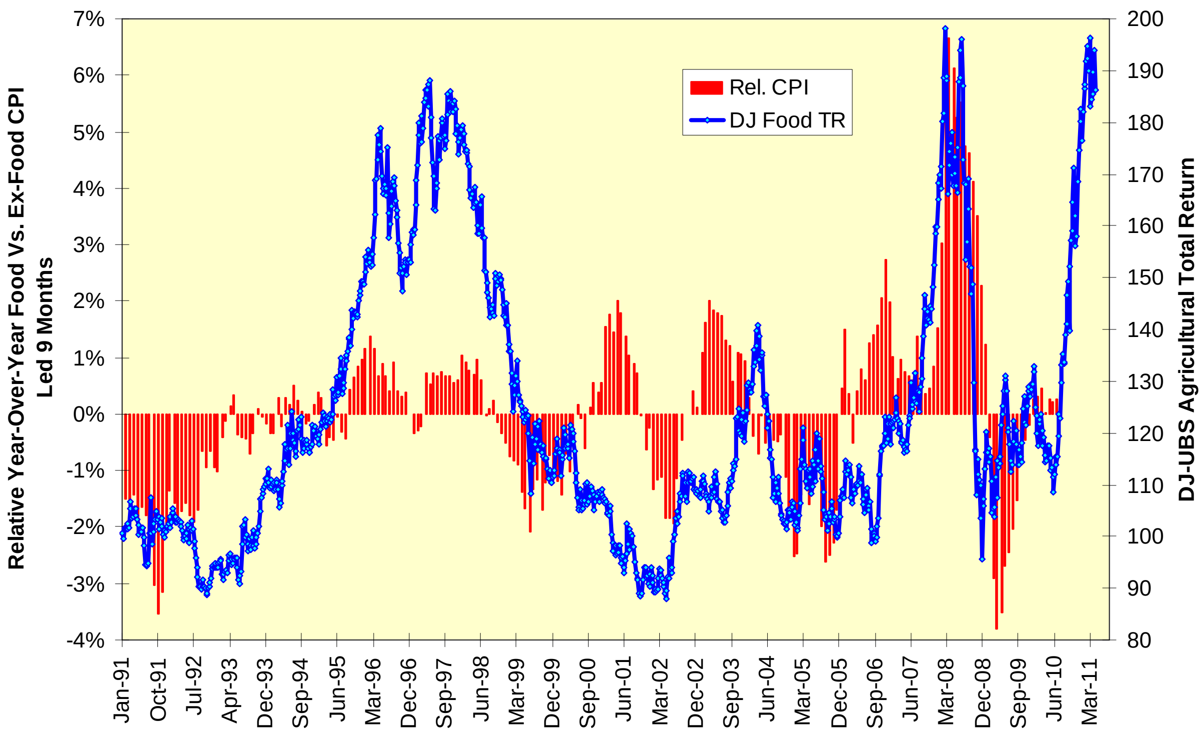
# Food Industry Efficiencies

I could probably get more people to believe in UFOs or they will receive Social Security someday than I can get to believe anything implying an increase in productivity or economic efficiency. People just seem more at ease in believing the worst about each other. I say this as a prelude to today's topic, the surprisingly low excess rate of food price inflation relative to the CPI Ex-Food.

The problem was sort of the opposite last June when I wrote about declining relative food price inflation. This was before the drought hit in the wheat-growing areas of Eastern Europe and the former Soviet Union. By January 2011, a remarkable string of natural and manmade disasters including floods in Queensland and the decision to feed 40% of the U.S. corn crop to yeast to produce low-grade motor fuel, led to the equally bold prediction higher relative food inflation was baked in the cake.

What do we see today, now that inflation is supposed to be an increasing scourge upon the land? First, the total return on the Dow Jones-UBS Agricultural sub-index peaked in early March. It has not retreated much, but when you compare the gains on food, something all of us have to have, to the gains on the precious metals, something at least I can live without, it is downright bearish.

**Agricultural Futures Have Misdirected On Relative Food CPI**

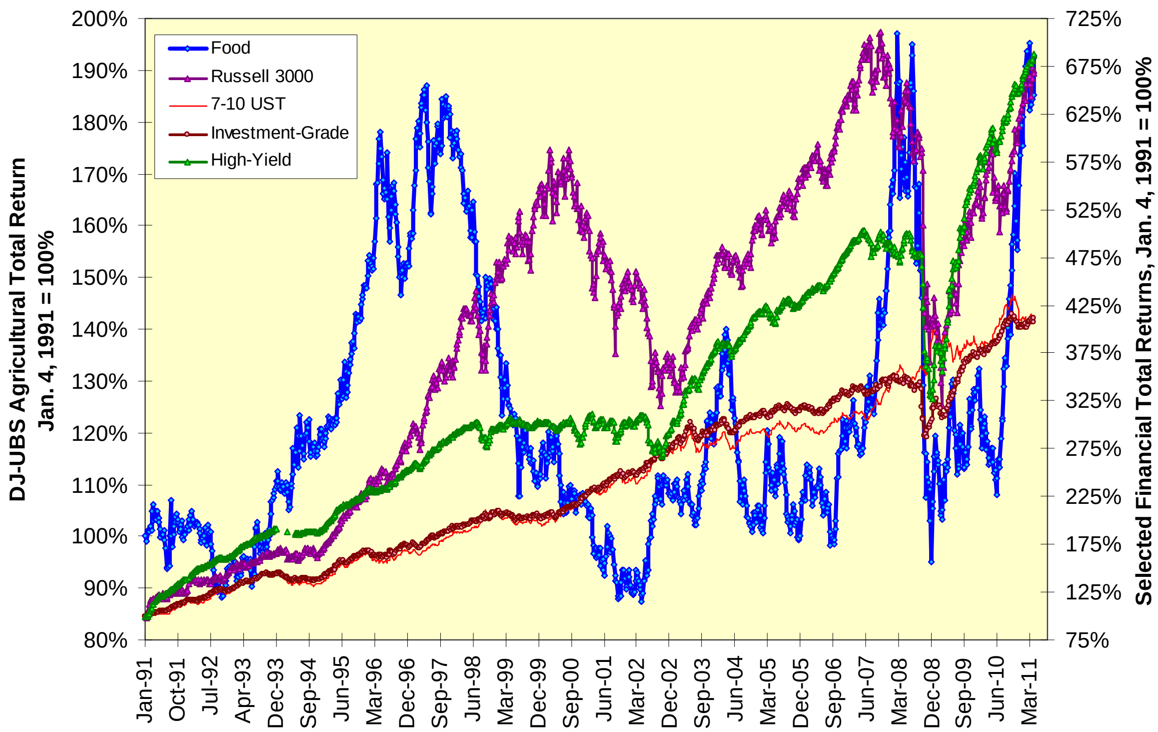



If we then look the relative year-over-year gains for the Food CPI to the CPI Ex-Food, the difference is all of 0.25% over the past year. In a world where money flows like water – and there are many places in the world where money is more abundant and quite possibly cleaner than water – this is a trivial difference.

While it may not seem like it given how grocery stores have taken on a House of Pain feel, the only plausible explanation for this lack of relative food price inflation is increased efficiency all up and down the food supply chain. It was a given for years the cheapest thing in a box of corn flakes was the corn itself, and this holds true today for all manner of processed foodstuffs. Yes, price of front-month coffee futures may have increased more than 125% over the past year, but the labor, rent, insurance and other costs at your local Starbucks still commands a greater share of the final price.

One thing still holds true, however, and that is the aforementioned DJ-UBS Agricultural index is a poor investment relative to common financial alternatives. If we turn the clock back to January 1991, when the U.S. was feeling good about its adventure in Iraq, the DJ-UBS index' average annual total return has been 3.04%. Returns for high-yield bonds, the Russell 3000, 7-10 year Treasuries and investment-grade bonds, respectively, have been 9.51%, 9.36%, 7.00% and 6.97%.

**Agricultural Returns Trail Financial Returns Badly**




Some will counter commodity futures are a diversifying asset. I counter, "So what? A handful of dirt is not correlated to much, either, and yet that is not a reason to go long mud, is it?"

The next time you wince in the checkout line, consider how much worse it could be if the food supply chain was not able to absorb these higher raw materials costs. This is a market in operation, and if given time, it will lead to a least-cost solution as it always does.