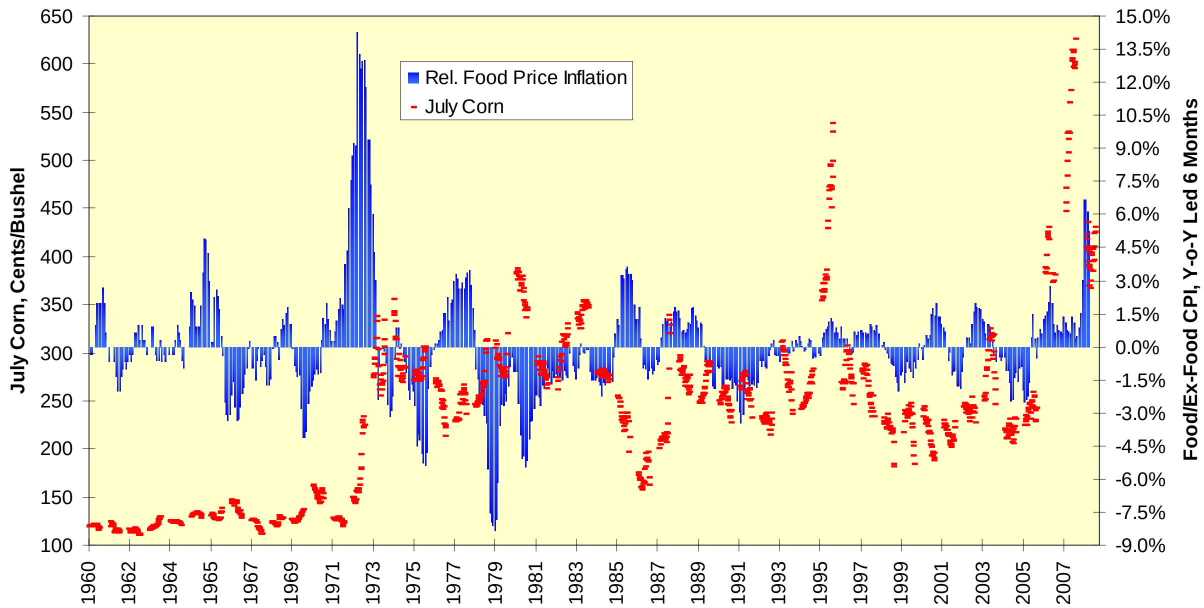
Food Prices Eat Packager Profits

"Give us this day our daily bread," is a good starting point for knowing your place in the grand scheme of things. For most people in most parts of the world over most of human history, the struggle to make it to tomorrow without starving first defined existence. They would find our willingness to turn corn into ethanol and soybeans into biodiesel in a vain attempt to shave a few cents off a gallon of fuel to be unseemly, which of course it is.

We have come to regard cheap and abundant food as a birthright. It is not. The vagaries of weather, fertilizer prices, policies on pesticide use and genetic modification all place the size of crops at risk. The rise of incomes in previously poor countries has shifted diets up the protein curve and placed further demands on grains to feed livestock. As a result, the relative Consumer Price index for food relative to the CPI Ex-Food is climbing to levels last seen during the inflation of the early 1970s. If the rise in old crop corn prices is any indication, and it has led this relative food price measure by six months on average for years, we should see higher relative food prices for the remainder of 2009 at least.

Northern American Old Crop Corn And Relative Food Inflation Since 1960

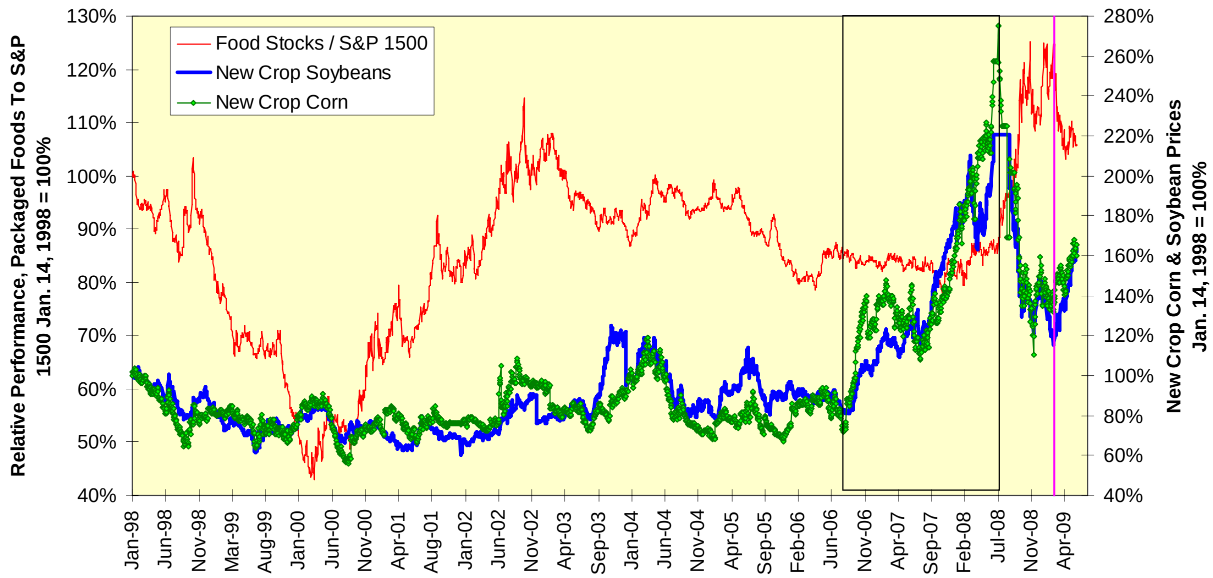


Looking Forward

Just as the food price debacle of the early 1970s developed over several years, so too has this one; I wrote about rising beef prices [two years ago](). Both corn and soybean prices moved sharply higher between August 2006 and June 2008. How did these higher prices affect the relative performance of the S&P Supercomposite's packaged foods index relative to the Supercomposite itself?

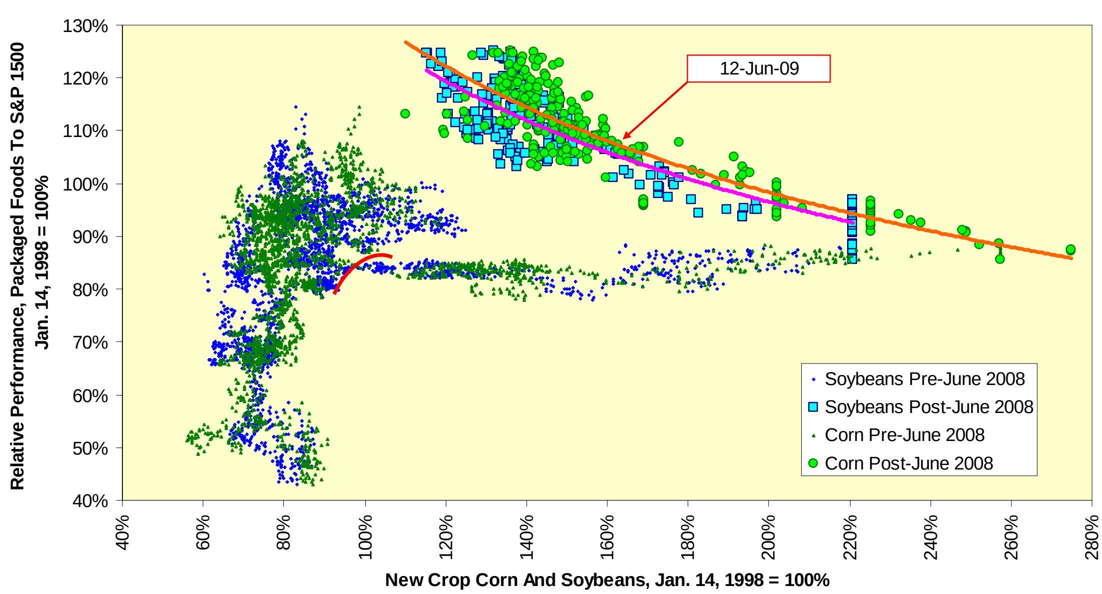
If we look at a simple time chart with the rally period highlighted in a black rectangle, the answer would seem to be, "not very much at all." The food stocks were market performers, give or take. Another period is marked with a magenta vertical line, and is the early March low in both grain and stock prices. Please note how the relative performance of food stocks to the broad market became negative after that point.

Packaged Foods' Relative Performance Declining As Corn & Soybean Prices Advance



If we rearrange the data in the chart above, a different answer emerges. The pre-June 2008 prices for corn and soybeans are marked with small green and blue markers, and the breakout zone in August 2006 is highlighted with a red arc. The relative performance of food stocks shifted from a wide range higher and lower to a narrow range as crop prices surged. After June 2008, relative performance started to turn negative as a function of rising grain prices. We must pay attention to such shifts in factor dependence. If this relationship continues, the food stocks will be condemned to habitual underperformance. Everyone has to eat, but no one has to make money supplying this perpetual demand.

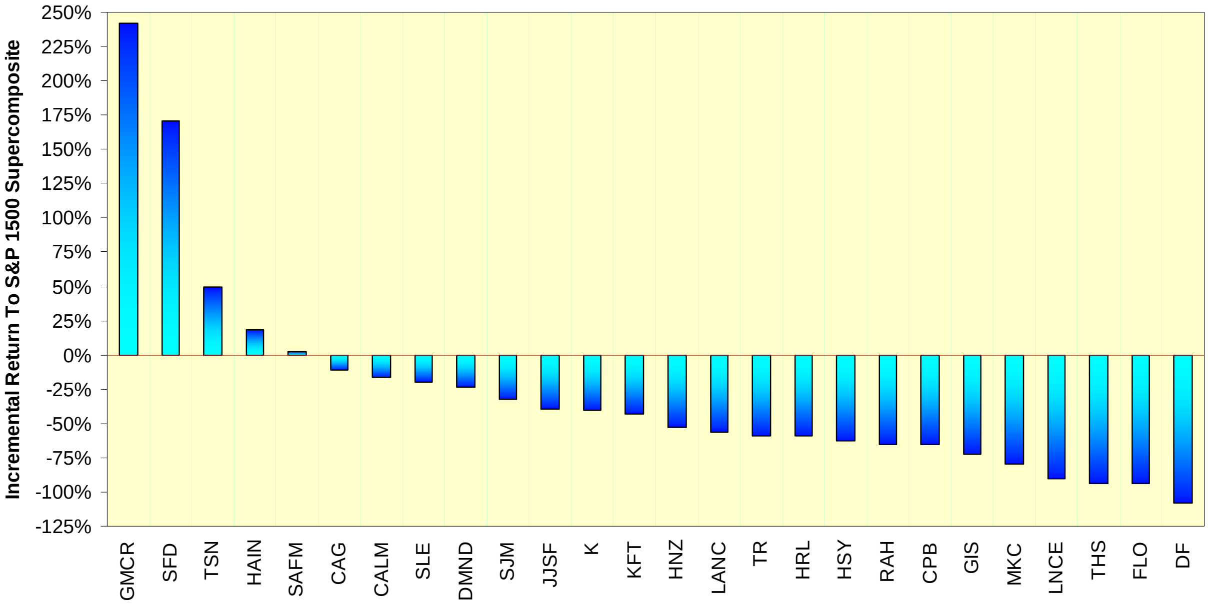
Relative Performance Of Packaged Foods Threatened By Higher Crop Prices



Winners And Losers

The relative performance of stocks in the packaged foods group since the March low tells an interesting story in itself. The best performer, Green Mountain coffee, clearly has no relationship to corn and soybean prices. The next two in the winner column, Smithfield Foods and Tyson Foods, both a large-scale buyers of feed grains for their livestock. This is unexpected given past patterns. ConAgra and Sanderson Farms, in contrast, have underperformed slightly.

Relative Performance Of Food Companies Since March Low



Many of the largest food processers including Kraft Foods, General Mills, Kellogg, H.J. Heinz and Sara Lee are stuck in a zone of mediocre underperformance. Kraft and ConAgra are both large dairy buyers, and along with Dean Foods their exposure to rising dairy prices is notable. Kraft in particular has struggled with its hedging programs for a wide range of foodstuffs in the past.

Too many investors struggle with the difference between a good stock and a good business. The food business is and will remain a good business for the simple reason demand will not disappear. The stocks have struggled, though, as margins get buffeted about whenever commodity prices rise, as they have been doing for the better part of three years.

Good stocks can exist without an underlying good business; we saw that is spades during the late 1990s bust and we may be seeing a repeat on a global scale today as the funny money created by central banks has to flow somewhere. But, then again, man does not live by bread alone.