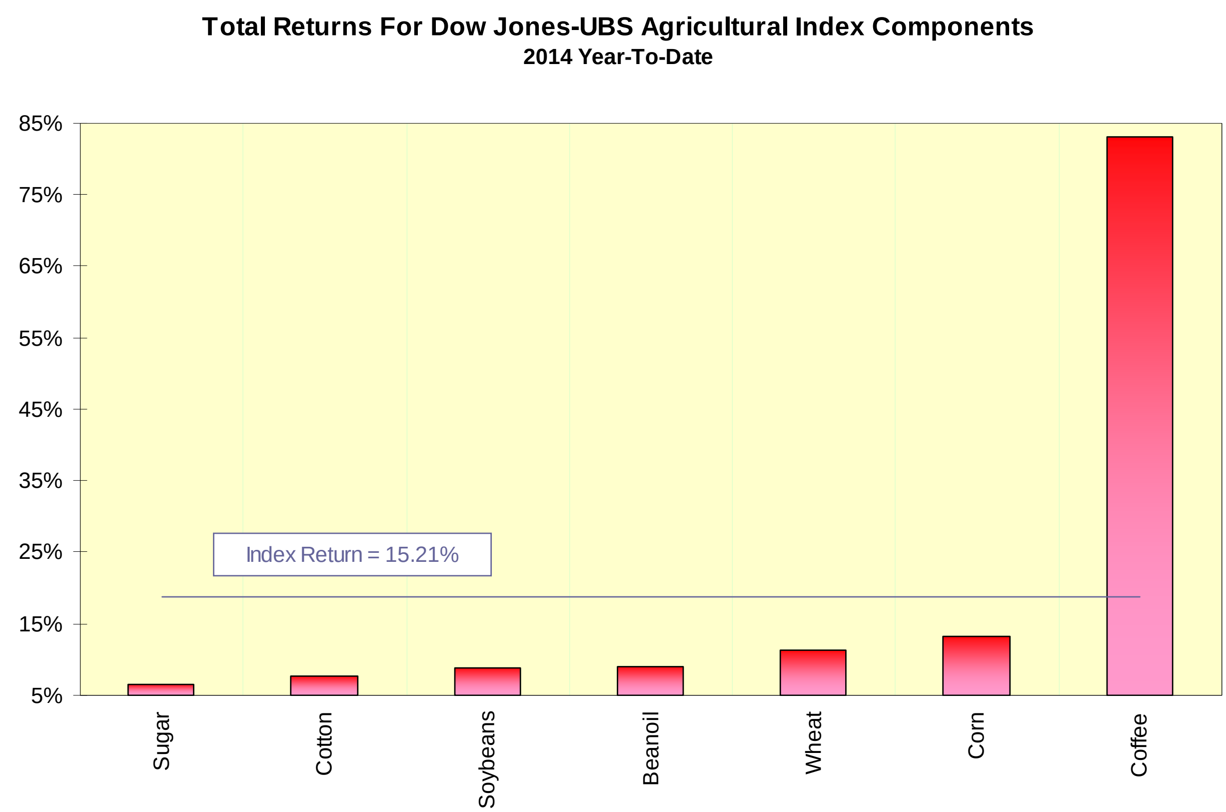
Coffee Perks Up Agricultural Index

Long before natural gas futures entered the scene in the early 1990s, coffee 'C' or Arabica futures traded then on the New York Board of Trade, now part of Intercontinental Exchange (ICE) were the most volatile physical commodity. There are several good reasons for this. First, the supply of coffee is very inelastic; small changes in supply can have a very large effect on price. Second, demand is elastic as firms such as Starbucks (SBUX) have shown. If you need your fix of morning joe, you probably are willing to pay up to obtain it and a lower price probably would not induce you to guzzle more. Third, while certain goods do not grow on trees, coffee does and a crop shortfall leading to higher prices today will induce large new production in subsequent years.

The Agricultural Index

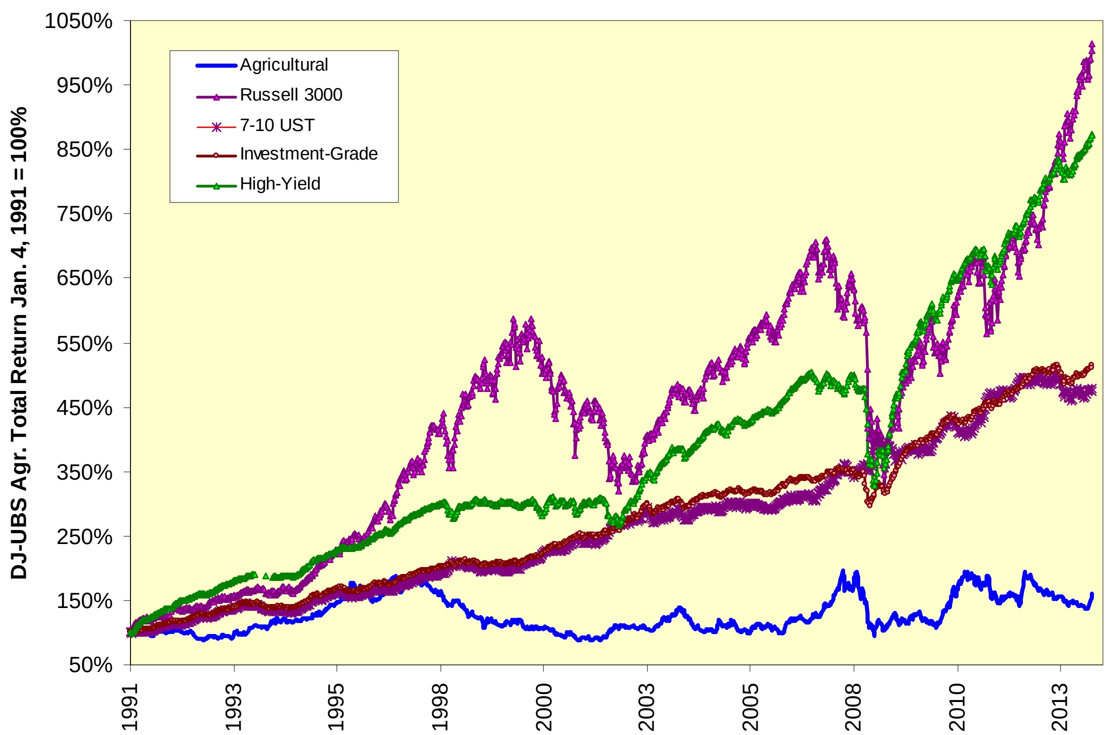
While grains such as wheat and corn probably should not be lumped together with soft commodities such as sugar, coffee or cocoa, they do have the common thread of crop cycles, sometimes in one hemisphere, sometimes in two hemispheres. The good index-meisters at Dow Jones-UBS have separate indices for grains and softs and a combined one for agricultural commodities. The year-to-date total return on this index is 15.46%. This is what happens when you have droughts in Brazil and unnaturally cold weather in the winter wheat belt of the U.S.

If we peek behind the curtain at this gaudy return, we find it is skewed massively by coffee's 83.1% gain. Corn is a distant second at 13.2%. This is the sort of thing that gets stock market technicians yelping about narrow market advances and the like.



We also need to step back, presuming we are not standing near a cliff's edge, and look at the history of the agricultural index' total returns relative to those for U.S. stocks as measured by the Russell 3000 index (IWV), 7-10 year Treasuries (IEF), investment-grade bonds (LQD) and high-yield bonds (HYG). Instruments such as the PowerShares DB Agricultural Fund (DBA) did not exist in January 1991, but the comparative underperformance of the agricultural index should give you food for thought.

Agricultural Returns Still Trail Financial Returns Badly



Let's just say this index does not scream "buy-and-hold" as much as it does "chuck and duck." The long-term history is one where upturns arrive swiftly and disappear swiftly and where the roll yield between futures contracts eats you alive. The old floor traders understood coffee to be a great day-trading instrument and behaved accordingly. Why anyone would want to expose themselves long-term to an index dominated by a single commodity is beyond me.