ECLECTICA
ASSET MANAGEMENT

for financial advisers only

a bumper crop?

October 2008

George Lee, Fund Manager of the Eclectica Agriculture Fund, explains the factors that he believes are driving agriculture related investment opportunities.

Food prices have declined in real terms for 35 years and no one invests in a world of declining prices. Given the multitude of competing uses of capital available to speculators, no one in their right mind would have considered investing in farmland. As the productivity improvements brought in by the Green Revolution came to an end, supply growth has stagnated.

And yet, demand for agricultural products has grown steadily and may be set to accelerate. The world's population has been growing at 1.5% annually. This may not look much, but over 30 years it adds up, especially as 40% of the population living in Brazil, India and China is getting richer and demanding a higher protein diet, increasing the burden on agricultural land.

For eight out of the last nine years, the world has consumed more food than it has produced. One might therefore wonder why prices have failed to respond but the reason is simple: excess inventories. Government support in developed economies sought to favour the farmers, but in reality mismatched supply and demand. As a result, the continent has been wallowing in excess inventories of commodities such as wheat, milk and butter. Under intense pressure from emerging producers and international organisations such as the WTO, agricultural markets are slowly changing. As this excess production has been curtailed and demand continues to grow, the surplus inventories are finally starting to disappear. So with low inventories, stagnated supply growth and rising demand, we sense an opportunity.

why agriculture now?

Between 1975 and 2003, despite having deflated when measured against everything else, corn had kept its value relative to energy. The ensuing fivefold increase in oil, however, has changed everything. Food has become so cheap relative to energy that making fuel from food seems like a good idea.

This incremental demand from energy has tipped the balance in the agricultural markets. Measured in absolute terms, inventories have halved since 2000. Unless supply can respond, the world will be facing acute food shortages in the next few years.

how does this translate to equities?

One could probably get agricultural exposure simply by owning the large cap stocks such as Deere and Monsanto. However, by digging deeper, we have discovered a universe of over 600 stocks globally which will benefit from the forthcoming once-in-a-generation bull market in agriculture.

The initial beneficiaries will of course be companies that own farmland. Farmers keen to maximise production as prices rise will spend more on fertiliser and chemicals. In time, a sustained transformation in the economics of farming will bring forth a new group of speculators and they will have to invest in new machinery, such as tractors and combine harvesters. In drier parts of the world irrigation systems are crucial for increasing productivity. And as the new supply comes on, the need to transport it from the fields to consumers will highlight the inadequacy of existing infrastructure.

The Skandia fund will not mirror the performance of the underlying fund because of Skandia fund charges, taxation adjustments (if appropriate) and the Skandia investment process.

The CF Eclectica Agriculture and CF Eclectica Continental European Funds launched on Skandia's Life and Pensions fund range and the Selestia Investment Solutions investment platform on 11 September 2008.