3 March 2011

Inter Commodity Spread Report (Chana- Guar seed)

Recommendation (NCDEX): **BUY** chana **SELL** guar seed at the current difference of (chana-guar seed) of -340 to -400 targeting 0/+200 with the stop loss below -550

**This recommendation is applicable for March and April contracts only.*

The difference between the near month contracts of chana and guar seed is currently very wide which is expected to come down in the near term. The widening of the gap was driven by individual fundamentals of both these commodities. The rise in the prices of guar seed was around 50% and the fall in the chana prices was around 11% in the near month contract which led to the increase in the difference between the prices. The strong demand for the guar gum from the export destination like US and china supported the steep rise in the prices of guar seed. While the unchanged production estimates of chana at 7.37 million tons and the increase in acreage by 76% in Rajasthan regions pressurized the prices to fall from the highs of 2812 in the near month contract. This is a very unusual difference in the inter commodity spread (guar- chana).

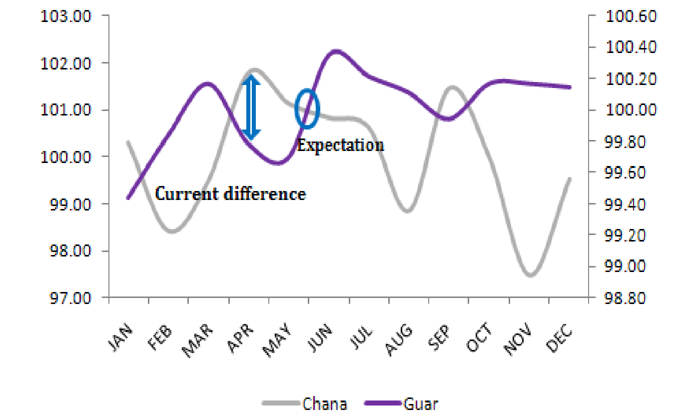
KCTL research expects this spread to narrow down in medium term based on the fundamentals of each commodity.

Chana fundamentals: The prices of chana are expected to correct steeply in near term while the long term outlook is bullish in the commodity. The harvesting of chana has started across Madhya Pradesh regions which shall be followed by regions of Rajasthan in short while. The increase in arrivals is expected to pressurize the prices initially which might widen the difference. The steep correction in chana prices is anticipated to create good buying point for the bull run in medium – long term (3- 6 months). The fresh crop arrivals come to end during April from when the future demand for the commodity increases. The festive season in India starts from the month of August which prolongs till November during which the consumption of chana and besan are higher. The millers procure chana during the months of May-June for processing it into dal and besan to meet the festive demand for the products which might support the prices. Thus the increase in prices of chana is anticipated to work on lines of decreasing the difference of the spread.

Guar seed fundamentals: Guar seed prices are projected to rally initially in the near month contracts due to strong demand for the guar gum from the crude oil extracting nations. The consignments of the exports of guar gum from India for the peak season of crude oil extraction during April-July starts gets dispatched during the months of February and March. The demand during this period is at its peak for guar gum. Later on as the arrivals of guar seed comes to an end across the spot markets the market activity decreases gradually. Towards the expiry of the march contract the prices starts to decline due to the adverse effect of demand on the prices. The prediction of the international weather agencies about the normal and above normal monsoon is expected to weigh on the market sentiments. The positive correlation existing between the production of the guar seed and the rainfall data is also supportive to the fundamental analysis that the guar seed prices might decline in medium- long term (3- 6 months). The crude oil extraction seasonality also indicates that the crude oil extraction gradually declines due to the weather vagaries after the month of July. The decline in demand from the major industrial consumer of guar gum i.e. crude oil industry from April end pressurizes the prices. The dematted stocks in the commodity bourses during the current year are comparatively higher with the deliverable dates of far month contracts compared to near month contracts. The pressure of the exchange deliveries might also exert pressure on the markets in the medium term. The anticipated fall in the prices of guar seed might support the decline in the difference between the guar seed and chana.

Price seasonality: The price seasonality index of both the commodities (five years data) supports our view i.e decrease of the spread in the short term (March- May) which is represented in the graph. The graph is plotted as per the seasonality index which indicates the prices have followed a regular pattern of movement. The patterns show an increase in the spread difference during the months of February and March and reduce there after. The time duration for the current spread to reduce to the normal level might be 3 months after which the spread difference is expected to widen based on the broad fundamentals in medium term.

Price seasonality of chana and guar seed



Source: Bloomberg

The spread between the two commodities has touched the low levels of -481(chana- Guar seed) from where the difference is reducing which we are expecting to further reduce and turn positive.

SPREAD SUMMARY	
Last	-481
Mean	-44.02
Off Avg	-436.98
Median	-69
Std Dev	173.95
Off Avg Std Dev	-2.51
Percentile	0
High 10/20/10	369
Low 02/26/11	-481

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