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# 2018 FIRST & SECOND QUARTER OUTLOOK

Presented by

Sean Lusk & Ben DiCostanzo

# Section A: Grains
# Section B: Livestock
# Section C: Precious Metals
# Section D: Stock Indices

## Sean Lusk, Co-Director Walsh Commercial Hedging Services Division

Sean Lusk is a registered commodity broker and Co-Director of the Commercial Hedging Division of Walsh Trading in Chicago. Sean began in the business as a runner on the trading floor during summer breaks from college in 1993. Upon his graduation from Southern Illinois University at Carbondale in 1996, Sean began his career on the trading floor of the Chicago Mercantile Exchange (CME). Overseeing billions of dollars of transactions working as a clerk in the Eurodollar pit, Sean took the next step and became a floor broker and member of the CME in 2003. He handled customer orders for banks and investment houses from all over the world from inside the Libor pit at the CME.

Now, at Walsh Trading, Sean utilizes his experience in the marketplace and his professional client service skills to aid and assist customers in their trading endeavors.

Sean writes daily and weekly commentaries focusing on Precious Metals and Agricultural Markets along with related market activity. He has been quoted in various media outlets discussing futures markets. These include, Futures Magazine, Reuters, Forbes, Kitco, Nikkei Press and CCTV.com.

## Ben DiCostanzo, Senior Technical Analyst

Ben is a graduate of Pace University with a degree in Accounting. In 1984, he became a member of The Index and Options Markets of the CME. He is Series 3 Licensed. Ben has been involved in many areas of the Securities industry, from working as a runner on the NYSE to taking care of professional traders and institutional clients for Salomon Brothers on the CME. He traded equities as a local before moving on and working with individual clients.

Ben understands that every client's need are different and he prides himself in tailoring his service to each client's unique circumstances and needs. Individual client experience, risk tolerance, and capital all play a role in how he approaches the markets. He is very involved in all markets using technical analysis to find opportunities. Ben's approach is driven by principles of capital preservation. His trading philosophy is that if you can recognize and manage risk, you have a better chance to be successful in trading. Ben advises all his clients to always use stops as money management – in his opinion, it is the most important ingredient in trading commodities

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# Walsh Trading 1st Quarter 2018

Contained in these sections are a fundamental and technical outlook for 4 different commodity sectors and a trading game plan using futures and option strategies. As years and decades in commodities have taught us, long term outlooks past three to four months don't hold water as far as predictions are concerned. This is due to so many external factors previously unforeseen that cause immediate reversals in market direction or stunt directions and trends. Markets in general make moves and then fill gaps on the charts. It is then paramount that one deciphers the major players in each market and understands how these major stakeholders identify market trends and then study their tendencies. We have submitted a written prospectus on 4 sectors:

Grains
Equities
Precious Metals
Livestock

A fundamental and then technical outlook with specific trade recommendations accompany each market. The trade recommendations include futures and options on futures recommendations for you to consider. Trade entry levels first and then profit objectives are included to round out each game plan. One that does not have an exit strategy in our view is simply guessing and therefore throwing darts at a wall. Ben and I handle execution on both entry and exit and would enjoy the opportunity to discuss each with you.

Sincerely,

Sean Lusk and Ben DiCostanzo



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# 2018 1st and 2nd Quarter Outlook Grains

## Section A

Grain price seasonal patterns and monthly trends provide endless opportunities in cash grain marketing. I often receive calls from producers asking me the question, when is the best time to sell my grain? My reply, "there are too many to list!" As we move into 2018 many of the same pricing fundamentals that look to drive futures prices and control cash prices remain the same. Yet we should expect the fundamentals that give grain futures their vast sweeping moves and commercial dominance over cash movement to continue to move them further apart, creating a two tier market system. The cash and grain markets are driven by two very different groups and mind-sets. Since 2008, there has been a change in the roster of grain movers and shakers. The year's prior saw price action in the cash market controlled by large individual traders and 5 to 10 million seasoned Ag trading funds. It was said if you wanted to make money, follow the commercials, (ADM, Cargill, Bunge) since they were the big money in grains. Commercials developed what is known in the grain market as the seasonal trend. They bought the grain at seasonal harvest low cash prices-often the low of the year and sold to feeders, processors, and importing countries at seasonal demand –time high prices and often the highs of the year. The problem was it was always in the commercials best interest to keep prices down when growers went to harvest and needed to sell grain to pay debt due at harvest time. If ending stocks were ample as they are these past years for let's say corn and wheat, commercials never bought futures contracts on news. Rather the commercials sold more short grain futures to protect their grain in storage, as an insurance hedge from prices falling. Their mindset remains the same till this day, and it is in their best interest to keep cash prices under control and not follow the spiraling futures rallies.

Futures are now controlled by massive billion dollar index funds these outside the traditional AG industry funds entered the commodity world in 2007-08 after the U.S. government changed laws that now allow money from stock trading companies once considered too risky. Virtually overnight the market went from trading $5 to $10 million in Ag trading funds to $50 to $200

billion index funds. These monies originated from massive billion dollar conservative stock managed accounts from teacher, auto, and private company pension funds. What was witnessed since their entry into the grain sector was a buy first mentality from the money managers who controlled the trading. They were technicians whose trading psychology was 90 percent chart patterns. Their pattern was to buy any news that entered into the market and sell at month or quarter end. They didn't know a bushel of corn from a phone booth and didn't care as they knew little of fundamentals of commodities. In the last few years since the introduction of bio-genetic seed, we have seen these funds establish sizable short positions in corn and wheat. As crop sizes and global carryouts have grown, corn and wheat supplies have outstripped demand. Here is a look at each market in depth heading into 2018 with charts and option strategies to consider.

## Corn

The corn market has no friends at all. We have a huge surplus and no way are we going to get rid of it. Everybody is discouraged - thinking that corn will not be able to move higher. Good markets need fundamentals that either back up the idea that the surplus is too big or that use outstrips supply. There's talk already that we will plant more corn than beans next year. I disagree with this especially if we can rally this bean market into a hedge able position. The next few months I think will be quite important to see how the world perceives usage and what the energy market does as far as price simply because corn is also a fuel in the form of ethanol. One of the neat things about our country is that we are able to approach energy from a number of different resources. Fossil fuels will need to be cleaned up in the coming years to concentrate on cleaner burning of the carbon producing energies which are contributing to global warming.

I see the basis tightening in the corn market. What this tells me is that we may have finally built enough storage and have given the corn producer enough power to hold onto his corn and make the end users come in here and up the ante. We have no power over the market except for the ability to keep the product off the market. This will depend on how much lasting power the grain producer will have. As we move up in the grain market there will be more corn priced above it all the time. The funds' huge short will dictate market movement much more

than the fundamentals. There is a pretty good feeling that the Chinese will expand ethanol production by six times by 2020. I also read a report that of the huge amount of corn they have in storage 70% is unusable for feed and will have to be blended to make ethanol. We finished up harvest here and we have the bins locked up which will afford us the chance of being more in control then we have been in the past. One thing I do like about the corn market - chart wise - is the huge sideways movement we've had since Aug. 31. Market does not go on up much, market does not break much. These types of movements are characteristic of markets that don't have much direction but also there is an old adage that says you do not sell a quiet market.

## Wheat

Wheat market like the corn is suffering from over production and has been going sideways since Aug. 22. It has not been able to foster many friends from the long side and there is no compelling reason why it should go higher. For the last few years wheat like corn has had some bumper production and there has not been any reason for it to go on up. Like corn it has a wide basis and a number of its producers have given up on ability of the market to move higher. This is a dilemma for the producers and I think you will see more beans planted next year in wheat country because it worked out relatively well in the Southwest where they did plant beans even though they do not yield what they do in the Midwest. They help cover costs better because of the low inputs and the nitrogen derived from the bean crop aids in wheat production. We have also had the funds holding a big short position which has not made them much money in the last 90 days. If anything starts to concern them, we will probably see them coming out of the short side of the market. One of the reasons that they haven't made much money is simply the inability for the market to move down like corn. Sleeping markets are a bad time to be short. We have already experienced lethargic markets through these bumper crops. At the present we have a big dry pocket in the winter wheat area and we need to see if that continues into the spring. The long term forecast currently predicts the Southwest to be dryer and the winter milder. We need to see how this develops.

## Beans

Funds are holding a very modest position in beans at only long 24K contracts**.** Extended monthly European weather model forecasts were released this AM. They show the potential for continued dryness for Argentina and S Brazil heading into March! It's likely that these extended models forecasts offered some prodding for fund managers to start building a larger net long soy position. I think we have a pretty good shot of going to $10.30 in Jan futures or higher. I would be look at contracting new crop Nov 18 or Jan 19 from $10.30 up to $11.30 with the possibility of where beans can go. I don't know what would move this market up like that but I'm also with the idea that the funds hold a big short position in the corn and wheat. Beans like to run and the funds like to play them. So that is about my best thought of why this market could move higher. The other idea is that farmers are pretty much down on their own product and a lot of times that will make a market move positive. I like to trade by the contrarian theory and that is when everyone is running one way, I want to be slowing down to see what the commotion is and probably start heading the other way. We need to watch the weather both here and in South America. If there is either prolonged dryness or moisture, we could change the amount planted and the yield.



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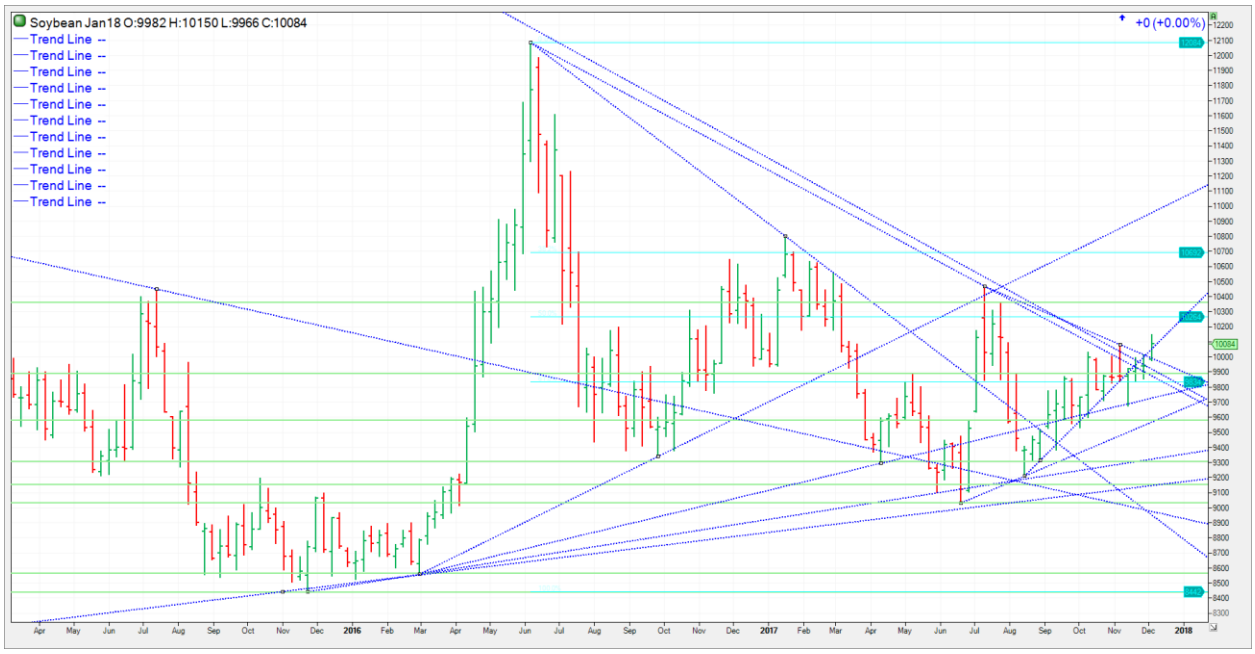


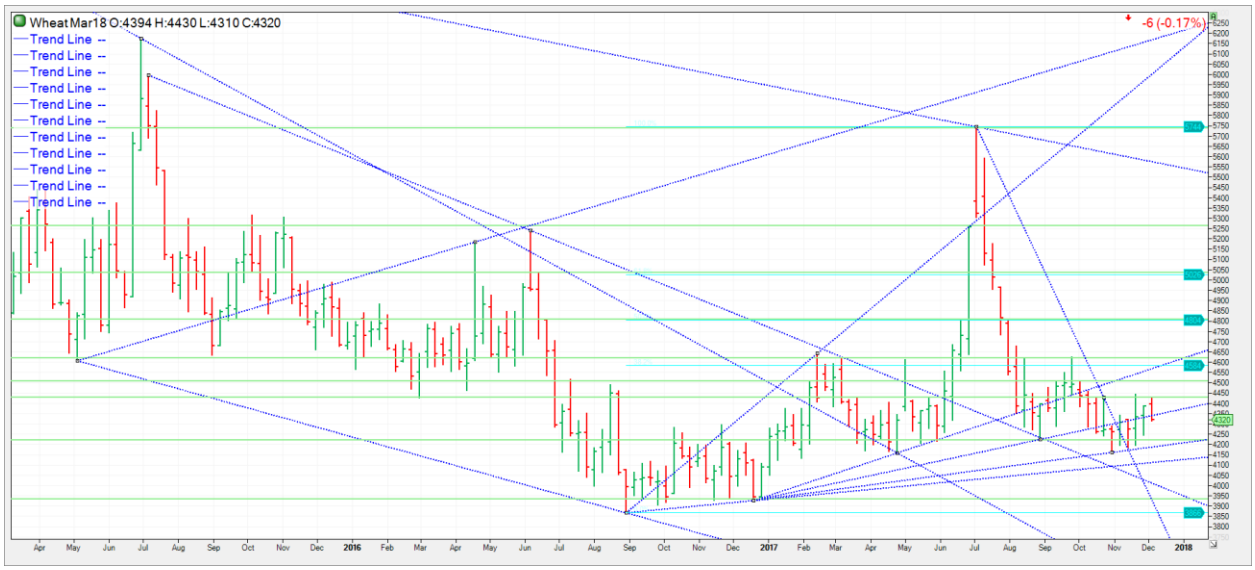

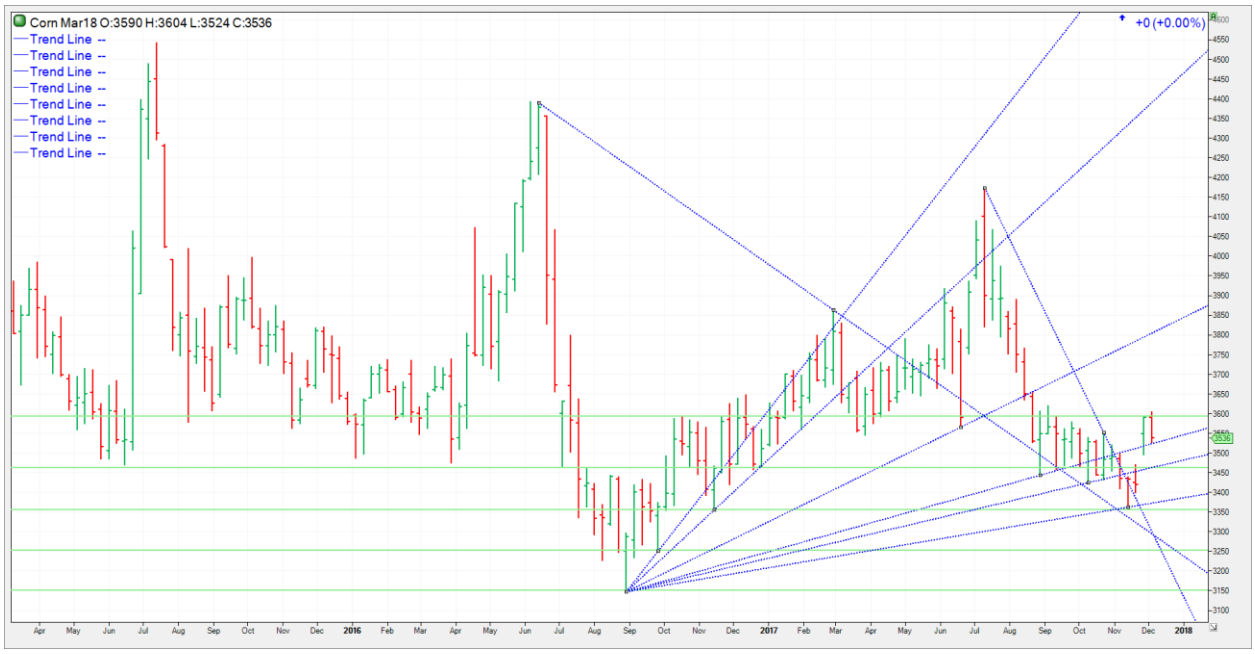


## Trade Recommendations

## July 2018 Corn Options

1. Buy the July 2018 corn 380 calls while simultaneously selling 2 July Corn 360 puts.

Cost to entry is 2 cents or better or $100.00 plus commissions and fees. Risk is 10 cents from entry with an exit strategy at 40 cents or $2000.00 per spread.

## July 2018 Wheat options

1. Should trend line support hold we look to be a buyer of wheat. Using options we suggest buying 1 July Chicago wheat 460 call and selling 2 July wheat 430 puts for even money. Cost to entry is zero dollars plus commissions and fees. Trade target is to take profits at fifty cents on the long calls or $2500.00 per option spread.

## Soybeans

1. We want to be long in the near term and short in the longer term. With the premise that beans will perform better in the late December and January time frame. Therefore we will look to buy in the money calls using March 2017 10.20 calls for 25 cents. To finance this purchase we will look to sell the May 2017 1120 call at 14 cents and the May 1160 call at 9 cents. Cost to entry at zero dollars plus commissions and fees. Looking for a beans move to 1050 -1060 area and take profits on the rally at 40 cents on the long March calls.



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# 2018 1st Quarter Livestock Report

## Section B

The livestock markets have been volatile. Funds have been on the long side of the cattle markets and have pulled out of the long side of the lean hogs market. If they decide to move out of cattle, I think we could see price revisit levels from August – September 2017. At the time of this article, we are starting to see some liquidation by funds. Failure to see support levels hold up could lead to more aggressive selling and the breakdown to the August – September lows. The liquidation should slow near these levels as cattle should find solid support as we near the spring. Last spring price was expected to crash because of the onslaught of tremendous supply coming into the system. The supply was there but demand was greater than expected and packers purchased and slaughtered as many cattle as they could get ahold of. Demand for meat has grown both here and abroad as the world economy has improved. We continue to see better demand for all meat as the pocket books of foreign consumers grow. People want more meat protein and cattle and hogs are growing in favor. China has shown a willingness to purchase more US beef as their population's desire for beef grows. I would doubt that these patterns will change much unless the world / China falls' into some type of setback or recession. The trade agreements that President Trump has voided need to be renegotiated. We need Mexico and China to continue to be a huge consumer of corn, beans and pork from the United States and China to expand its beef purchases. The Chinese ecommerce retailer JD.com has come into an agreement with the Montana Stock Growers Association for a minimum commitment of $200 million to import Montana beef and to invest up to another $100 million to build a brand-new processing facility in Montana to support Montana beef production. The President of the Texas Farm Bureau summed up the impact of a full withdrawal from NAFTA this way, "NAFTA helped boost US Ag exports to Mexico and Canada from $8.9 billion in 1993 to $38 billion today supporting 509,000 jobs and driving a fourth of farmer's income". Mexico also says that if the US withdraws as a negotiating tactic that it will turn its energy into negotiating new deals with Brazil, Argentina and the EU. The South American Ag sector is hoping for a failure to re-set NAFTA seeing it as an opportunity to "Make South American Ag Great" as they soak up market share from Mexico and Canada.

## Cattle

Cattle on feed placements have come in higher 9 out of the last 10 months. Some placement months were the result of low placement figures a year ago. Yet, some feedlots are nearing capacity. In 2018 we could see the effects of 2017's higher placements. If there isn't expansion in feedlots we could see stagnant growth in feedlot placements. More cattle may be available because of the rebuilding of the cattle herd over the last few years. Corn farmers have been purchasing cattle to feed because of the low price of corn. They hope they could do better by feeding cattle. We will have the supply, the question is - "Will we have the demand for beef?" The economy has provided some very good incentives for the cattle market plus a world that is hungry for beef. As countries advance, their diets become better and people want more of what the rest of the world has. We have had huge demand and as long as the Equity markets and world economy continue to grow, we should see demand for beef continue to grow.

I think cattle could pull back into January. A breakdown through support at 115.50 could see price test 112.90. A breakdown through 112.90 could lead to a test of support at the rising trendline now at 107.475. I think price could find a bottom around the trendline and we could see a spring rally similar to spring 2017. I think a person needs to be hedged, contracted, or at least have some type of puts on any rally towards resistance. Look to get out of hedges on any successful test of support and look for upside potential.

## Feeder Cattle

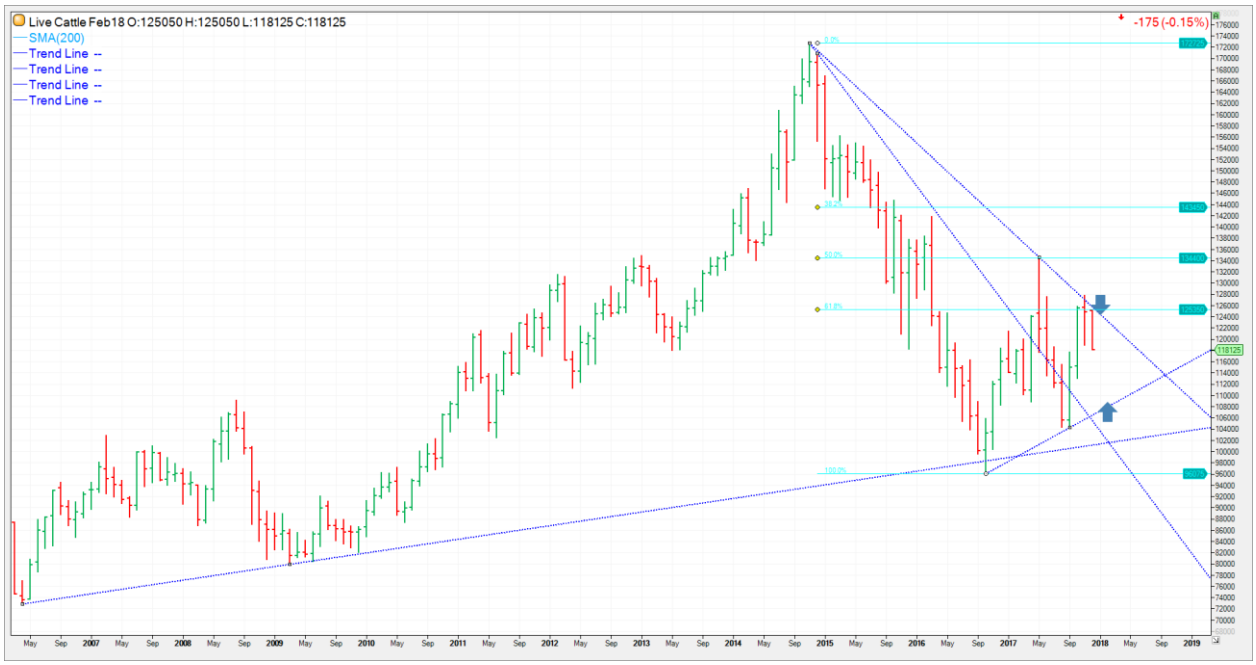
Feeder Cattle have also increased in price since September – October 2016. Since peaking in May 2016 it has traded in a 25 handle range (163.50 to 138.35). That is pretty wide. It is heading towards the low end of the range at the time of this article. We ended the week at 144.975. A breakdown from 138.35 could lead to a test of strong support down at 133.55. This could present us with a buying opportunity.

## Hogs

We continue to bring a large number of hogs to market every day due to some pretty good competition between the new processing plants coming online trying to obtain their market share. Supply continues to grow and there are some fears that short-term supply could be burdensome. One of the biggest problems we've had with pork is that demand from China has faltered. They have been able to take care of their needs domestically. We continue to rely on demand because of the huge supply that we are currently going through. NAFTA and Mexico are the important ingredients to our demand structure. We had a pretty decent rally off the bottom and the prices are very attractive on the summer and spring hogs presently from a hedging or contracting standpoint.

## ****Trade Recommendation Live Cattle****

Off the blue arrow and trend line support going back from the 2016 and 2017 lows we have a buy point coming in at 108 in the Live Cattle. Should we purchase futures contracts there we look for a move towards the downward trend lines designated by the downward arrows near the 125 level currently. As time moves on this downward resistance line will sit around the 120 level come spring time. Given market conditions and supply and demand this line represents where we will take profits per contract. It will be up to us if we exit all of our longs at this level or a portion. Again this will depend on the supply /demand spread in cattle at that time. Appropriate stop losses of 200 to 300 points are put in place risking 800-1200 per contract. Our premise looks to capture and net around a 1200 point move in live cattle for approximately $4800 per contract.




## ****Trade Recommendation Feeder Cattle****

Keeping with the same premise as the live cattle recommendation we are again suggesting buying a dip at major trend line support. In Feeder cattle we are looking to buy futures contracts at 134.10. This level represents strong support off of lows coming up the page from the lows two years prior at the 134.10 for the month of December. If bought in January, we are looking to buy a dip at 135.50, as the chart moves up the page month on month. Our targets and sell orders include downward resistance back at the 156 level designated by the downward arrow. We are looking to catch an 1800 point move in Feeder cattle through the first two quarters which equates to a $9,000.00 move per one contract. Appropriate stop losses are put in place should our entry points not be exact.



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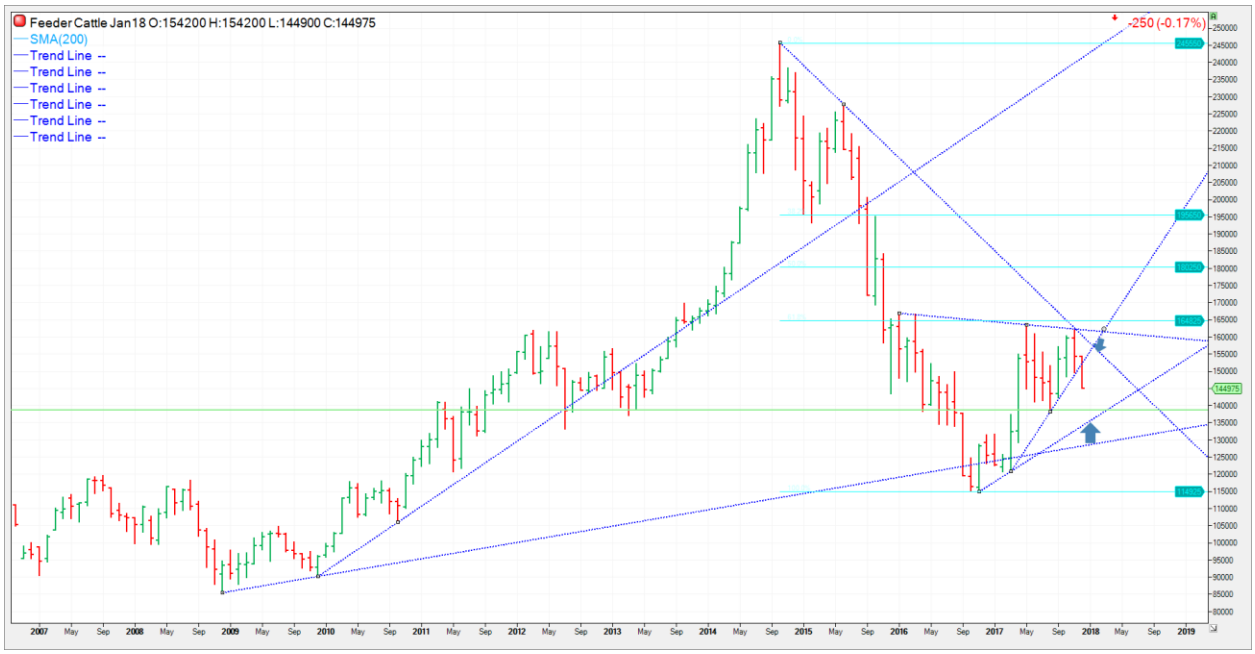




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# Precious Metals Report 2018

## Section C

Gold and silver markets have seen sizable percentage gains in 2017 up until the late November and December timeframe. It is important to examine reasons for the reluctance of continued buying in both gold and silver as we enter into 2018. First, sizable longs in the market continue to liquidate previously held positions as equities continue to be the investment of choice. Second, the anticipation of a more hawkish Fed has kept a bid under the Dollar as the markets are starting to price in two to three more interest rate hikes in the next 9 to 12 months. Third, a lack of perceived buying interest from the number one and number two world buyers of physical gold, India and China have dampened expectations of increased physical demand. A conundrum exists with China as they are producing less while consumption is up. Fourth, the emergences of the crypto-currency where investor interest is being drawn from traditional futures contracts and in some cases where futures contracts are being used as a hedge against fledgling investments like Bitcoin per se.

Having said all that I believe that gold and silvers very recent swoon lower is nothing more than the underlying futures contracts seasonal slumber into year end. I mentioned prior that the long position in gold stood at 250K contracts while silvers stood at 90K. While these are far from all-time record long positions, the reluctance of any sellers in equity plus a U.S. Dollar that has remained firm has given investors little reason for safe have coverage. Seasonal tendencies work as follows in metals.

Jan through Mid-February (Valentine's Day) =Bullish

Mid Feb through April = (Bearish)

May through July 4th weekend (Neutral)

Mid July through Mid-September (Bullish)

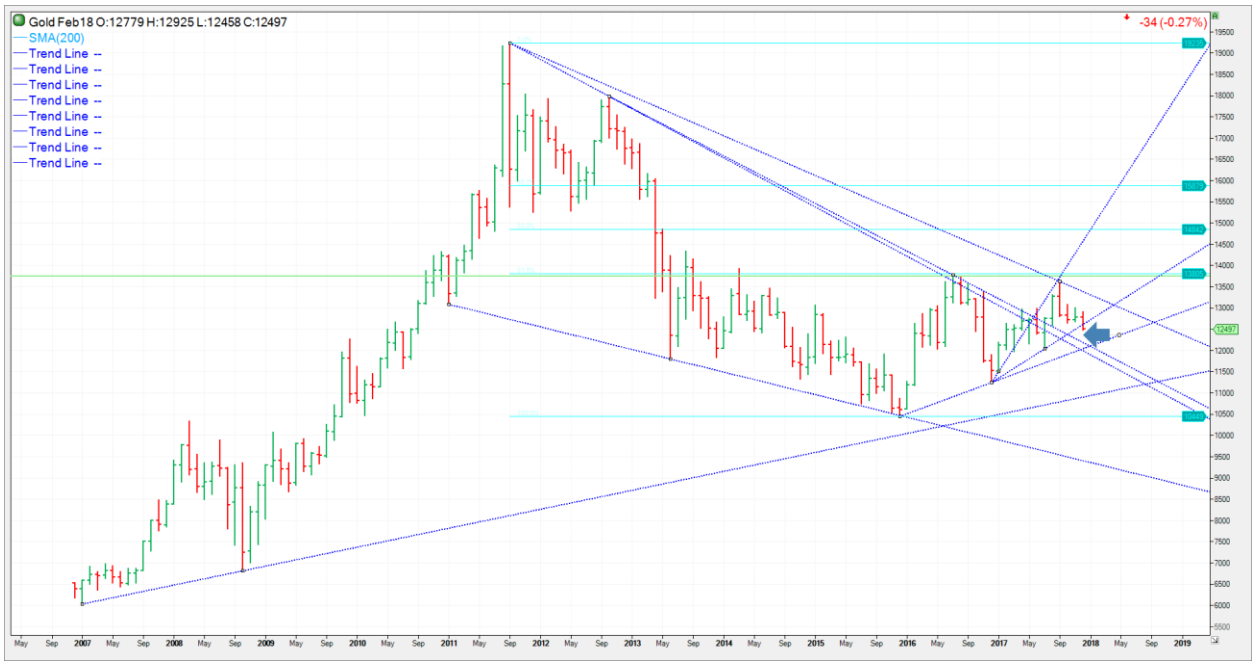
Mid Sep-through Mid Oct (Bearish)

Mid Oct through Early Nov (Bullish)

Early Nov until Christmas (Bearish)

These seasonals are predicated on global buying patterns most notably from India and China with the most notable being Indian Wedding season in late/summer early fall. India is the world's top consumer of Gold and is said to own over 12 percent of all the gold in the world. Due to import duties in recent years to offset the inadequacies in their trade deficits, Indian demand has been suppressed. The Trump trade and investor fear in regards to a new administration in Washington offset the lack of physical global demand this year, along with geo-political uncertainties, North Korea, terrorist attacks, etc.

These recent dips in our view will provide buying opportunities heading into 2018. While timing is everything we go to our chart maps for direction. Looking at the charts we want to buy gold off of trend line support at 1220 (Designated by blue arrow). A conservative way to play the market is using options. I also included a buy are in silver futures at 15.50. The gold chart is a monthly continuous chart. The silver chart is a weekly continuous chart. I believe using either futures or options contracts on buying dips to the aforementioned buy levels would be the appropriate course of action.




## ****Trade Alert****

Buy February Gold futures at 1220 or better.

Buy March Silver futures at 1554 or better.

## Long Term options play Gold

Buy 1 April gold 1280 call for 16 points

Sell 1 April gold 1320 call for 9 points

Sell 1 April gold 1360 call for 6 points

Option strategy cost $100.00



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Option target objective exit $3000.00 collection

**Long Term options play Silver**

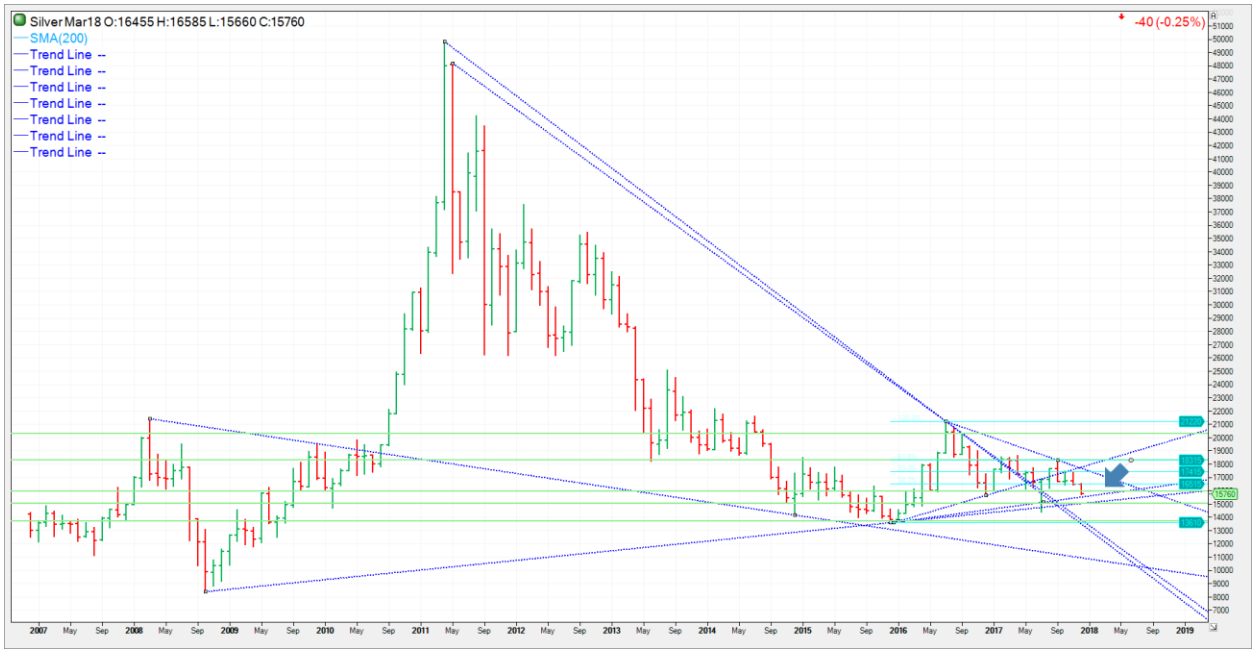
Buy 1 May 2018 Silver 1650 call for 48 points

Sell 1 May 2018 Silver 1750 call for 28 points

Sell 1 May 2018 Silver 1850 call for 15 points

Cost per entry is 5 points or $250.00 plus commissions and fees

Objective or exit strategy is $4000.00



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# Stock Indices Futures Outlook

## Section D

We are implementing a two pronged approach in equities as it relates to investment in the S&P, Dow, and NASDAQ indices futures. Fear gauges like the volatility index (VIX) indicate to us that the overall stock markets are overbought and in need and due for a correction. I attached a volatility chart and a corresponding trade into late 2017/early 2018 that would have exposure to the downside. However, we think ultimately that initial dips or corrections in this case would reveal only longer term buying opportunities in equities. I detail a reason why later in this section but first offer a trade idea that offers the investor initial downside exposure in the S&P 500.

Below is a weekly CBOE VIX (volatility) price chart. The vertical lines display time cycle studies. The index's most recent low reading is on the extreme of the last three decades. Option premiums have been steadily depressed. Investor funds of Volatility sensitive ETF are at record levels of 2.3 billion. These instruments are designed to appreciate in a bearish VIX environment. Algorithmic run programs are extremely engaged in short premium strategies. The effect of this current mass mindset can be observed in multiple markets. Market moves in our opinion are highly correlated to investor psychology whether it is overly pessimistic or euphoric. Market extremes are not uncommonly seen in this landscape. It is our belief, as a measure of risk/reward; the opportunity will soon present itself for a contrarian play. Blended times cycles suggest a possible change of course around mid to late December.


## ***Trade Alert***

A modest four percent correction into yearend as of this writing and the end of January would push the S&P futures contract down points to 2525 in the mini S&P 500 from 2630... Four percent would equate to around 1/4th of the 17 percent rally that has taken place this year so far. In our view a correction of that percentage would certainly be sustainable. The following trade using end of month (EOM) options for January 2018 would offer downside exposure using the following option strikes. There is no cost per entry minus all commissions and fees using our strategy.

Buy 1 EOM (End of Month) February 2018 2600 put for 38 points

Sell 1 EOM February 2018 2500 put for 21 points

Sell 1 EOM February 24.25 puts for 14 points.

The following EOM strategy using put options spreads would cost $150.00 plus commissions and fees. A four percent correction by the end of January would take the S&P 500 down to



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2525. Our target on the exit would be to close the position at 60 point or to collect $3,000.00 per option spread.

## Long Term Bullish Play

The stock market has been climbing a wall of worries: back to back devastating hurricanes, North Korean's missile launches, debt ceiling and potential government shutdown, Fed's shrinking of balance sheet starting in Oct this year, potential trade war with China, and all too familiar terrorist attacks in Europe. However, the market has taken all of these in stride, in August; Dow Industrials set a new record every day for nine days!

It has been said this is the most hated bull market in recent history, if you read in any financial news, there are numerous experts calling the demise of the bull market. I expect these feelings to exacerbate in the coming weeks should we get the slight correction we are calling for.

**Earnings Growth**: generally, Investment Return = Earnings Growth (ΔE) + Dividend Yield + Change in P/E (ΔP/E. After a 5 quarters retraction in 2014-2015, earnings have improved steadily, after 98.5% companies reported, the 2017 second quarter's earnings per share for SP500 is at historically high at $30.51 with total earnings for 2017 projected to be $127.13, about 20% higher than that of 2016. The consensus for 2018 is $144.88 which is about 14% higher than that of 2017.

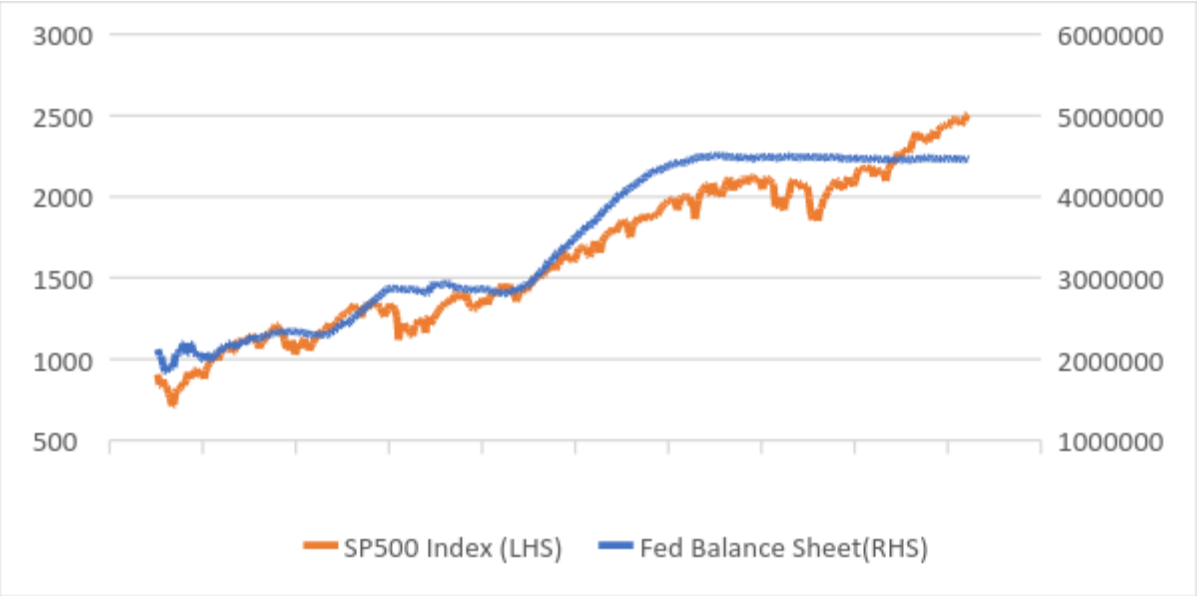
The projections for rest of 2017 and 2018 are very bullish due the best earning environment in years:

- Production index such as Industrial Production and ISM production index,
- Financial environment measured by 10-year minus 3-month treasury yield Spread, Baa vs Aaa Credit spread and junk vs investment Grade yield spread,
- Price pressure is low as shown by CRB Raw industrials year over year change and ISM price index
- ISM composite index and ISM Non-manufacturing index

Momentum of S&P EPS and % of S&P with upward estimate revisions all are favorable.

In fact, the market has transited from a QE driven bull market to a much healthier earning driven market. The S&P 500 performance was highly correlated with Fed's balance sheet's

growth from 2009-2015. After the Fed stopped growing the balance sheet in 2015, the SP500 entered an earning driven market.




## ****Trade Alert****

This trade is predicated on a 4 percent break in the market. Should we get it we would be looking to buy the calendar option spreads using June 2018 option spreads. The option strikes would be contingent on where the underlying futures contracts are trading and more importantly when the charts indicate buying the market.

Buy 1 June 2600 ESM 18 call for 60 points.
Sell 1 June 2700 ESM 18 call for 38 points
Sell 1 June 2750 ESM18 call for 17 points

Cost per entry for unit here is 5 points. $250.00 cost plus all commissions and fees. To sum up we are looking for a near term correction and then a resumption of the late 2016/17 rally. Both strategies take advantage of our premise.