10 December 2009

Chilli Spread

Harvesting process has already started in Northern states of Rajasthan, Gujarat and Punjab for this red hot spice popularly known as Chilli. Harvesting is also slowly gaining pace in the major growing states of Andhra Pradesh, Karnataka, Tamilnadu and Maharashtra. Significant arrivals will start coming to the market by the end of December month. The contribution of Andhra Pradesh is 58% in terms of total domestic production and nearly 26% in terms of total acreage in the country.

It is a usual trend that prices undergo some dips on account of fresh arrivals. This has been further corroborated upon analyzing the price trend for previous two years.

Let's first have a review for 2008 Feb and March futures on NCDEX. Chart 1, shows the spread difference between Feb'08 and March'08 contracts on NCDEX. The difference between Feb'08 and March'08 which was prevailing around 150 has narrowed down to the negative territory as Feb'08 futures were trading lower than March'08. The highest negative side difference was -68 by 22 Jan'08 when March was 3695 levels and Feb ended at 3627 levels.

Chart1: Prices charts for February'08 and March'08

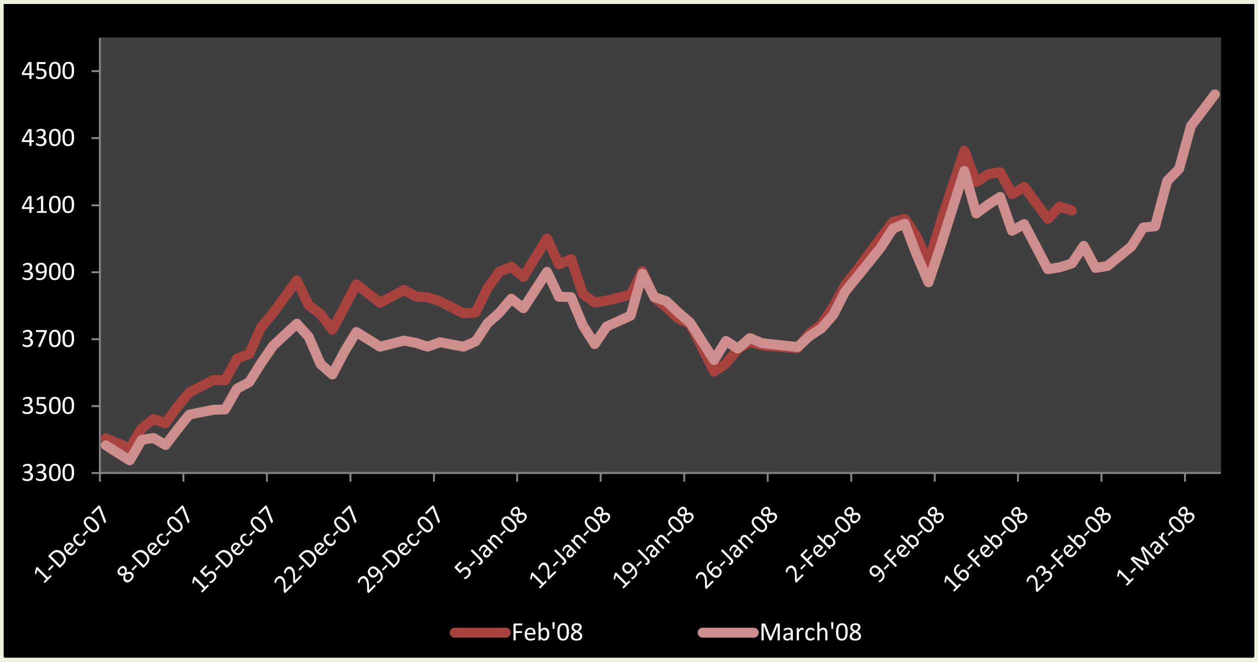
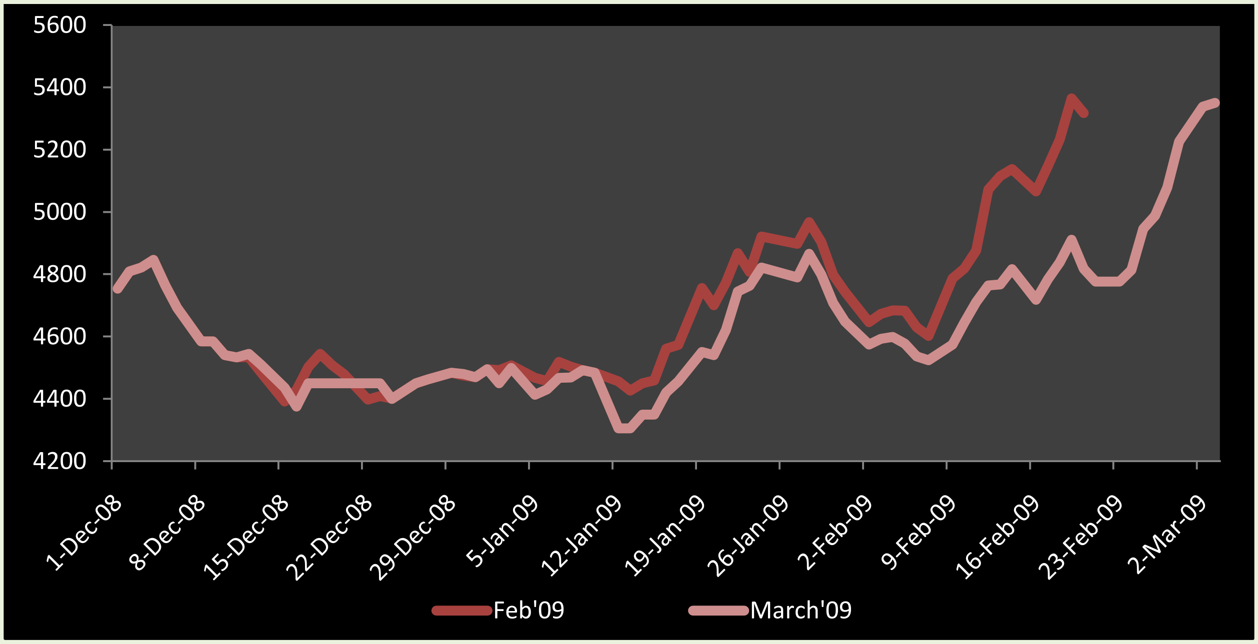


Chart 2 depicts the price trends for February and March chilli futures in 2009. During 2009 Feb and March futures were moving in tandem. But the difference was 94 around 18 Dec when Feb futures were trading at 4544 while was March was trading at 4450 levels. The spread difference between Feb and March has turned to the negative territory around 22 Dec'09 when Feb was trading at 4398 and March ended at 4450 levels.

Chart2: Prices charts for February'09 and March'09

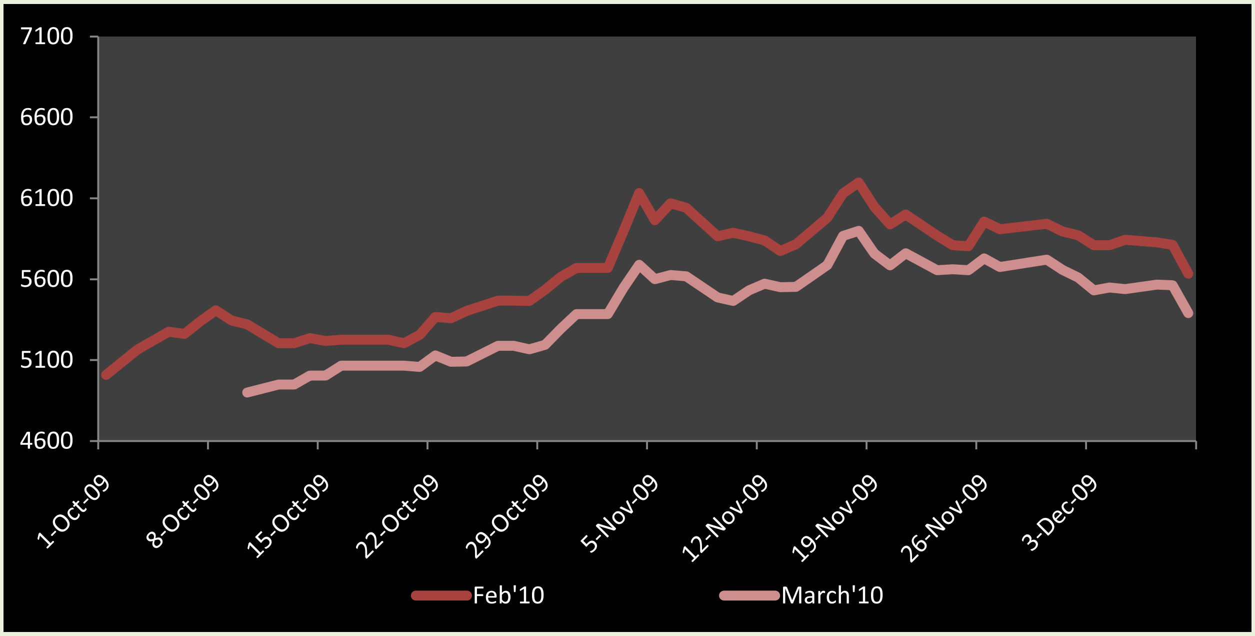


Astonishing: Why the difference between February and March futures for these two years of 2008 and 2009 have turned negative by end of December month?

The answer to this question is fresh arrivals. On account of fresh arrivals prices have been trading lower. As the arrival season is usually from December to January so the fall in prices have been more for Feb contract than March. Arrival season ends by the month of February.

Now, have a look at the current year: as of now Feb 2010 and March 2010 chilli futures are trading at a difference of 242 levels. As per the previous two year, it is expected the futures prices for February 2010 and March 2010 futures will converge and will enter into the negative territory by beginning of Jan 2010 supported by the factor of fresh arrivals.

Chart3: Prices charts for February'10 and March'10



Outlook

Currently, February is trading around 5700 levels while March 2010 is trading at 5470 levels. We expect the difference to narrow down by the month of January 2010.

Our stance:

Investors can take the spread position by selling February and buying March at the difference of 240-260 for a target of 10 with the stop loss above 360.

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