



Taking Stock: Investors Gorge On Food, Glorious Food

By Spencer Jakab

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NEW YORK – It was 210 years ago, at the start of the industrial revolution, when economist Thomas Malthus theorized that “the power of population is indefinitely greater than the power in the earth to produce subsistence for man.”

Luckily, his predictions of famine and disaster turned out to be deeply flawed, but his name is coming up in conversation again as food shortages grip the world. Seeing opportunity in adversity, investors unable or unwilling to buy commodities or farmland have bid up stocks sensitive to agriculture. The sector is looking frothy even to some of its fans, though, but the fundamentals pushing food prices higher don't appear to be coming to an end any time soon.

March of the Meat Eaters

One big beneficiary of the agricultural theme has been Mark Coffelt, chief investment officer of Empiric Funds. A heavy focus on stocks tied to the sector has helped his main fund, Empiric Core Equity A (EMCAX), roughly double the performance of the Standard & Poor's 500 over the past five years. It remains a big bet with agricultural chemicals and fertilizer companies being his biggest concentration. Seed company Syngenta AG (SYT), with a total return of 220% over three years, was his second largest holding recently and fertilizer company Agrium Inc. (AGU), with a return of 442%, was also a top 10 position.

“Agriculture has been a huge driving force,” said Coffelt. “If you look across the globe, you have a lot of (developing countries) simultaneously doing well at the same time. In a lot of these countries, you have people striving to eat meat.”

You also have many people striving to eat anything at all, which may become a growing source of political instability. On Friday, the headline of the New York Times blared: “Across Globe, Empty Bellies Bring Rising Anger,” accompanied by dramatic pictures of Indian villagers clamoring for subsidized rice and malnourished Haitians scavenging through a garbage dump. Recent days have brought scenes of rioting or hoarding in Egypt, the Philippines, China, Mongolia, Indonesia and

elsewhere while a number of countries have adjusted import and export tariffs to keep food and fertilizer at home and off the world market.

Are we seeing shades of a Malthusian catastrophe two centuries late? It's a bit more complicated than his equation of geometrically growing population outstripping finite arable land.

One big element in the spike in food prices is the boom in oil and gas since 2001. A white paper published last year by Nudgem Richyal, a portfolio manager at Baring Asset Management in London, looked back at commodity cycles starting with the War of 1812 and repeatedly saw expensive energy pass the baton to food, a trend he correctly predicted was far from peaking. Richyal argues that rising wealth is a better explanation for soaring food prices than population alone.

Economist Paul Krugman recently dubbed this the “march of the Chinese meat eaters.” Richyal noted that the typical Taiwanese and Chinese citizen consume 2,500 calories each per day but that wealthier Taiwanese eat nine times more animal protein which in turn can consume seven times as many calories in grains to produce.

Other elements are weather-related and possibly linked to climate change or other manmade causes. For example, a horrific drought in Australia's rice growing areas has caused chaos in Asia while booming development and a water shortage have harmed Chinese crop output. Water is such an overlooked but valuable commodity that one investment manager, **Gregg S. Fisher**, president of private advisory firm **Gerstein Fisher**, has advised clients to overweight investments in countries like Canada and Brazil with abundant water.

Trees Don't Grow To The Sky

For most investors, the easiest way to benefit from the agricultural theme is through individual stocks or exchange-traded funds. Aside from seed and fertilizer companies, indirect plays have been a good bet. Some popular ones are equipment manufacturers like Deere & Co. (DE), with a return of 214% over three years, or

transportation stocks like Union Pacific Corp. (UNP) and DryShips Inc. (DRYS), up 129% and 419%, respectively.

ETFs benefitting from crop prices include iPath DJ AIG Agriculture (JJA) and Rogers International Commodity Agriculture (RJA) and PowerShares DB Agriculture (DBA), while food funds like Van Eck Market Vectors Global Agribusiness (MOO) have launched in recent months.

Others have cut out the middleman and come closer to owning the futures contracts traded daily in the pits of Chicago, a relatively new area for individual investors. Except for brief bursts such as the 1970s, agricultural commodities were at best dull and at worst a route to subpar performance. In the past few years, though, they've been a great hedge against both shaky stocks and creeping inflation.

"When we started adding this to our portfolio back in 2001 and 2002, people thought we were crazy," said **Fisher**, who has urged clients to allocate 10% of their portfolios to commodities. Unlike pure equity managers, he has been a proponent of direct investment in crop prices through index products such as those tied to the Dow Jones AIG Commodities Index, which has a big food component along with energy and metals. The advantage of direct investment is the low or negative correlation with stocks and bonds, and he has eschewed investments in stocks tied to the sector.

"If you want to jump off the deep end, there are more speculative ways to play this, but I wouldn't recommend it," he said. "When you buy a stock, even if it gets a significant amount of earnings from agriculture, you're getting less diversification than just buying a basket of commodities."

He's not alone in being wary of some hot agricultural-related stocks. Despite all the macroeconomic arguments behind rising food prices, some share prices are beginning to

resemble dot-com stocks in the 1990s. Those that have appreciated the most from the agricultural boom include fertilizer makers Mosaic Inc. (MOS) and Potash Corp. (POT), with returns of 946% and 657% over three years, respectively. Both trade at higher trailing price-to-earnings multiples than tech darling Google Inc. (GOOG).

"The fertilizers have just gone bonkers," said Coffelt. "It doesn't matter which one you owned, they've all done well, but it's a question of when the merry-go-round ends. The minute they stop coming out with very good earnings, they'll get pounded."

Fisher's approach is passive since he said his clients' commodity bets are more about diversification than making a directional bet on crop prices. When commodity bets do very well relative to more traditional assets, he has cut down his exposure and used the cash to boost

other holdings. He recently sold down some commodities holdings for his clients.

"I'd be extremely mindful of using this as a funding source," he said. "The best way is to pick your percentage and stick to it."

Though he also has taken some profits, Coffelt said he sees more gains for agricultural investments in the near term. Still, he acknowledges that trees don't grow to the sky and that he needs to be wary of a big reversal in this winning bet.

"They've certainly gone a lot further than I would have expected," he said. "They're clearly in the momentum area and at some point there'll be downside."

(Spencer Jakab writes Taking Stock, a global column that gives insightful analysis about equity-related topics around the world.)

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