

Good News And Bad News On Food Prices

The Important Commodities Are Rising

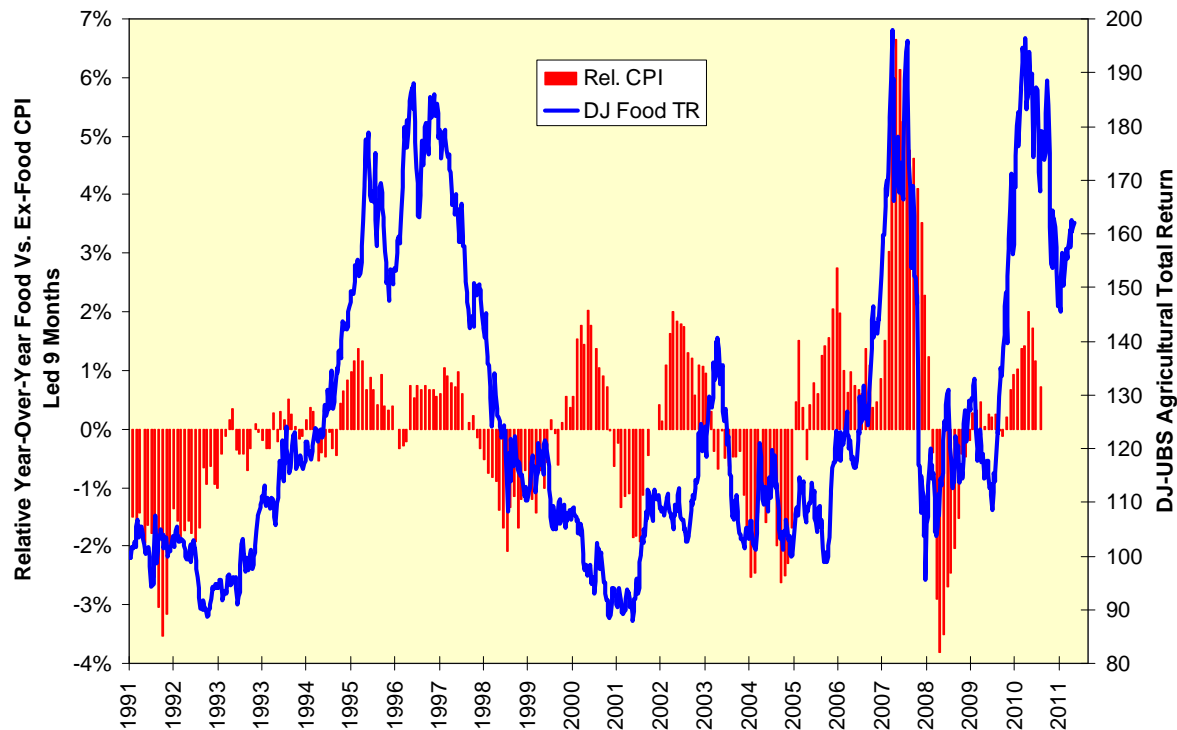
If there is anything world food experts agree on it is the era of cheap food is drawing to a close as surely as the era of cheap energy has. This conclusion was shared at a recent seminar I attended by fertilizer manufacturers such as CF Industries (CF), the still-intact Kraft Foods (KFT) as well as assorted academics, supranational institutions and non-governmental organizations. As an aside, I have attended such confabs on and off for almost forty years and 1) I never heard anyone predict the actual bounty produced worldwide in recent decades and 2) I never have had bad chow when people gathered to express their concerns about world hunger.

There are major differences between the food and energy industries in terms of projecting doom-and-gloom. While food production has undergone huge productivity gains via the application of fertilizer and by limited adoption of genetically modified organisms, it still faces an arable land constraint. New energy provinces such as offshore Brazil have been discovered, but the probability of someone discovering another U.S. Midwest or Ukraine is remote. Another significant difference is people everywhere realize they can save money by increasing energy efficiency, but people everywhere try to climb the dietary curve wherever and whenever possible.

Relative Food CPI

Our good friends at the Bureau of Labor Statistics keep consumer price indices for food and ex-food, as if it is possible for a consumer to avoid food. Oh, well. The performance of the food CPI relative to the ex-food CPI trails the total return for the Dow Jones-UBS agricultural price index by nine months on average; this lag reflects time in the supply and processing chains. Sure enough, the explosive move higher in this DJ-UBS index in the winters of 2007-2008 and again in 2010-2011 led the relative CPI measure.

Agricultural Futures Pointing Toward Weakly Higher Relative Food CPI



The DJ-UBS index' decline into December 2011 has led a decline in the relative CPI measure to the extent we can say the remainder of 2012 should see weakly higher relative food inflation barring a disastrous growing season.

Index Components

One of my many pet peeves is how people lump unrelated commodities together in an index as if they have common behavior. This does not hold even for a focused subindex like the DJ-UBS agricultural index. The soy complex is on a tear and may remain on a tear for the rest of the year given planting intentions and carryover stocks. Coffee is

in a decided downtrend and soft red winter wheat is in a mild downtrend just the way corn is in a mild uptrend. However, as literally everything in the grocery store can be traced back to either corn or soybeans, the gains here are far more important than the losses in coffee. The DJ-UBS agricultural index thus has much greater capacity to surprise to the upside and have a greater impact on consumer budgets than it does to surprise to the downside.

**Total Returns For Dow Jones-UBS Agricultural Index Components
2012 Year-To-Date**

