

## By Bread Alone

*With apologies to The Doors...*

*This is the end, bear market trend*

*This is the end, my only trend*

*The end of our bearish plans*

*The end of everything that stands*

*The end*

I speak, of course, of wheat, not stocks – yet. A former colleague in the commodity business used to refer to the dirt-wheat spread: Farmers bought dirt and sold wheat.

This is not a very flattering way of looking at one of the oldest and most useful businesses in the world. Think about your own diet and how few days you do not eat wheat in at least one form. The whole thing can make you misty-eyed thinking about those food pyramids, the four food groups and other elementary school folderol.

So, if wheat is so popular and so useful, why has its price been depressed for so long now? More important, now that we seem to be having a grain rally that lasts for more than two days – sounds a little like stocks over the past year, doesn't it? – what should we look for as traders and investors?

### **Wheat Is Not Wheat**

In two weeks' time, I will be making my annual “mid-Kansas in mid-July” trip to lecture at the International Grains Program at Kansas State University, which is located in Manhattan, Kansas (the “Little Apple,” as its signs proclaim). In the hallway is a veritable museum of the different types of wheat in global commerce. Let's concern ourselves with those types traded on U.S. commodities exchanges:

Chicago Board of Trade: soft red winter wheat

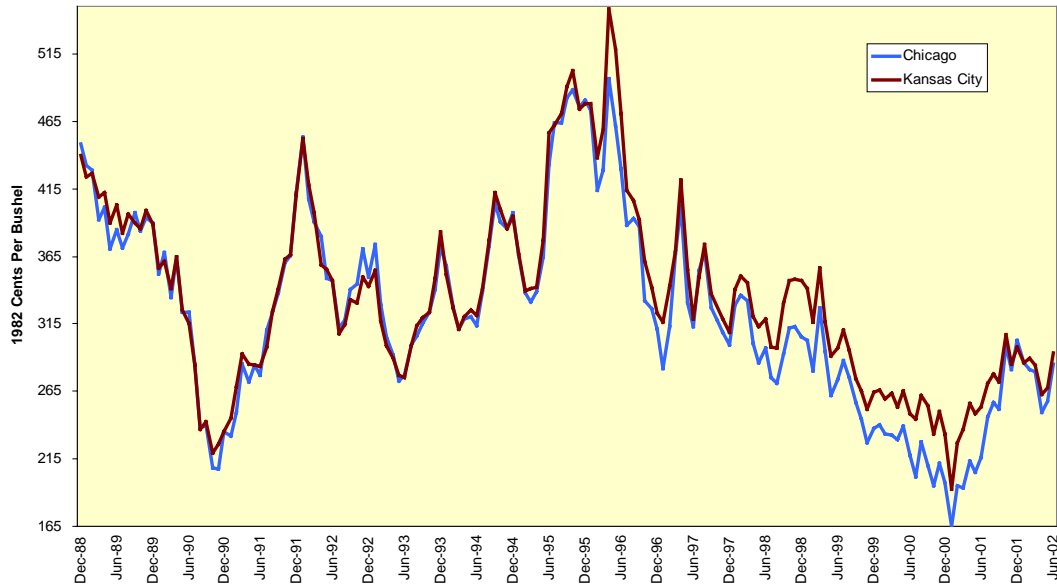
Kansas City Board of Trade: hard red winter wheat

Minneapolis Grain Exchange: white wheat, hard red spring wheat, and durum

Of these, the Chicago contract is the most heavily traded even though most bread is made from the Kansas City basis hard red winter wheat. White wheat is used in noodles, durum in harder pastas like spaghetti, and soft red wheat is used in products such as rolls. The different growing areas, crop cycles and final uses of the various wheat markets produce some very actively traded spreads, none of which will be discussed here today.

One of the differentiating characteristics of all these different wheat varieties is protein content; the more protein, the harder the wheat and the more valued it is for feeding applications and specialty processing. What makes unique among grains is a protein called gluten that allows wheat flour to stick together in a dough: No gluten, no bread as we know it.

### Wheat Bear Market Ends



### Shake And Bake

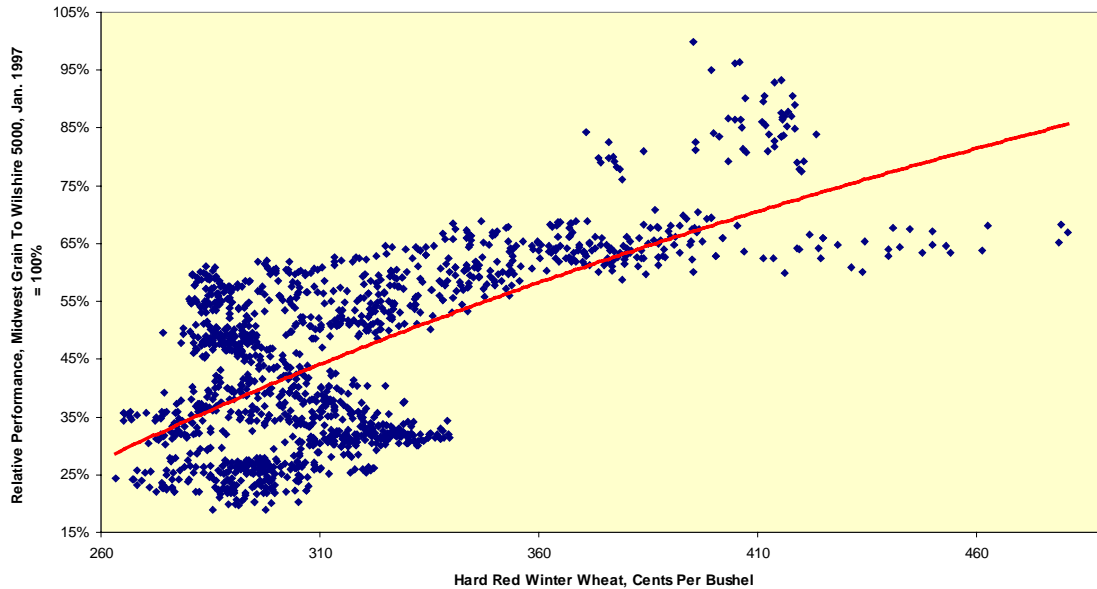
As is the case for so many agricultural products, a free market in wheat simply does not exist. Wheat is subsidized heavily nearly everywhere, which leads to overproduction and the sort of long-term and persistent price downtrend seen between 1996 and the start of 2001. The recent farm bill will perpetuate the problem of keeping marginal producers in business, especially if the current move higher restores farm incomes somewhat.

The weaker dollar will increase the relative attractiveness of U.S. wheat in export markets, and if that fails, there are always the inane subsidies of the Export Enhancement Program and Public Law 480, an Eisenhower-era food giveaway program designed to fight communism wherever and whenever by shipping free food to favored nations and in the process bankrupting the local farmers who couldn't possibly compete with this largesse. Can food exports stop terrorism? In the dreams of farm state politicians, you betcha, and get ready to hear that argument sometime in the near future.

### Rootin' For Gluten

Gluten is produced as an additive by various agribusiness firms, many of which like Cargill and Koch Industries are privately held. Archer Daniels Midland, known best for soy processing and playing ethanol subsidies like a Stradivarius, and Bunge are two of the larger publicly traded players in the wheat market. But, to get a more focused wheat play, we need to turn to a small stock such as Midwest Grain Products, which produces premium wheat starch and ethanol along with gluten. The stock has a total return of 26% over the past year, 17.1% in 2002 alone, and none of its executives or auditors have had to pose for mug shots. If there's anything the bean counters can count, it's beans and other grains.

### Higher Wheat Makes This Stock Sweet



What makes these shares appealing is their ability to capture the gains from higher wheat prices at low volatility. While Midwest has gained in price over the past year, ADM has fallen 14.8% and Bunge 12.4%. These firms are affected more by the higher feedstock costs for their processing operations.

### Moving Forward

In a gold rush, sell shovels. In a period of rising farm subsidies and higher grain prices, sell tractors. The agricultural supply business – fertilizers, seeds, chemicals and equipment – will do a much better job of capturing the money flow than will anyone moving the grain. For example, Deere has gained 11.9% so far in 2002. We'll take a look at this whole class of suppliers soon.

In the meantime, remember that the long-term price trend for farm commodities is lower, and significantly so. Just as forays into gold should be sold too soon, so should investments in the agricultural sector. It's a tough way to make a living; the joke runs that an Iowa corn farmer won the state lottery. As the news cameras were rolling, a reporter asked what he planned to do with the windfall. He replied, "I don't know. I guess I'll just keep farming until the money runs out."