Of Money And Food

Sometimes you have to be fair, no matter how much it hurts. Even though the Federal Reserve's everyone-will-be-a-billionaire-by-the-time-we-are-through campaign has created an inflationary environment for financial assets and has helped fuel consumer inflation elsewhere, and even though rising food prices will be part of our economic landscape for the remainder of 2011 at least, not everything (wince) is the Federal Reserve's fault.

Farming is a risky occupation; it always has been and always will be. The labor level is so intense and the returns are so uncertain you can summarize human history since the Neolithic era as "people leave the land and do not return." Most Western cultures understand the gambles involved and the need for food and therefore opt to subsidize agriculture, and it is no accident the futures industry in the U.S. rose around the crop cycle.

The Blame Game

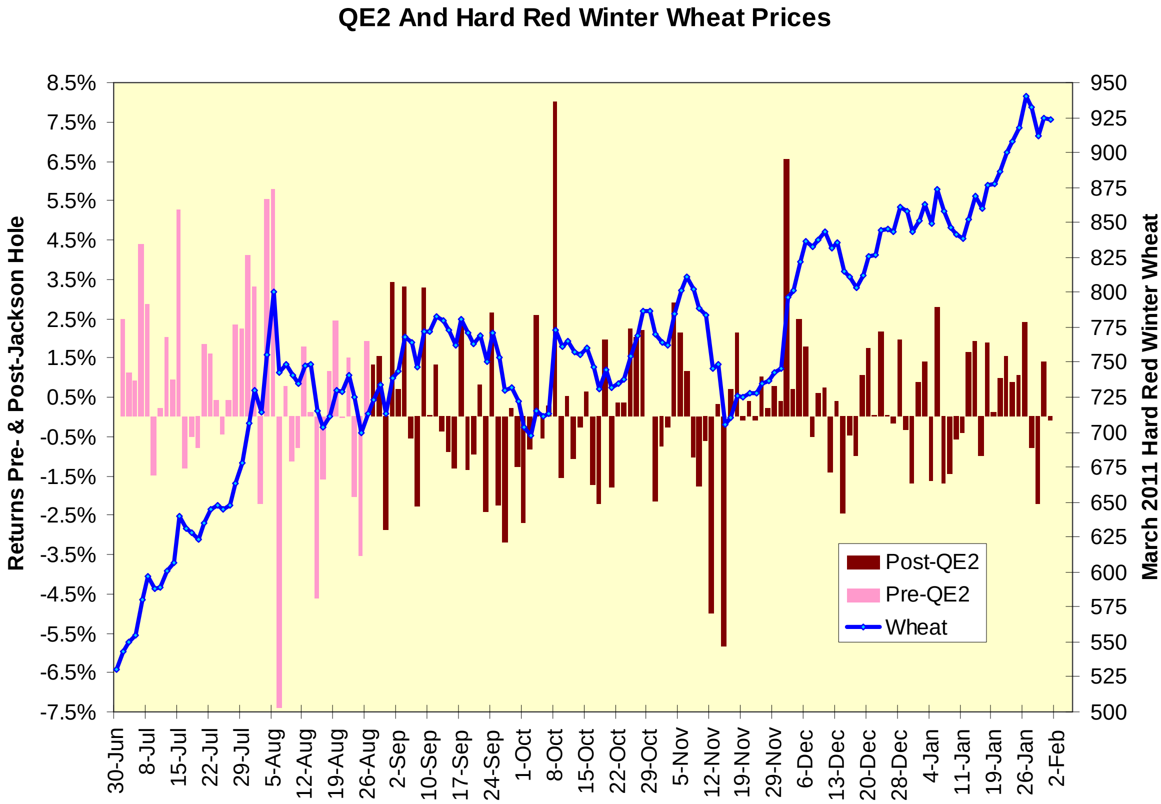
Imagine, then, my surprise at hearing how the displeasure expressed in Egypt over the Mubarak government was linked to the rising price of wheat, and that in turn was linked in turn to our money-printing in general and to the warning of QE2 by Ben "Let my dollars flow!" Bernanke on August 27, 2010. If memory serves me correctly, the big rally in wheat started last summer with a drought in the former Soviet Union (FSU).

Other agricultural commodities in the Dow Jones-UBS Agricultural index, a passive approach to these markets bested by active agriculture-focused commodity trading advisors, had supply shocks of their own. For example, sugar moved higher in 2009 as the monsoon failed in India, and cotton failed in 2010 with bad weather in key Asian growing regions. The present Southern Hemisphere wheat crop in Australia has been hit by floods and the one in Argentina by drought.

Unless Ben Bernanke is a monetary maestro by day and Zeus by night, chances are the Federal Reserve had very little to do with these natural calamities.

Cannot Cause The Past

Let's engage in a little final exoneration for the money-sprayers by comparing the daily returns for hard red winter wheat, the kind used for bread and traded at the Kansas City Board of Trade, between the start of the FSU drought and August 27, 2010 to those afterwards.



The average daily return pre-QE2 was 0.742% with a standard deviation of returns of 2.677%. After QE2 the average daily return and standard deviation were 0.237% and 1.971. The pre-Jackson Hole return during the FSU drought rally was more than three times as powerful as the post-Jackson Hole rally, which did not accelerate until Australia's and Argentina's weather problems began. We can be 89.38% confident these results are statistically significant, a very high figure given the small data samples involved.

Did QE2 cause a preceding event, the FSU drought? Hardly. Did it bring a second round of Biblical plagues unto the Land of Egypt, misdirected this time to Australia and Argentina? I think not. Should I blame higher bread prices in Egypt on monetary incontinence? No. Everything in financial market analysis should be this simple and straightforward.