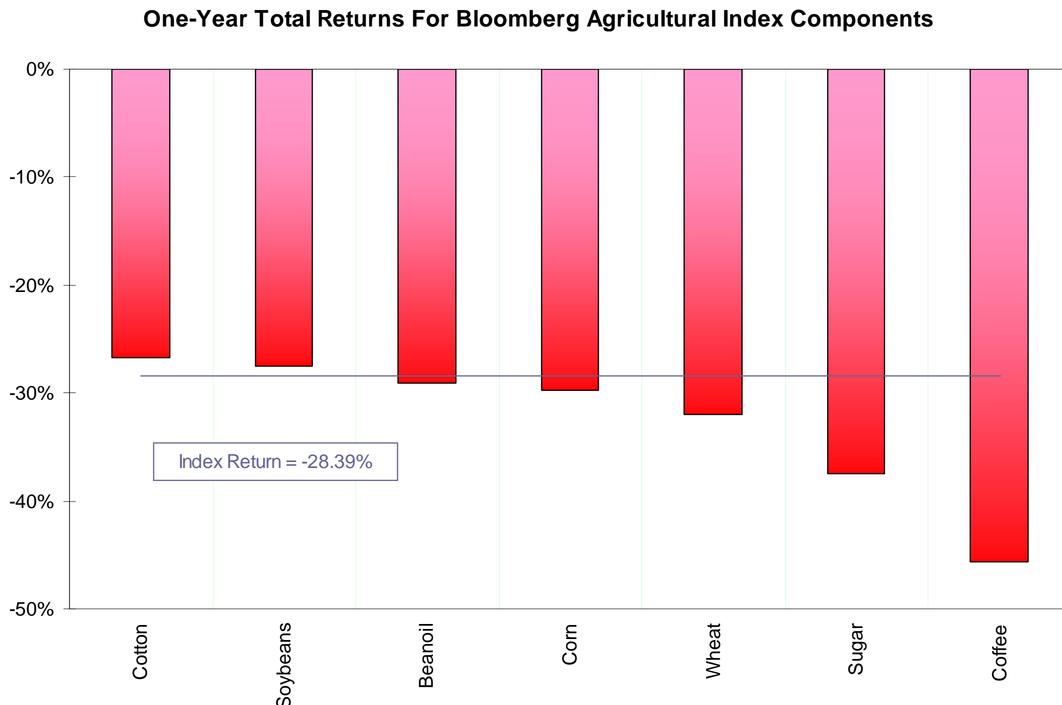
Agricultural Commodities And Food Prices

There are certain stories in this business I refer to as “rubber chickens” after the vaudeville adage a comedian could always get a laugh with a rubber chicken. One of my favorites is dumping all over the idea there is something out there called “commodities” that will protect you, the reader/consumer/trader/investor/voter/taxpayer against the ravages of the inflation your non-elected central bank is trying to push higher.

Let’s take agricultural commodities. The Bloomberg Agricultural total return index, which is composed of futures contracts on coffee, corn, cotton, soybeans, soybean oil, sugar and wheat has lost 28.39% on a trailing one-year basis. This decline has not been confined to a single commodity, but rather has been distributed across all index components.

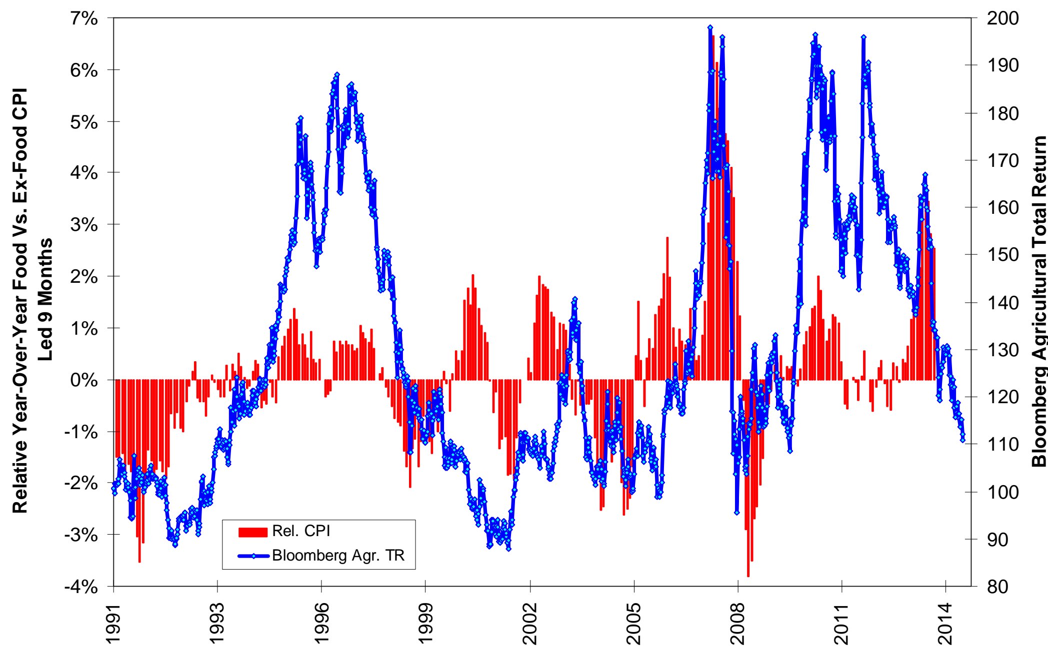


Relative Food CPI

Agricultural futures lead the CPI for food relative to the CPI Ex-Food index by nine months on average. This suggests relative food price inflation will decline into the first quarter of 2016. As the key components of the index are quite literally in the ground or in storage, only a significant and negative shift in Northern Hemisphere growing conditions will reverse the downward course of agricultural commodity prices regardless of monetary conditions.

A cynic, should one of those be found, might note the entire concept behind core inflation arose during the inflationary 1970s to excuse monetary authorities for higher food and energy prices. They noted, with good reason, supply shocks such as the 70 years of bad weather used as an excuse for Soviet agricultural failures, were not amenable to a monetary response. The U.S., I am proud to note, only uses bad weather to explain first quarter GDP in recent years. Let it snow, let it snow, let it snow.

All of this raises the question whether falling food prices should be used as an excuse for delaying the interest rate increase that may or may not have anything to do with inflation for another 12-18 months; remember those long and variable lags if you are keeping score at home.



Poor Investment

The Bloomberg index' average annual return since January 1991 has been 0.40%; this compares most unfavorably to average annual returns of 10.03%, 9.04%, 6.71% and 6.94% for the Russell 3000, high-yield bonds, investment-grade bonds and 7-10 year UST, respectively.

The average year-over-year changes in the CPI and PPI since January 1991 have been 2.48% and 2.14%, respectively. The Bloomberg Agricultural index has not afforded any measure of inflation protection.

While past performance does not predict future results, a quarter-century of performance data underlain by solid fundaments should not be ignored willfully. While we have no idea what future returns for financial instruments will be, especially given current valuations and discount factors, we do have a very good idea human ingenuity will continue to advance. That will serve to create new economic efficiencies and profit opportunities to be captured by financial instruments while simultaneously increasing the productivity of the agricultural sector.

While there have been and will continue to be short-lived production disruptions leading to bursts of higher agricultural returns, some of which may intersect with periods of negative financial returns as in 2008, the long-term prognosis for agricultural futures as an investable asset class remains poor. Diversification is not an unalloyed good; unless accompanied by positive risk-adjusted returns it is pointless.

Agricultural Returns Trail Financial Returns Badly