

"Sharpening Your Trading Skills:" Seasonality in Markets

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Two of my favorite trading subjects are cycles and seasonality. In this feature, I'll discuss seasonality in agricultural markets.

I want to start out by emphasizing that seasonality or cycles, by themselves, do not make good trading systems. However, they are great "tools" to add to your "Trading Toolbox."

Seasonality in agricultural markets is a function of supply and demand factors that occur at about the same time every year. For agricultural markets, supply stimuli can be caused by harvest, planting, weather patterns and transportation logistics. Demand stimuli can result from feed demand, seasonal consumption, export patterns, etc.

Livestock futures, too, have seasonal tendencies. Hog and cattle seasonals tend to be caused by production, marketing, and in the case of hogs, farrowing.

Grains tend to follow the general rule of lower nearby futures prices at harvest more than other agricultural commodities.

Here is a quick summary of seasonals in several markets. (If you are interested in a more complete study of seasonality, there are entire books written on the subject.)

Corn: This market's seasonality can be divided into three time periods: late spring to mid-summer; mid-summer to harvest; and post-harvest. The most pronounced seasonal trend in corn is the decline of prices from mid-summer into the harvest period. Prices are often near their highest level in July because of factors associated with the old crop and uncertainty over new crop production. Even in years when a price decline begins before mid-July, it can continue after mid-July if the crop outlook is favorable. Harvest adds large supplies to the marketing system, which normally pressures prices to their lowest levels of the crop year. Prices usually rise following harvest. However, the "February Break" is a well-known phenomenon whereby corn prices usually show some degree of decline during the month of February.

Soybeans: The July-August period is usually a bearish time for soybeans. Closing prices during the last week in July are usually lower than those of the previous week in July. Closing prices at the end of August are also usually lower than those at the end of July. Also, soybean prices in late January are usually higher than those in late December. Soybeans many times also succumb to the "February Break" seasonality phenomenon. Soybean meal and oil have the same seasonal tendencies as soybeans.

Wheat: The seasonality of wheat prices works best when a trader is on the long side from the period of harvest lows to October/November. On the short side, from winter into summer harvest tends to work well. Wheat has two prominent seasonals: One is a strong tendency to decline during late winter and spring as the harvest

approaches. The other is to rise from harvest lows into the fall or early winter. Wheat prices begin a seasonally weak period by January or February, in most years.

Live Cattle and Feeder Cattle: Seasonality in feeder cattle prices depends on the seasonality in live cattle prices, along with annual fluctuations in feeder cattle supplies. In general, feeder cattle prices are strong from late winter through spring, drop during the summer, and stabilize at lower levels in the fall, before turning up in December. Live cattle prices normally trend higher from January through May. Prices for live cattle reach their seasonal peak in May and then usually begin a downtrend that extends through the end of the year. Demand for feeder cattle also begins to peak in May, and prices fall into July.

Live Hogs: Seasonal marketing pressure increases during March and persists at increased levels during all or part of April. The reason for this is that August and September farrowings are usually larger relative to other farrowing months. Slaughter levels decline seasonally from March-April into July or August. Thus, prices could generally be expected to rise from March to May and decline from May into August.

Cocoa: The yearly seasonal low tends to occur in January with the Bahia (Brazil) main crop, rather than in May or June with the Temporao (Brazil) crop, because of consumer demand. Consumer demand tends to rise into late fall and early winter, which boosts prices during that timeframe. As demand peaks and then begins to decline, cocoa prices fall into January. It's important to note that seasonal tendencies in cocoa are not very strong.

Coffee: The frost season in Brazil occurs during the May-August period. In anticipation of this frost, prices tend to rise from January into June. This seasonal tendency is not real strong, however, because coffee can come from other producing countries, such as Mexico. Still, the potential for a Brazilian frost should be monitored. The other seasonal influence is during the winter, when U.S. coffee consumption tends to rise.

Cotton: Cotton is a market where the "trade" has very heavy participation and seasonals tend to be a function of heavy deliveries issued against the expiring futures contracts--December, March, May, July, and to a lesser degree, October. In November, the market tends to recover from harvest lows, and then in January the market tends to back off to lower levels.

Orange Juice: Seasonal price movement of FCOJ (Frozen Concentrated Orange Juice) does not usually reflect the December-February freeze period in the southern U.S. Seasonal tendencies are caused by harvest, production (also called "pack") and demand ("movement"). The most significant seasonal move in O.J. is that prices generally fall from November to January. Freezes cannot be completely ignored, however.

Sugar: Prices tend to peak in November because of a combination of supply and demand. Production at this time is not complete, as the European crop is not yet on the market. Demand in the Northern Hemisphere, however, is usually at its peak in the fall.

I would classify seasonal tendencies as "secondary" technical indicators in my "Trading Toolbox." I do follow seasonals, but they are not my "primary" trading tools. I have seen much hype in the marketplace regarding seasonals. I remember one summer hearing a radio advertisement from a futures brokerage that went something like this: "Colder weather is just around the corner and heating oil demand will increase. Thus, you should buy heating oil futures now, and profit from the increase in demand." If only futures trading were that easy! Every professional trader and commercial firm knows that heating oil demand rises in the winter--and even in the summer months they have already factored that rise in demand into the prices of the farther-out (deferred) futures contracts. The same is true for other markets' seasonal price patterns. The professional traders and commercials all know about seasonals in the markets, and position themselves accordingly. It is always good that we speculators have as much information on markets as possible. Seasonal price patterns are just one more bit of information to factor into our trading decisions.