Inventory Clearance Sale

When a merchant finds himself contra-seasonally overstocked, he probably will conduct an inventory clearance sale. Such a sale rations some buying power away from alternative uses including savings. In this case, he has a "sale" because it is probably cheaper in the end to cut prices than to pay the carry costs, interest, storage, and face risk of spoilage. This analogy has some bearing on commodity markets. When the market is contra-seasonally overstocked, prices may be forced to decline to a point where buying power is rationed away from reasonably acceptable substitutes. (It is essential to remember here that total oil consumption is increased only very slightly, if at all, in response to low prices, whereas merchandise consumption may actually increase in response to low prices.

Sometimes it is sufficient to lower nearby prices only enough to encourage inventory accumulation. This may help the market over a temporary rough spot. This can sometimes be accomplished by strength in deferred positions—which is a form of weakness in nearby. If this is the case, then this will almost certainly be only borrowed "consumption," whereas actual nearby weakness might price out some competing item. When the position is one of true overstock, then both absolute and carry charge weakness are likely to be required.

Oil markets in recent months have undergone both types of weakness. Nearbys have gone full carry under deferreds so many times in the last 18 months that inventorying lost all potency as an aid to the market. A full scale "clearance" was forced. Soybean oil fell to post-war lows. Soybean oil bore the major brunt of the selling because it had saturated the total fat and oil structure. Soybean oil now seems to have bought its way back into the world free dollar market for at least the time being. There is no question but that 7⅜ oil is fairly cheap by almost any standard, but we have to distinguish between a market that has bottomed and will rally and a market that has bottomed and cannot rally. Whether the dip was deep enough and lasted long enough to allow major price advance later on is unknown as yet.

This probably will be shown by the action of stocks over the next six months or so. Oil stocks are down over 100 million pounds from their high (See table). By end-season they will be down perhaps another 350 million pounds to about 1.4 billion, of which about 100 million will be insulated from the market as Food-For-Peace oil that could not find takers. Despite this considerable fall from the top, an available 1.3 billion pounds is an enormous stock especially since it occurred despite frantic government give-away efforts—including purchases of 456 million pounds of Food-For-Peace oil. Thus, even if the government takes 500 million pounds of cotton oil under the cottonseed support program, this would roughly equal only what was taken under Food-For-Peace last year. Additional Food-For-Peace buying appears unlikely until the old inventory is largely liquidated, especially with reports some spoilage is taking place and also since the U.S.D.A. is cranking up a substantial butter and/or butter oil give-away overseas. Thus, the prospects for new crop production and exports again become the key to whether there will be further weakness.

I think that the experience of this season holds one strong lesson in analysis of the oil market—that processors will continue to crush beans at what appears to be very unfavorable margins. An analysis of why they do so is not germane here. Crush is not likely to be reduced much, if any, from the high level of this season unless European meal demand evaporates. Based on a 15.1 million bale cotton crop, cottonseed oil production is likely to be approximately 1,925,000,000 pounds versus 1,850,000,000 during the season just ended.

It is not clear yet whether the U.S.D.A. can chase up sufficient additional give-away receipts. If that agency can do so, (India?) then maybe we could have some flattening of actual and potential differences due to reduction of inventory. Otherwise, we may be in for another siege of nagging carry charges. This point is critical because, over time, carrying charges can run a reasonable price up too high. For example, the current quote of 8 cents for cash oil could probably, with some degree of confidence, be called cheap. However, depending on the interest rate, the amount of oil seeking storage, and the level of refinery stocks; board differences could eventually total between 1 and 1¾ cents per pound to carry oil for a year. Thus, 8 cent oil even without a major rally could easily become 9¼ to 9½ cent oil. There is considerable question in my mind as to whether this could still be called cheap. Add say, a cent rally to the structure all along the line and we are over 10 cents. That sounds high in view of probable stocks plus probable production. This will sound especially high if there is another cut in the soybean loan for the 1963 crop which should be announced in February.

During surplus years, new crop bean prices on the board tend to approach closely the national average loan. Since lower beans allow lower products, a lower loan could mean inventory liquidation by users during the final half of the season—which in turn means carrying charges unless stocks are reduced. So here we are in our circular argument about stocks and charges again. If the bean loan is reduced, which seems likely unless mandatory acreage controls are applied to beans, then buyers will refuse to carry oil since carrying oil from one crop to another at a loss is a form of hidden carrying charges. Over the last year and a half, buyers have had considerable adverse experience with just that kind of hidden carrying charges.

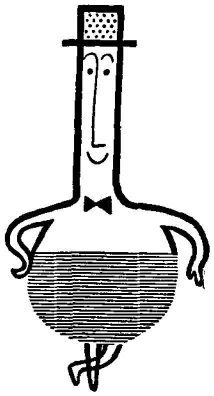
Census Bureau End of Month Oil Stocks
(in millions of pounds)

	SBO	CSO	Products	Total
End September	308	217	187	712
1960				
October	366	323	194	883
November	446	392	179	1017
December	469	426	208	1103
January	537	432	197	1166
February	594	434	188	1216
March	707	449	226	1377
April	680	433	344	1457
May	703	379	371	1453
June	769	313	397	1479
July	767	250	314	1331
August	766	183	285	1234
September	677	170	288	1135
1961				
October	735	245	305	1285
November	791	320	334	1445
December	873	376	353	1602
January	929	434	379	1742
February	957	489	375	1821
March	956	477	405	1838
April	925	513	435	1873
May	930	458	472	1860
June	811	402	540	1753
July	750e	340e	520e	1610e
August	675e	275e	500e	1450e
September	650e	300e	450e	1400e

Thus, the whole problem settles back on the manly shoulders of the U.S.D.A. If that agency is willing to take perhaps a billion pounds of oil over the next couple of years, either in the form of oils or products, then the market has some chance to go. If not, then farmers, the U.S.D.A., industry, and traders are likely to have to reconcile themselves to lower bean acreage, lower bean loans, lower crush margins, lower crush volume, or some combination of the above.

Having a clearance sale is a wonderful way to dispose of merchandise. However, it should not have to develop into a constant marketing policy. Unless oil stocks are greatly reduced, the necessity for persistent clearance sales might become a recurrent problem.

James E. McHale
Merrill Lynch, Pierce, Fenner & Smith
Incorporated



Meetings

A.O.C.S. National Meetings

1962—Toronto, Royal York Hotel, October 1–4
1963—Atlanta, Atlanta Biltmore Hotel, April 22–24
Minneapolis, Radisson Hotel, September 30–October 2
1964—New Orleans, Roosevelt Hotel, April 19–22
Chicago, Pick-Congress Hotel, October 11–14
1965—Houston, Shamrock-Hilton Hotel, April 25–28
Cincinnati, October 11–13
1966—Los Angeles, Statler Hilton Hotel, April 24-27
Philadelphia, Bellevue-Stratford Hotel, October 4-6
1967—New Orleans, Roosevelt Hotel, May 7–10
Chicago

A.O.C.S. Section Meetings

*Northeast—October 2, at Whyte's Restaurant, 141 Fulton Street, New York. December 4, same location
*Southwest—September 13, Los Angeles

Other Organizations, 1962

Sept. 17–29, 1962—International Course on Chromatographic Methods, Milan, Italy
*Sept. 18—Association of Consulting Chemists & Chemical Engineers, Inc., The Chemist's Club, New York City. For reservations write A.C.C. & C.E., Inc., 501 Fifth Ave., New York 17, N. Y.
Sept. 18–21—First International Congress of Food Science and Technology, Imperial College of Science and Technology, London, England. Address: Francis J. Griffith, 14 Belgrave Square, London, S.W. 1, England
Sept. 20–30—Seventeenth International Exhibition of Preserved Food and Packaging Materials, Parma, Italy.
Sept. 26–28—American Society for Testing and Materials general meeting on "The Practice of Gas Chromatography," at the Kellogg Center of Continuing Education, Michigan State University
Sept. 30–Oct. 5—Pacific Area Meeting of ASTM, Statler Hilton Hotel, Los Angeles, Calif.
*Oct. 3, 1962—New York Cosmetic Chemists, New York
Oct. 3–5—Gas Chromatography comprehensive course, West Haven, Conn.
*Oct. 8–12—12th Annual Instrument Symposium and Research Equipment Exhibit, Bethesda, Md.
Oct. 15–17—International Congress on Plastics and Problems of Choice, Amsterdam
Oct. 15–17—Federation of Societies for Paint Technology Annual Meeting, Chase-Pard-Plaza Hotel, St. Louis, Mo.
Oct. 16–19—Annual Meeting of the American Council of Independent Laboratories, Edgewater Beach Hotel, Chicago, Ill.
*Nov. 7, 1962—New York Cosmetic Chemists, New York
*Jan. 21–23, 1963—Seed Protein Conference, New Orleans, La. Foreign and U. S. scientists are expected to participate.
*Jan. 28–Feb. 1, 1963—Short Course on "Measurement Engineering," Arizona State University. Brochure may be obtained by sending letter-head requests to Peter K. Stein, Director, 1963 Short Course, MEASUREMENT ENGINEERING, Associate Professor of Engineering, ARIZONA STATE UNIVERSITY, Tempe, Ariz.

* Additions to previous calendar.