

Food Fights

Tariffs and subsidies need to disappear as investors need to hedge

BY ROMANA KING

Farmers haven't only been feeding cities. In the last few quarters farm commodities have soared in the stock markets with some investors reaping the rewards.

While this is great if you are well-positioned, some macro-level economists, such as Donald Coxe, are worried that hedging your investments is not enough against the looming food crisis.

"Sure there are people that

say there is still enough food in the world, but that's rather like saying there is enough oil in the world, because they added in the oil in Russia, Venezuela and Kazakhstan," explains the global portfolio strategist at BMO Financial Group. He concedes that it is good in theory, but not in reality.

The basic reasons for the shortage boils down to two factors: a

rising global middle class that is adding meat and dairy to their diet, and an antiquated global agriculture system that relies on tariffs, subsidies and artificially suppressed production.

"Buy your food now for Christmas," Coxe declares, as the "imposition of Hitler-style autarky on the grain trade" is the first signal of a shortage.

He is referring to the export

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tax on soybeans in Latin American countries, the quasi-embargo on exports in Thailand and the lifetime prison sentence imposed on anyone caught hoarding rice in the Philippines, to name but a few examples.

"We have never been closer to a free market economy, but because the agriculture sector is crippled by autarky, export bans, and punitive taxes, we are moving away from those principles." Coxe suggests returning to the supply and demand equation that applies in other sectors.

"We pay farmers not to produce. That's where many of these subsidies go," he explains. Yet,

with another 100 million joining the ranks of the middle class in China alone, Coxe questions the rationale of subsidizing farmers not to produce.

He also rebuts recent arguments that the upcoming food crisis is due to worldwide droughts, high fuel costs or speculators.

"There was only one drought [in 2007] and it had nothing to do with corn [or any other bio-diesel-based grain]," says Coxe.

Coxe lays more of the blame on green-initiatives than weather. Last year, China, Indonesia and Thailand asked the EU to stop production of biodiesel, because the redirection of soy and other grains to the production of biodiesel was hurting their diets – their people could no longer afford the high prices for commodities in order to make staples in their diet.

"The EU's response was to appoint a committee to investigate the situation," said Coxe. "And then continued their biodiesel program."

If the lack of political will in the EU was bad enough, the matter isn't even on the table for discussion in the U.S. Coxe points out that Obama's home state, Illinois, is the second largest producer of ethanol, yet this U.S.-presidential hopeful is not the only politician ignoring the food-fuel link. In fact, under current U.S. legislation there "won't be much corn used for food, it will all go to ethanol," by the year 2015, says Coxe. "Now that's insanity."

Coxe also confirms that speculators are not the cause of increasing food costs (and, subsequently, the impending food shortage). "Global stocks keep falling while prices keep rising – a response that has nothing to do with supply and demand and evidence that speculators are not responsible."

Coxe suggests a number of ways investors can take action to hedge against this upcoming staple crisis. He urges analysts to start factoring food and its associated costs into their forecasts. "No matter what the asset class, assume food price inflation for the next two years. If there are major crop failures, assume five years." One recommendation is to go long in companies "where it is absolutely essential for them to prevent this problem from spinning out of control." One basic example is for investors to go long on eggs and short on restaurant stock.

"Food is not a luxury, it's a necessity."