



Top of the crops

Climate change and strong demand is pushing up food prices, providing an investment opportunity.

By John Collett

After 25 years of falling prices, most agricultural commodities are enjoying a huge reversal of fortunes. Some analysts believe the sector's bull market can continue for years. That means higher food prices but also creates opportunities for investors to harvest returns from rising crop prices.

Wheat is trading in Chicago at about \$US8 (\$9.30) a bushel, more than double last year's price. Prices are at record levels for corn and soybeans and the prices of many other agricultural or "soft" commodities, if not at record highs, are the best they have been for years. Dairy prices have risen by more than 60 per cent over the past year. Skim milk powder is trading at prices more than twice its long-term average.

Economic growth, particularly in China, India and South-East Asia, is creating more demand for Western foods such as meat, bread, dairy products and coffee.

Higher oil prices are making the production of alternative fuels more economically viable. In the US, in particular, government policy encourages alternative energy and ethanol plants are springing up throughout the Midwest. That is increasing the demand for corn, from which ethanol is distilled.

Weather patterns are expected to become increasingly erratic as climate change bites. Drought in Australia, dry weather in Argentina and Canada and excessive rainfall in the US have reduced this year's global wheat crop.

Research by the Commonwealth Bank says smaller wheat crops mean the "world is going to cut further into already dwindling inventories".

Inventories of wheat are likely to fall to about two months' supply. "Levels have not been that low for the best part of half a century (and perhaps even longer)," says Commonwealth Research in its September 4 "Soft Spot" report.

Greg Smith, the managing director of boutique fund manager Global Commodities Limited, has been bullish on soft commodities for years. He says the "market has really been asleep on this one" because the focus has been on the resources sector.

Smith says that as more crops are grown for biofuels rather than food the world farm economy, already faced with the challenge of feeding 74 million extra people each year, will come under even greater strain.

Ingrid Richardson, a senior food and agribusiness analyst at Rabobank, says demand for corn is the fastest-growing among the grains. Increasing demand is coming from the feed industry as well as from the emerging biofuels industry. As economic conditions improve in the developing world, more poultry, pork and dairy products are being consumed. Livestock is fed mostly on grain, particularly corn.

Richardson says the various end-users, those producing food, biofuels and animal feed, are competing for use of the world's limited supply of arable land. That is sending the prices of all grain commodities higher.

It is hard to see any of these trends changing, says Dominic McCormick, the chief investment officer at fund manager Select Asset Management. "We think that we are in a longer-term bull market for commodities, generally. That is across the board," he says.



Commodities volatile

However, commodity prices are notoriously fickle. McCormick says there will be huge corrections in prices along the way but the fundamentals are likely to remain to support higher prices over the long term. He says the main trend is the growth of Asian demand. Just as it is creating demand for resources, it is also the main driver of higher agricultural commodity prices.

Han Lee, the founder of boutique fund manager Prime Value Asset Management, says China has been improving its manufacturing industry and somewhat neglecting food production. "China will soon be importing [more] good-quality food and that is where Australia is in a good position to benefit," Lee says.

The biggest risk for all commodities is a slowdown in the world economy. That would cause consumers, especially those in emerging economies, to stop buying luxury foods such as meats, sugars, oils and coffee and fall back on longstanding staples such as rice.

McCormick says that while a faltering US economy would have an impact on commodity prices in the short term, the emerging markets growth story should remain intact. "I think those economies are being driven more and more by domestic growth and a slowdown in the US is not going to interrupt that in a major, long-term sense," he says.

However, for small investors the opportunities to take on agricultural commodities are limited. The most direct route is through the futures contracts for the various commodities traded on the sharemarket. But that is more for day traders and speculators than long-term investors. And while there is nothing wrong with that, it is definitely not for the faint-hearted, McCormick says.

Any venture into the commodities sector for long-term investors should be as part of a well-diversified portfolio. However, only a handful of managed funds give small investors exposure to agricultural commodities. Select Asset Management has its Select Alternatives Portfolio, which has a 7.5 per cent exposure to soft commodities. The fund has exposure to a wide range of alternative investments such as hedge funds, private equity and infrastructure.

Direct shares

For many investors, the preferred way to buy into the soft commodities story is through Australian sharemarket-listed companies.

Wheat exporter AWB and storage and handling companies GrainCorp and ABB Grain are likely to do well in the long term, says Belinda Moore, an analyst at ABN-AMRO Morgans.

Moore says their profitability is influenced in the short term by Australian grain production. Their share prices have fallen significantly over the past several weeks as investors worry the crops are faltering at a critical time. Moore says there may be consolidation in the agricultural sector and she has a positive view of the sector over the longer term. The factors driving prices higher are structural and here to stay, she says.

Shane Kelly, the managing director of investment researcher Adviser Edge, says: "You can rest assured that when the production outlook improves, the

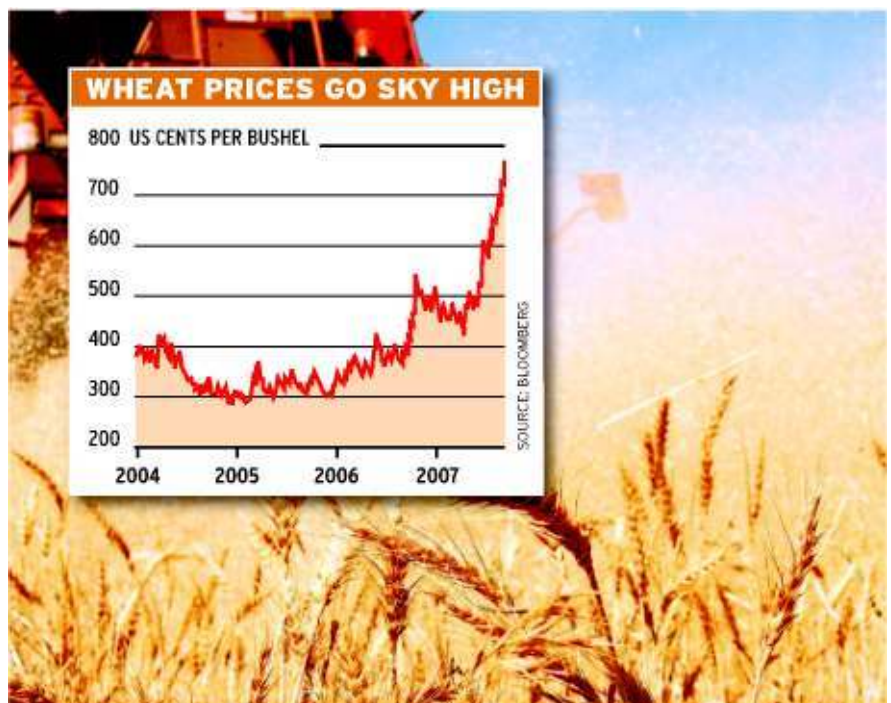
share prices will move back up again.

"But picking the entry point is going to be difficult because if weather conditions stay dry for another month or two we may not have seen the end of the fall away in the share prices [of the three companies]."

Global population pressure is decreasing the amount of available arable land and there is pressure to increase crop yields. Makers of fertilisers and crop protection chemicals are doing particularly well.

The listed company NuFarm makes pesticides and is well diversified into overseas markets. NuFarm is being talked about as a possible takeover target, which is helping its share price.

Another growing Australian listed company is fertiliser maker Incitec Pivot. The profitability of these companies is subject, to varying degrees, on seasonal conditions.





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**Winds of
change ...
could the new
boom be in the
food sector?**

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