High Commodity Costs Will Matter For Food Stocks

It All Comes Down To Corn And Soybeans

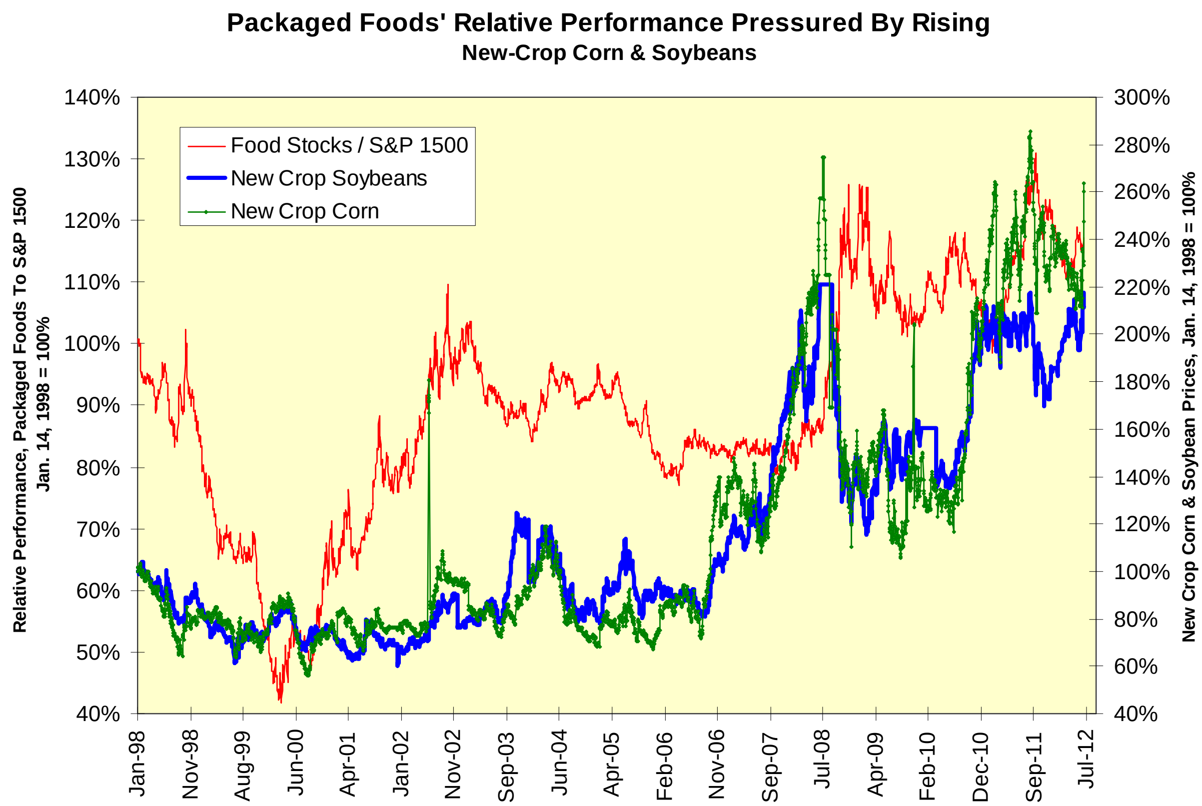
I used to work with a geophysicist-turned-economist who thought he had a knee-slapper with, "Seasonally adjusted, there is no Santa Claus." I often wondered what the going conversion rate was between his knee-slappers and my face-slappers, but that shall remain a mystery for the rest of time.

Traders as a rule are mystified, or so it seems, by the whole seasonality thing. I have yet to see heating oil fail to rally on the first cold fall day in New York or soybeans and corn fail to rally the first time it reaches 90° Fahrenheit (32.22° Celsius for Canadian readers and metric system aficionados) and does not rain for a few days. I have yet to see a growing season where the crop was not destroyed at least once, sometimes more often, by the shocking reality much of what we now call the Western Corn Belt was marked on early maps as The Great American Desert.

This Time For Sure

It shall come to pass in the end of days (is that clause copyrighted?) the crops shall be destroyed for real. How will this affect the Packaged Foods group before you starve to death? This group is the home of stalwarts such as ConAgra Foods (CAG), General Mills (GIS), Kellogg (K), Tyson (TSN), H.J. Heinz (HNZ), Hormel (HRL), Kraft Foods (KFT) and Hershey Foods (HSY), inter alia.

The answer for now appears to be negatively. The relative performance of this group to the S&P 1500 Supercomposite often has increased during long periods of quiescent prices for new-crop corn and soybeans or during the immediate aftermath of a price peak. As corn and soybeans used to battle each other directly for acres in the days before someone thought it would be a bright idea to feed 40% of our corn crop to yeast to make low-grade motor fuel, the two crops' prices used to track each other closely.



That ceased to be the case last winter; corn had unexpectedly large carryover stocks while soybeans embarked on a rally. Interesting, the relative performance of the Packaged Foods group turned lower as soybean prices rose. Soy-derived products are everywhere in the food chain and the market understood the high carryover stocks for corn would be drowned in our green-energy ode to Whiskey River.

Now that new-crop corn prices have joined their legume cousin's in a bullish move, the relative performance of the Packaged Foods group should continue under pressure. This is not a group capable of passing on strong increases to their customers during a time of stressed consumer budgets; people can and will shift down the dietary curve from higher value-added products to more basic foods.

The big mistake real-estate lenders make is their loan is against something tangible. True, but as we have discovered, tangible is not synonymous with profitable. The big mistake defensive investors in a Consumer Staples sector group such as Packaged Foods make is assuming because people have to eat, they must eat profitably.