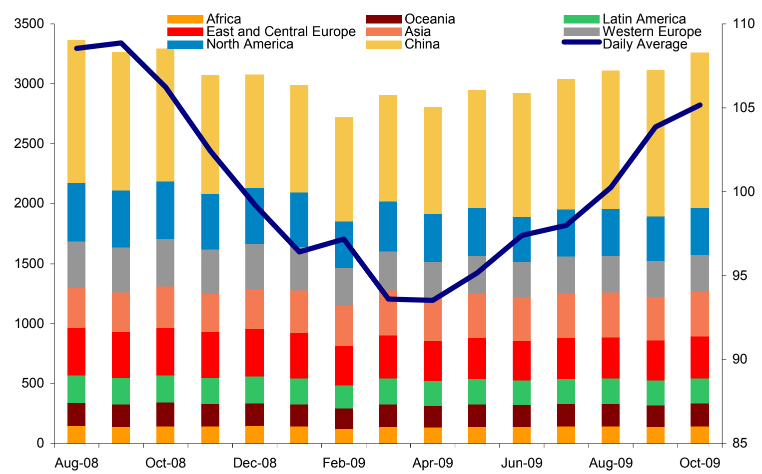
(Vertical axis: price, US¢/lb; horizontal axis: weeks)



Source: WBMS, Morgan Stanley Commodity Research

Primary Aluminium Production

(kt)



Source: IAI, Morgan Stanley Commodity Research

Copper: Despite Inventory Build, Still Our Preferred Base Metal

With the exception of lead, copper has been the best performing metal in 2009, by a large margin. YTD, LME cash prices have risen by 130% in USD, reflecting the impact of aggressive Chinese restocking in 1H09, relatively low inventory levels, scrap tightness and a limited amount of idled capacity.

All of these factors are expected to influence prices again in 2010. A 2H09 inventory build in the US and Asia and an easing in apparent consumption growth in China as imports moderate have made the market anxious about the sustainability of recent strong price moves on the back of investment demand and as such we see an initial period of consolidation as likely early in 2010.

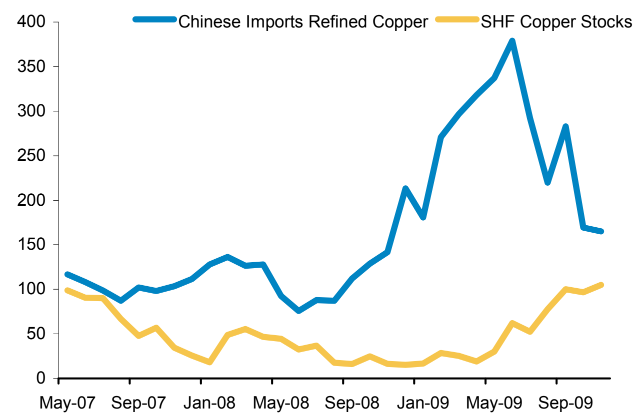
However, as the period of Chinese "indigestion" from excess imports subsides and global growth prospects improve during 2010, we expect the underlying positive dynamics of the copper market to reassert themselves once again, laying the basis for another price rally.

Key elements of anticipated renewed price strength in 2010 will be the persistence of tightness in the scrap market, especially in China, resulting in upward pressure on demand for primary feedstock. Concentrate supply, in turn, is also expected to struggle in the face of the long-term trend of falling head grades and the impact of rising labour militancy in a number of key copper regions.

An anticipated shortfall in refined supply in the face of improving demand for refined copper in the OECD and strong growth in China is, in turn, expected to put renewed downward pressure on the stock-to-usage ratio and upward pressure on price.

Chinese Imports of Refined Copper vs. Shanghai Stocks

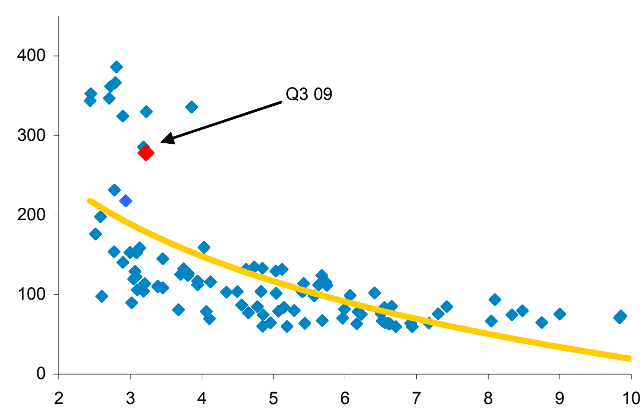
(kt)



Source: CRU, Bloomberg, Morgan Stanley Commodity Research

Copper Stock to Use, 1984-2009

(Vertical axis: price, US¢/lb; horizontal axis: weeks)



Source: ICSG, Morgan Stanley Commodity Research

Gold: At Risk From A Strengthening USD

An investor-led surge in demand in Q409, triggered by weakness in the USD, saw gold prices break decisively above the long-held resistance level of US$1,000/oz to reach a new all time nominal high in US dollar terms of U$1,221/oz on Dec 3, 2009.

Since then, a strengthening USD, either driven by changing interest rate expectations or a weakening in other major currencies such as the euro and yen, has seen the market under pressure from forces which we think will dominate the outlook in 2010.

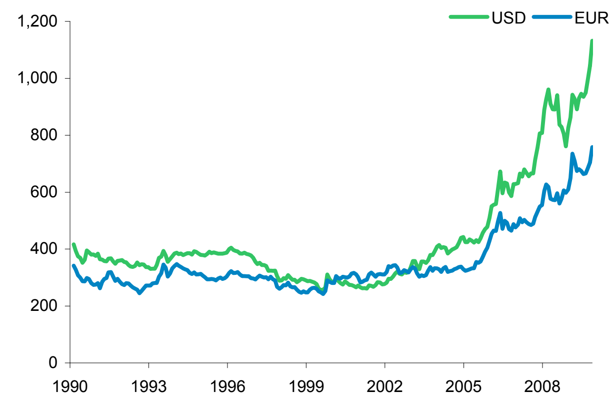
Based on this recent experience, we think a key risk to the gold price outlook for 2010 is the unwinding of the massive short US dollar/long gold position as part of a broader rerating of the US currency. While we expect that this will only occur when the market has greater certainty on the timing of a turn in the interest rate cycle in the US (our current expectation is Q310), anxiety over this event and its impact on gold prices will make further gains from the 2009 high harder but not impossible to achieve, in our view.

Furthermore, we do not expect the gold bull market to unravel owing to continued concerns about sovereign risk in a world of burgeoning public sector debt — and the difficulties of managing a reduction in global liquidity without stalling the fragile recovery in growth. We expect fears about incipient inflationary risks associated with excess liquidity, as well as central bank net purchases, to continue to be supportive of the gold price.

In short, 2010 has the makings of much more volatile gold market than 2009 as these opposing influences are assessed by investors.

Gold In USD & Euros, 1990-2009

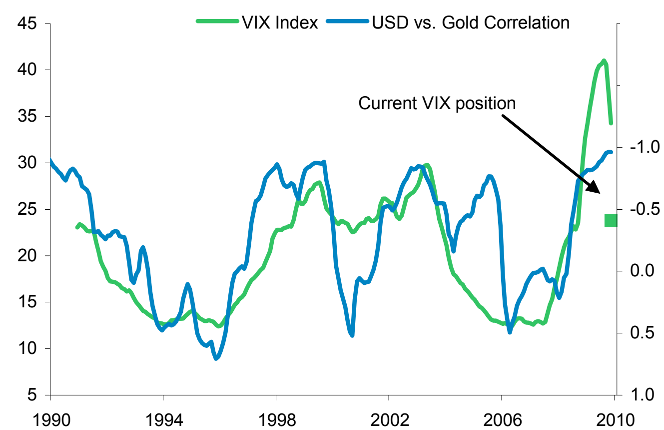
(Gold price: USD/oz, EUR/oz)



Source: Bloomberg, Morgan Stanley Commodity Research

Gold Correlation with USD vs VIX Index

(left axis: VIX Index, 12 mma; right axis: US vs. Gold 12m correlation)



Source: Bloomberg, Morgan Stanley Commodity Research

Platinum: Demand Recovery And Continued Supply Constraints

In a year when gross auto sector platinum purchases have fallen by almost a third as a result of the Great Recession, it is remarkable that total demand for platinum is likely to be down only 4-5% owing to strong growth in Chinese jewellery demand, essentially for restocking and further stock building.

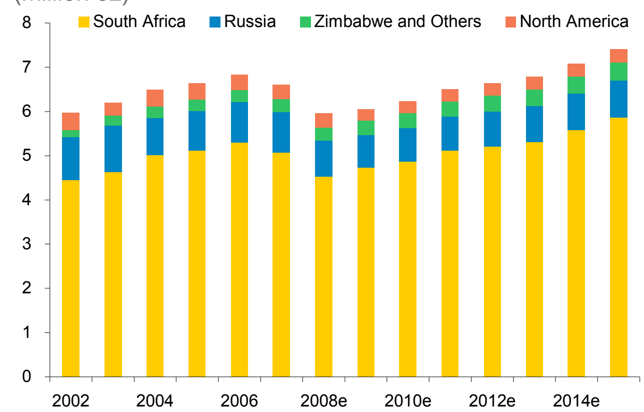
YTD USD price increases of 85% are likely to erode jewellery demand in 2010 in this very price-sensitive sector. Although some recovery in consumer purchasing of platinum jewellery is expected with an improvement in economic growth, we do not expect to see a repeat of the inventory-driven surge in Chinese demand either in that country or elsewhere.

In 2010, we expect automotive demand to again drive an increase in total demand for platinum and the wider group of platinum group metals. We expect this demand to come from a recovery in fleet purchases, especially in Europe, and a recovery in diesel-engine market share. In addition, the introduction of the first stage of Euro 5 emissions legislation in September 2009 for new light duty models is expected to give platinum an extra boost.

Platinum is a supply constrained industry, and this is expected to provide a powerful driver for price performance in 2010 as automotive demand recovers. South African producers sold 210Kozs more than total production in 2009 due to delayed sales of metal refined late in 2008. This overhang has now dissipated but underlying mine production is not expected to increase materially. This could lead to a return to a market deficit in 2010, as production problems persist in all of the major producers in South Africa, as a result of safety issues, rising power and labour costs, and the impact of a strong currency.

Platinum Production By Country, 2002-2015e

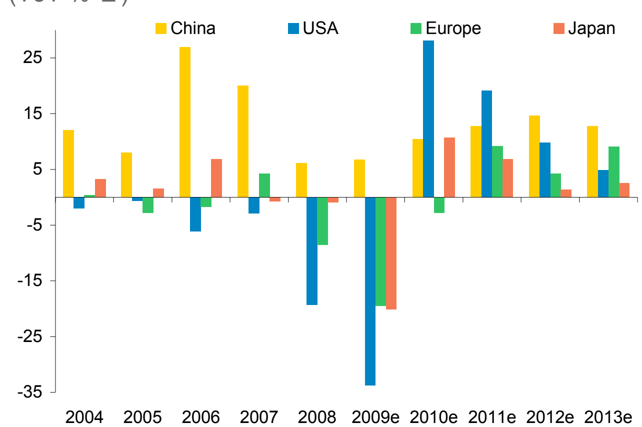
(million oz)



Source: Johnson Matthey, Morgan Stanley Commodity Research estimates

Total Vehicle Production By Country

(YoY % Δ)



Source: CRU, Johnson Matthey, Morgan Stanley Commodity Research estimates

Corn: We See Tighter US Balances In 2009/10 And 2010/11

Corn has upside of some 15%, in our view, with our 2009/10 marketing year forecast calling for prices to average $4.50/bu. While much of the recent attention in the corn pits focused on the delayed US corn harvest and its impact on production, bigger issues lie ahead.

Importantly, we see downside in corn acreage stemming from a shrinking autumn fertilizer and fieldwork window, suggesting that near-ideal conditions and fast work will be necessary in the spring to adequately sow acres. Furthermore, though prices have dramatically increased over the last few years, we've not seen inventories build.

With considerable acreage shifted from corn to soybean planting in South America, and the prospect for the same in the US, we are looking at a tighter YoY US balance in 2009/10 and see the potential for further tightening in 2010/11 unless we see a relative increase in corn prices.

Commercialization of advanced biofuels are further down the line from large-scale viability. In the interim, increased demand from the federally mandated RFS will require an incremental 730 mln bu of corn in to produce ethanol in 2009/10, in our view.

Deferred corn prices have not kept pace with soybean prices, lessening the economic incentive to plant corn over beans, as already evidenced in South America. Therefore, we see corn acreage failing to increase by the 2-3 mln needed to prevent inventories from declining, unless prices move higher.

US Corn Harvest Remains The Slowest On Record, Limiting The Time For Fieldwork…

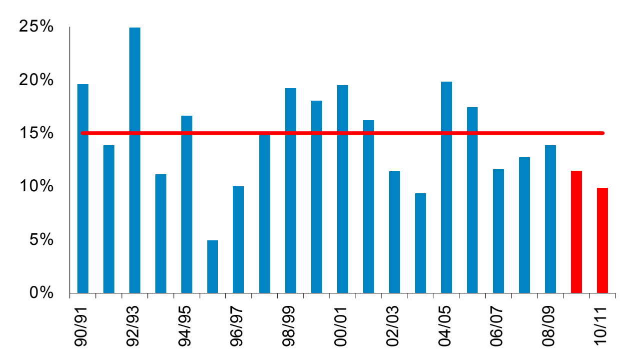
(US corn balance sheet)

Corn	USDA 07/08 Historical	Dec 08/09 WASDE	Dec 09/10e WASDE	MS 10/11e Forecast	MS 11/12e Forecast
Area Planted (mil acres)	**93.5**	**86.0**	**86.4**	**88.9**	**88.9**
Area Harvested (mil acres)	86.5	78.6	79.3	81.6	81.6
Production (mil bu)	13,038	12,101	12,921	13,016	13,302
Yield (bu/acre)	150.7	153.9	162.9	159.5	163.0
Imports (mil bu)	20	14	10	15	15
Total Supply (Inc Stocks)	14,362	13,739	14,605	14,706	15,169
Feed Consumption (mil bu)	5,938	5,254	5,400	5,000	4,800
Other Consumption (mil bu)	1,338	1,276	1,280	1,280	1,280
Fuel alcohol use (mln bu)	3,026	3,677	4,200	4,524	4,798
Ethanol Production (bgy)	8,322	10,112	11,550	12,440	13,193
Consumption (mil bu)	10,302	10,207	10,880	10,804	10,878
US Exports (mil bu)	2,436	1,858	2,050	2,050	2,050
Total Demand (mil bu)	12,737	12,065	12,930	12,854	12,928
Beginning Stocks (mil bu)	1,304	1,624	1,674	1,675	1,852
Ending Stocks (mil bu)	1,624	1,674	1,675	1,852	2,241
Δ in Stocks	320	50	1	177	389

Source: USDA, Morgan Stanley Commodity Research estimates

…And Leading To Tighter Supplies

(Corn stocks to use ratio, with 20-yr average)



Source: USDA, Morgan Stanley Commodity Research estimates

Soybeans: Strong Demand But South America Is On The Move

We are cautious soybeans for the 2H of MY 09/10 on a looming South American crop and a recently harvested record US crop. Chinese imports have remained impressive in the last 10 years, growing at a compounded annual growth rate of nearly 13.5%. The US soybean market has been especially strong by feeding China with its needs at the beginning of MY 09/10. However, the US will soon lose its status as the "only shop in town".

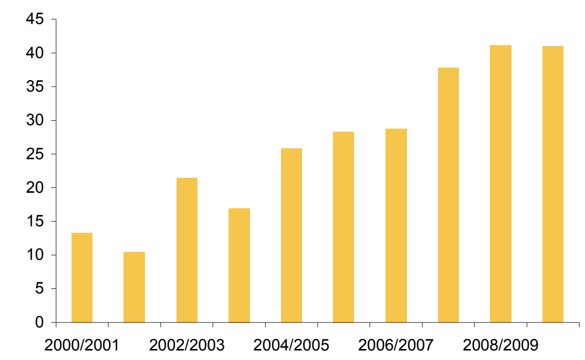
Following the Argentine drought that severely tightened world soybean stocks in MY 08/09 (production dropped to 32 MMT from initial expectations of 48 MMT), South America is fully expected to resume its upward production trend and post near-record production numbers (53 MMT for Argentina and 63 MMT for Brazil). This year's rally in the soybean flat price, greatly incentivized producers to substitute corn for soybeans.

Once the South American bean harvest starts, towards the end of January, China will have a bigger market from which to buy. This could lead to a higher than expected carryout for the 09/10 US crop. Further, any downside change to China's soybean needs could raise not only the US carryout, but the world balance as well.

We are bearish soybeans through the Nov 2010 contract as we see the market fundamentals softening. However, we remain bullish long term on the need for price appreciation to continue expanding acres.

Chinese Imports Remain Strong…

(Chinese annual soybean imports, MMT)



Source: USDA, Morgan Stanley Commodity Research estimates

…But US Supplies Loosen This Year and Next

(US soybean balance sheet)

Soybeans	USDA 07/08 Historical	Dec 08/09 WASDE	Dec 09/10e WASDE	MS 10/11e Forecast	MS 11/12e Forecast
Area Planted (mil acres)	64.7	75.7	77.5	**75.0**	**75.0**
Area Harvested (mil acres)	64.1	74.7	76.6	74.1	74.1
Production (mil bu)	2,677	2,967	3,319	3,250	3,295
Yield (bu/acre)	41.7	39.7	43.3	43.8	44.4
Imports (mil bu)	9.9	13	8.0	8.9	8.9
Total Supply (Inc Stocks)	3,261	3,185	3,465	3,514	3,626
Crush Consumption (mil bu)	1,801	1,662	1,695	1,712	1,764
Seed and Residual (mil bu)	93	101	175	185	195
Consumption (mil bu)	1,894	1,763	1,870	1,897	1,959
US Exports (mil bu)	1,161	1,283	**1340**	**1,295**	**1,295**
Total Demand (mil bu)	3,056	3,047	**3,210**	3,192	3,253
Beginning Stocks (mil bu)	574	205	138	255	322
Ending Stocks (mil bu)	205	138	**255**	322	372
Δ in Stocks	-368	-67	117	67	51
Stocks-to-use	6.7%	4.5%	7.9%	**10.1%**	**11.4%**

Source: USDA, Morgan Stanley Commodity Research estimates

Wheat: Still Plenty To Go Around

We maintain our neutral view on wheat at these levels. Corn and outside markets will lead the way for the time being. The world wheat supply is more than adequate to support current demand, with world stocks to use at 25% and the US stocks to use at over 43%, compared to 19% and 23% for the 5-year average, respectively.

US wheat exports face continued competition from Russia and other Black Sea countries, as wheat production around the world is increasing under favorable conditions. In MY 2007/08, the US exported 65% of the world's wheat. This falls to 58% in MY 2009/10. Should the USD strengthen, there will be additional pressure on US exports. As it is, the ready supply of wheat around the world leaves the possibility that the US carryout will increase further.

Should corn prices rebound as we expect, wheat could trade higher in sympathy and as a substitute for feed grain. However, that merely reinforces our neutrality as we view wheat to be a follower of corn.

Since the beginning of MY 2009/10, we have seen a high correlation (>0.7) between wheat and corn prices. We've also seen a somewhat negative correlation (-0.3) between wheat prices and the USD Index. Absent any further news that could reduce carryout, we expect these trends to continue for the time being.

With US Inventories Still High…

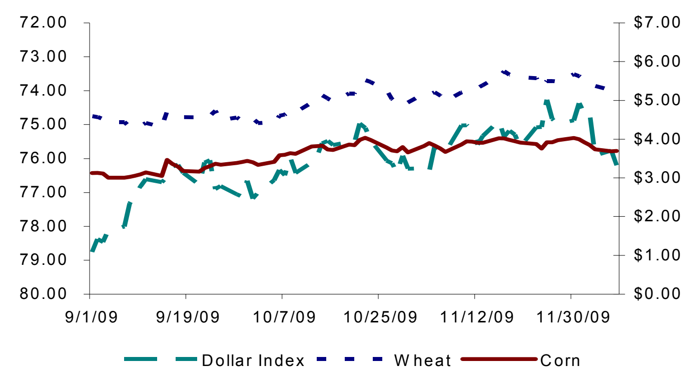
(US wheat balance sheet)

US	2007/2008	2008/2009	2009/2010	2010/2011
Beginning Stocks (million bu)	456	306	656	900
Area Planted	60	63	59.4	57.6
Area Harvested (mn acres)	51	56	50	49
Production (mn bu)	2,051	2,499	2,216	2,201
Yield (bu/acre)	40.2	44.9	44.4	45
Imports (mn bu)	113	127	110	111
Supply (mn bu)	**2,620**	**2,932**	**2,983**	**3,211**
Feed Consumption	16	260	190	190
FSI Consumption	1,035	1,000	1,018	1,038
Consumption (million bu)	1,051	1,260	1,208	1,228
Exports (mln bu)	1,263	1,015	875	1,138
Total Demand (mn bu)	**2,314**	**2,275**	**2,083**	**2,366**
Ending Stock	306	656	900	845
Stock to Use %	13%	28.9%	43.2%	35.7%

Source: USDA, Morgan Stanley Commodity Research estimates

…Expect Prices To Trend With Corn And USD

(left axis: USD Index; right axis: Front-month wheat and corn prices, $/bu)



Source: Bloomberg, Morgan Stanley Commodity Research

Morgan Stanley

Cotton: Turning Neutral

We are cautious in the near term as we feel that cotton's rally has gone too far and are staying on the sidelines for the time being. We see part of the gains in cotton of late as a reflection of strength in other agriculture prices as cotton as has followed corn and beans higher.

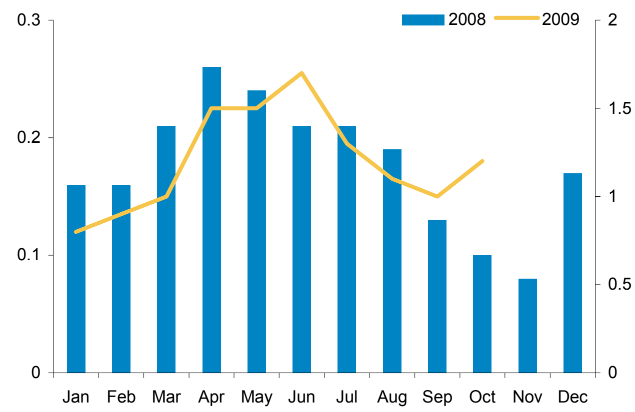
We note that fundamentally, China and India have both seen downward revisions to their production estimates. In its first estimate, in May 2009, the USDA forecasted Chinese cotton production at 33.0 mln bales. After successive downward revisions, the crop is now slated at 31.5 mln bales. India's cotton production estimate also continues to fall, now expected to reach 23.8 mln bales, down from 24.6 mln bales. Further, near-term support is gained from reduced crop prospects in the US, standing at 12.6 mln bales, down from 13.3 in USDA's first estimate.

Chinese import demand is likely to remain robust owing to concerns regarding the new crop which is suffering from delayed growth, low yield, and poor quality. The world stocks-to-use ratio is now standing at 45% vs. the 10-year average of 53%.

While US cotton exports may see a rebound later in the MY as supply dwindles from competitors, we remain neutral in the near term. Further rallies will be underpinned by strength in other ags, weakness in the USD, and continued global recovery.

Chinese Import Demand Continues…

(Monthly Chinese imports, MMT)



Source: Bloomberg, Morgan Stanley Commodity Research

…As World Stocks Tighten

(World cotton balance sheet, units in 1000 480-lb bales, unless otherwise noted)

	2006/2007	2007/2008	2008/2009	2009/2010
Beginning Stocks	62,371	63,134	62,156	61,123
Area Harvested (1000 HA)	34,734	32,942	30,755	30,438
Yield (KG/HA)	764	793	761	735
Production	121,953	119,908	107,480	102,719
Total Supply	222,379	222,034	199,894	197,724
Use	123,720	123,467	111,132	114,506
Total Dom. Cons.	121,979	121,406	108,544	112,041
Exports	37,266	38,472	30,227	33,876
Ending Stocks	63,134	62,156	61,123	51,807
Stock to Use %	**51%**	**50%**	**55%**	**45%**

Source: Bloomberg, Morgan Stanley Commodity Research estimates

Morgan Stanley

Coffee: Fairly Valued

Coffee has resumed its uptrend, reaching our 09/10 price target of $1.41/lb. Declining output in three of the world's four top-producing countries (Brazil, Vietnam, and Colombia, collectively responsible for 60% of global production) after heavy rains has underpinned the rally with the weaker USD providing additional support.

While recent reports have lowered global production estimates for 2009/10 to 125 mln bags, with similar consumption levels, our forecast already reflected a lower stocks to use ratio than USDA had forecasted (16% vs. our estimate of 14%). As such, our price forecast of $1.41/lb does not change dramatically with these new estimates.

Therefore, we are neutral on coffee as most of the recent supply and demand events have caused the crop to be fairly valued. However with stocks expected to remain equally tight in MY 2010/11, we remain bullish longer term.

As the Market Adjusts To New Data…

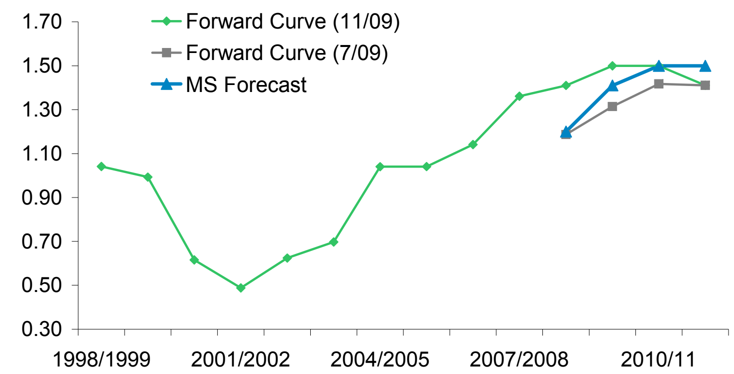
(World balance sheet)

World	2006/2007	2007/2008	2008/2009	2009/2010	2010/2011
Beginning Stocks	38.6	42.8	37.7	36.7	29.9
Area Harvested	10.1	10.3	10.3	10.2	10.3
Yield	13.2	12.0	12.9	12.3	13.7
Total Production	133.5	122.8	132.5	125.4	140.9
Total Supply	260.1	253.0	259.4	249.4	261.4
Domestic Use	115.5	119.1	120.9	122.0	124.4
Total Demand	217.2	215.3	222.8	219.5	228.4
Ending Stocks	42.8	37.7	36.7	29.9	33.0
Stocks-to-Use	**20%**	**18%**	**16%**	**14%**	**14%**

Source: Bloomberg, Morgan Stanley Commodity Research estimates

…Coffee Appears Fairly Valued

(Arabica coffee price, USD/lb)



Source: Bloomberg, Morgan Stanley Commodity Research estimates

Sugar: Staying Bullish At Least Through April

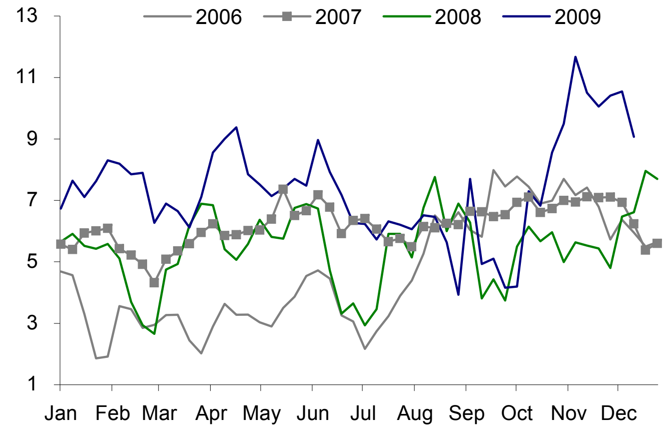
We expect the rally in sugar prices to continue, at least until the Brazilian harvest comes to market starting in April 2010. Spot prices have already more than doubled in 2009, as weather issues in Brazil and India added further pressure to a market already in deficit. It is clear that sugar will be scarce until the Brazilian harvest starts. The critical question for the market will be whether India buys raws or whites. Regardless of the outcome, we see sugar trading up to $0.30/lb prior to the start of the Brazilian harvest.

India will be the key driver of prices over the next few months. Poor rainfall looks set to limit 2009/10 production to ≈15 mln mt. Even if demand falters, we still think that India will need to import at least an additional 4 mln mt (on top of the 3-4 mln mt already contracted) to avoid the cupboard going bare. Our sources tell us that India has spare refining capacity of roughly 1 mln mt, meaning that India could be forced to import 3 mln mt of whites. This is driving the white-raw spread wider, and is bullish for the market as a whole.

In Brazil, sugar production for MY2009 is now seen at 34.0 mln mt. Mills are already winding down for the year, and ethanol demand is buoyant given relative pricing vs. gasoline and robust car sales. Heavy rains have curtailed production, forcing Brazilian mills to renegotiate ≈1 mln mt of deliveries from the end of 2009 into early 2010. Brazilian mills have only hedged ≈30% of their expected production for next year — well below their typical level of hedging — so when the Brazilian harvest starts we expect prices to come under pressure.

Indian Pull On New York Remains Strong

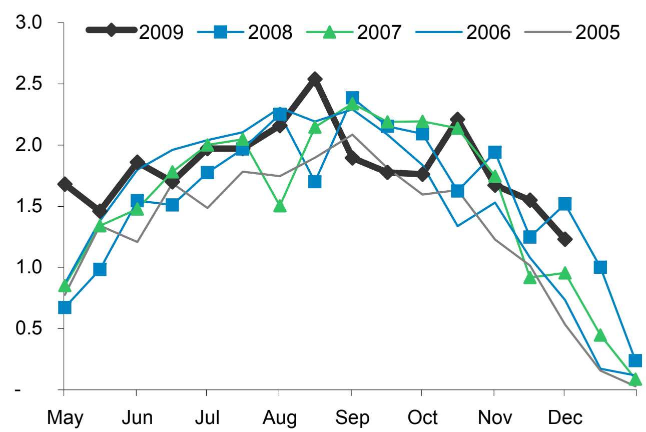
(Delhi M grade minus NY11s)



Source: Bloomberg, Morgan Stanley Commodity Research

Brazilian CS Sugar Production Has Disappointed

(mln mt)



Source: UNICA, Morgan Stanley Commodity Research

Live Cattle: Should Be Supported By A Year Of Stronger Appetites And Lower Weights

Live Cattle had a challenging year in 2009, owing to soft consumer confidence on the demand side while heavier cattle weights and an aggressive dairy cattle liquidation lifted beef supply.

2010 should be a year of improved beef consumption, both domestically and abroad.

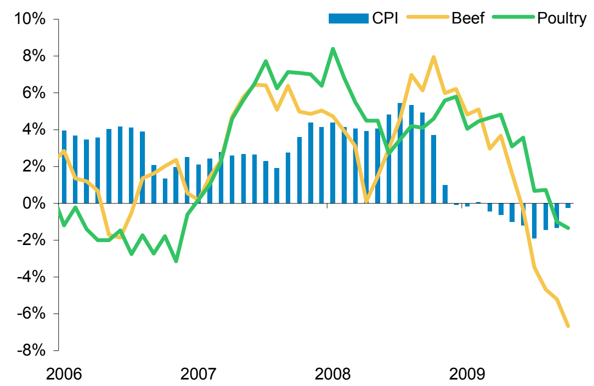
- US beef prices remain "cheap" in comparison to poultry on a YoY basis, as well as the entire consumer basket.
- An improved US and global economy should help support increased US beef demand, both through higher restaurant demand and a shift back towards beef.
- Strong rest of world growth should help export demand to continue to rebound.

2010 should also be a year of reduced supply, mainly driven by a return of more normal weather conditions, normal dairy slaughters, continued lower feedlot supply and poor feed quality.

- While 2009 saw favorable weather conditions for weight gain, weather of late has been poor, already lowering average slaughter weights. Normal weather conditions in 2010 are likely to result in a YoY fall in weights.
- Notwithstanding some overhang from this year, feedlots are expected to see lower YoY inventory levels, consistent with a general fall in beef cattle populations as cow-calf operations continue to rationalize their herds.
- Poor weather during the current corn growing season offers potential feed quality problems, likely affecting weights further in 2010.

Cheap Prices Should Help Beef Demand

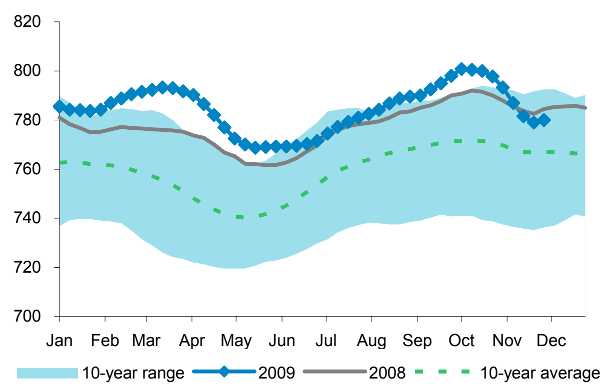
(YoY % Change in retail prices)



Source: BLS, Morgan Stanley Commodity Research

Feedlots Temporarily Rebounding, But Should Be Lower Again YoY in 2010

(Average dressed weight, pounds/head)



Source: USDA, Morgan Stanley Commodity Research

Feeder Cattle: Higher Corn Prices Mean Lower Feeder Prices

Feeder cattle prices are likely to be weighed down by higher feed costs in 2010, though falling cow-calf supply should keep prices from falling significantly — net feeder cattle should be marginally lower.

We remain bullish corn prices in 2010, which is bearish for feedlot prices.

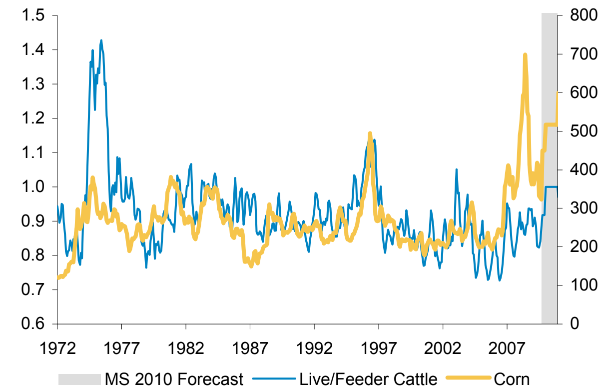
- Fluctuations in corn and feed prices put pressure on feedlot profitability (the difference between live prices and feeder prices).
- Because these fluctuations are normally reflected in feeder cattle prices with live prices more stable, a bullish corn view is bearish feeder cattle.
- Longer term, the bullish agriculture trend is bullish feeder cattle prices, as higher land values raise the opportunity costs for calf production.

Cattle inventories are expected to fall another 1.3% in 2010, implying lower placements onto feedlots — supportive for feeder cattle prices.

- While favorable 2009 weather has resulted in the recent surge in placements and rebound in feedlot inventories, lower calf production implies placements will weaken in 2010.
- Lower placements will prevent feeder cattle prices from falling significantly despite higher corn prices.

Higher Corn Prices Will Pressure Feeder Cattle Prices Lower

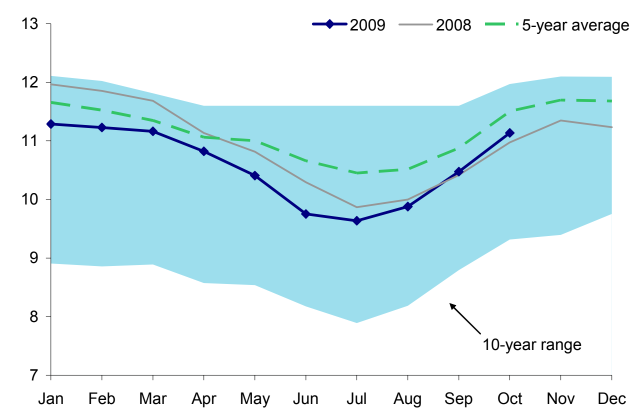
(Left axis: live/feeder cattle price; right axis: corn price, cents/lb)



Source: Bloomberg, Morgan Stanley Commodity Research

Despite Recent Rebound on Feedlots, Lower Placements in 2010 Lower Feedlot Inventories

(Million head)



Source: USDA, Morgan Stanley Commodity Research

Lean Hogs: Tightening Market, But Over Priced 2010 Rebound

Lean hog prices have traded beneath production cost for much of the past 2 years. With producers struggling to overcome strong production in the face of persistent demand challenges, prices are likely to grind higher, but less than is currently priced into the forward curve for 2010, in our view. However, with China a potential large importer of US pork, a USD/RMB correction presents a bullish risk to US lean hog prices.

Hog producers continue to be victims of their own success, with strong reproductive productivity preventing producers from adequately adjusting supply in a lower demand environment with feed prices continuing to cut into profitability.

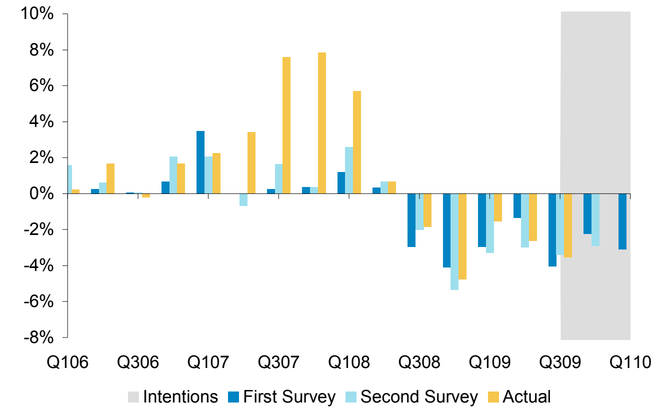
- Despite stronger resolve to cut farrowings and slaughter increased sows, producers are likely going to struggle to reduce supply enough to match demand until demand recovers sufficiently — this looks unlikely in 2010.
- Higher feed costs have offset increased lean hog prices.

2009 pork demand was negatively affected by reduced consumer spending, lower exports and misunderstanding of the H1N1 virus. In 2010, low pork prices, improving consumer demand and reduced H1N1 fears should all be supportive for demand.

- Pork remains historically cheap on a YoY basis, while rising global demand is likely to help exports — a more significant factor for the US hog market.
- Any significant adjustment in the RMB, meant to address global trade imbalances, would be particularly bullish for hog prices with China the largest global pork consumer.

Hog Producers Continuing To Show Some Discipline

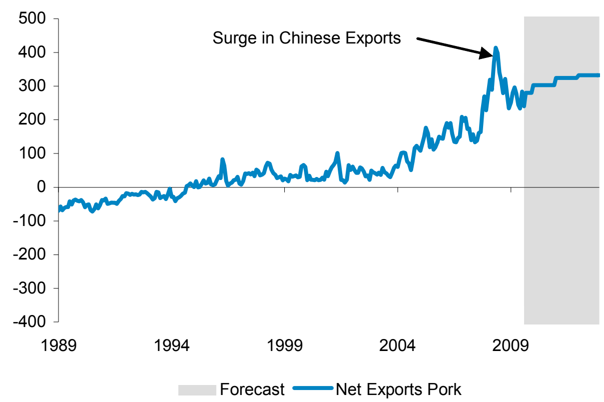
(Farrowing intentions, YoY % Δ)



Source: USDA, Morgan Stanley Commodity Research

Improved Global Demand, Positive For Pork Exports

(US net exports, million pounds/month CWE)



Source: USDA, Morgan Stanley Commodity Research

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