

Cattle Don't Get Mad, They Get Even

Fame and remembrance are fickle things. The conflict in Korea is hallowed as the Forgotten War, only a handful of baseball players enshrined in Cooperstown are more famous than the banished Shoeless Joe Jackson, and so on. Where have you gone, [Ozymandias](#), poets turn their lonely eyes to you, woo, woo, woo!

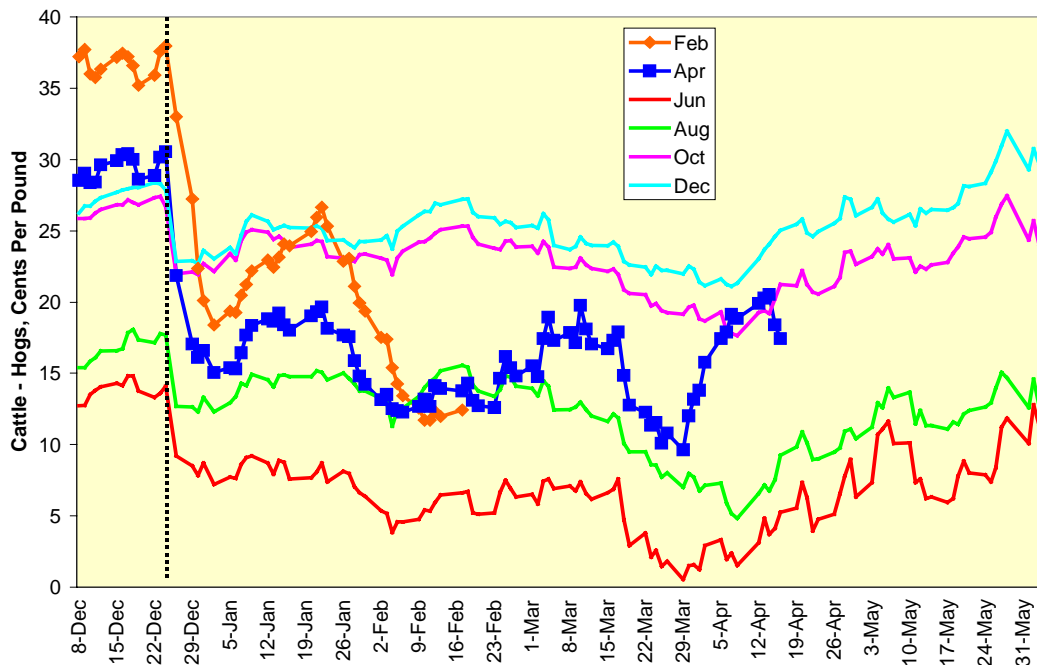
Commodity markets are similarly adept at dropping unpleasant developments down the memory hole. Last December's [Mad Cow](#) disease outbreak threatened to disrupt beef markets for a long time to come, as similar outbreaks had in Europe and in Canada. Stocks with any relation to beef, such as McDonald's, Tyson Foods and ConAgra rose and fell in reaction to news developments, and the prices of related commodities such as hogs, chickens, corn and soymeal had similar gyrations.

Did Anything Happen?

Unless you were previously of the vegetarian persuasion, chances are your beef consumption patterns have not changed a whit over the past six months. Moreover, if we are to believe the lame pronouncements of carbohydrate purveyors such as Krispy Kreme, more of us are reaching for the beef jerky than for a doughnut come snack time.

This can be seen in the pattern of the cattle-hog spreads on the Chicago Mercantile Exchange since the date of the December 2003 recommendation to sell cattle and buy hogs if the Mad Cow disruption persisted. The trade last for all of a week for the then-front February and April contracts, and the market continued to move in favor of hogs for the June and August contracts until April. At present, the August, October and December contracts have erased all Mad Cow memory and are moving steadily back in favor of cattle.

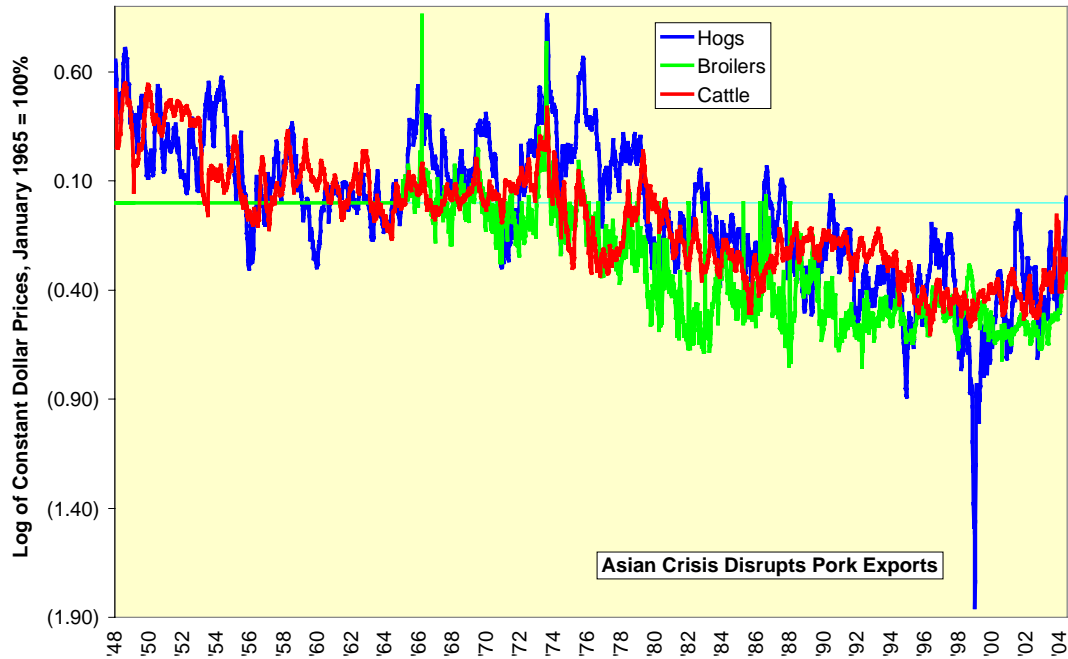
No Mad Cows Need Apply



Regardless of whether we ascribe food price inflation to the Atkins Diet, to three years of an accommodative monetary policy or to increased demand from countries such as China whose new-found prosperity is allowing them to climb up the dietary curve is immaterial. The simple and incontrovertible fact is livestock

prices are rising in constant dollar terms. The rate of increase in real hog prices has been such that their constant dollar prices are now greater than they were in 1965, bucking a long-term downtrend.

Meat Prices Rising

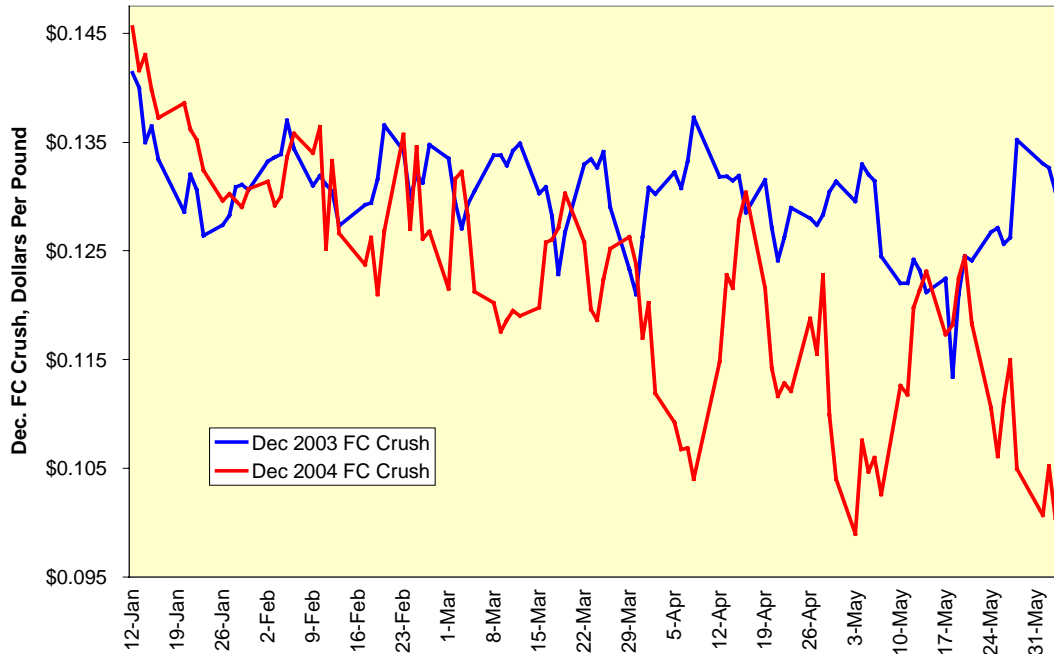


Effect of Corn Prices

Financial assets can be brought to market quickly, but livestock require time and quite literally care and feeding. In economic terms, cattle are but a device for turning low-value corn into high-value meat and [by-products](#). The central spread of the cattle feeding industry, ignobly dubbed the "cattle crush," is the margin between buying feeder cattle and corn, feeding the animals, and then selling them into the slaughter cattle market (the Chicago Mercantile Exchange calls the latter "live cattle" for obvious reasons).

The mechanics of this spread and a bullish 2004 forecast for cattle prices were discussed [here](#) last November. What are the implications of the current grain market for feeding margins for the December cattle crush, the spread involving August feeder cattle and September corn?

Lower Margins Maintain Bullish Outlook



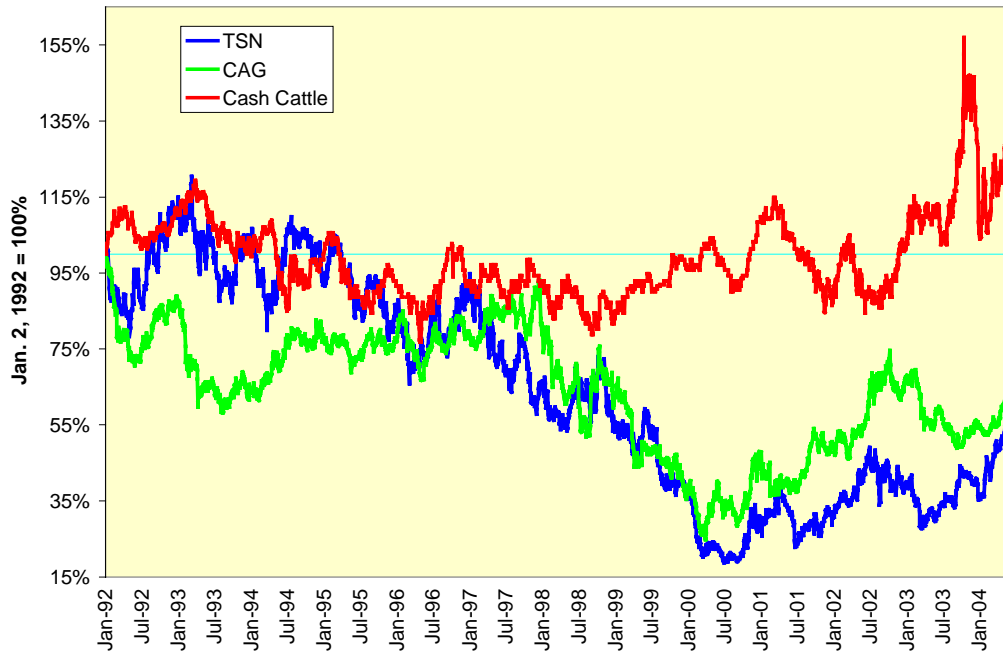
The outlook is bullish. The current margin for feeding cattle is 20% lower than it was last year at this time, which lowers the incentive for cattle feeders to expand their operations. Either corn prices have to fall or the price of competing meats have to rise relative to beef to alter this outlook, and neither is in the offing right now.

Equity Implications

Unfortunately, most investors have few ways of playing higher cattle price moves directly in the stock market. Cattle feeding operations tend to be either closely held or part of highly diversified agribusiness combines; this is typical of industries buffeted by commodity price volatility. Big beef buyers such as McDonald's and grocery stores are more than capable of passing higher prices on to you, the customer. To recapitulate my earlier comment on cattle, in economic terms you are a walking risk management device for purveyors of food, gasoline, heating fuels and other necessities whose price elasticities of demand are quite low. Sorry about that.

If we take a look at the performance of two publicly traded companies with big beef operations, Tyson Foods and ConAgra, relative to the Russell 3000 index, we see almost no correlation to the cash price of live cattle.

Not Much Of A Direct Play Stocks' Performance Relative To Russell 3000



Just as we have had to suffer through rising energy prices in 2004, we are going to get hit with higher food prices. It is, dare I say, baked in the cake. This has been building since late last summer when a late drought and aphid infestation cut into crop yields, and it continued through a smaller-than-needed South American crop.

The Federal Reserve can raise rates all it wants - and they really do not want to raise rates at all - and it will not cut into food price increases unless the economy collapses. And these price increases cannot be adjusted out of the Consumer Price Index by devices such as hedonic adjustments for technological improvement - what, make way for the Über Burger? - or imputed rent.

I find the concept of core inflation, what is left after food and energy prices are removed, unpersuasive. Food and energy expenditures are with us at all times and affect our ability to deploy our incomes elsewhere. They are real and must be faced.

As Alan Greenspan enters his last years as Chairman of the Federal Reserve, he and others surely will contemplate his legacy. I doubt a burst of 1970s-type inflation is what he had in mind. The words of Shelley's poem should come to mind:

*I met a traveler from an antique land
Who said: Two vast and trunkless legs of stone
Stand in the desert. Near them, on the sand,
Half sunk, a shattered visage lies, whose frown,
And wrinkled lip, and sneer of cold command,
Tell that its sculptor well those passions read,
Which yet survive, stamped on these lifeless things,
The hand that mocked them, and the heart that fed,
And on the pedestal these words appear:
**"My name is Ozymandias, King of Kings:
Look upon my works, ye Mighty, and despair!"**
Nothing beside remains. Round the decay
Of that colossal wreck, boundless and bare
The lone and level sands stretch far away.*