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### Will Agricultural Commodities Outperform in 2012?

“If I were buying anything I’d be buying agricultural commodities. Going forward we’re going to have huge shortages of everything – including farmers – I think ag will be a great place for the next 10 to 20 years.”  
-- Jim Rogers.

Agricultural commodities had started surging since June 2010. The benchmark Index – S&P GSCI Agricultural Index jumped from 281.17 to 570.5 at March 2011, the correction began afterwards. The gauge slumped to 398.23 in December 2011, which is 30.2% lower than previous high. However, the index rebound significantly in the past few weeks. Will agricultural outperform this year? We try to answer this question by analyzing both the demand and supply side factors.

The prices of agricultural products are affected mainly by three factors: Weather, Land & People. Weather affects supply directly, without good weather, supply will be lower. The production of farmland is affected by weather for sure. Also, the use of land, either for agricultural or industrial purpose, affects the supply of agricultural products. For the demand side, agricultural products can be served for consumption, industrial (i.e. bio-fuel), investment & speculative purposes.

We have collected 10 years data from Food and Agriculture Organization of the United Nations (FAO) and compared both the utilization and production data with the GSCI Agricultural Index and some major commodities. We could draw some conclusion as follows:

1) When production is greater than utilization (i.e. production surplus exist) in particular financial year (except 05/06), agricultural prices drop (i.e. S&P GSCI index fall in that year), vice versa. Please see table 1 for details.

2) From Chart 1, we forecast that production will probably greater than utilization in 2012/2013 if it follows the trend, which means the downside risk for agricultural price is much higher than the upside.

We also find that USD and agricultural prices are almost inversely correlated in the last few years. If euro crisis deepen, USD will surge, which may trigger massive selloff of the high-risk assets, including agricultural commodities.

As mentioned above, weather is one of the important factors affecting production. Last year, we predicted that the parabolic rise of food price is less likely to repeat in the second half year because the strength of La Nina’s event was likely to decrease.

La Niña is a coupled ocean-atmosphere phenomenon that is the counterpart of El Niño as part of the broader El Niño-Southern Oscillation climate pattern. During a period of La Niña, the sea surface temperature across the equatorial Eastern Central Pacific Ocean will be lower than normal by 3–5 °C. The name La Niña originates from Spanish, meaning "the girl", analogous to El Niño meaning "the boy".

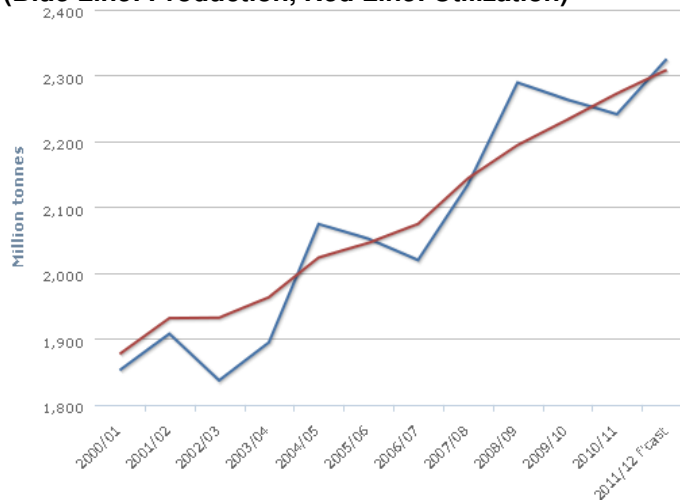
Based on the latest forecast made by some reputable meteorological models around the world, the strength of La Nina’s event will likely decrease again. In other words, supply side is generally positive. We expect agricultural prices will maintain around the current level or drop below that by the end of this year and high volatility will remain.

Jim Rogers is probably right (Agricultural prices will go up in the next 10 to 20 years), but it may not be fulfilled in this year.

**Table 1: Production Surplus/Deficit vs S&P GSCI Agricultural Index**

Fiscal Year	Suplus +ve or Deficit -ve	Suplus +ve or Deficit -ve	S&P GSCI Agricultural Index		
	Amount Million Tonnes	As % of Production	YoY(%)	High vs Beginning (%)	Low vs Beginning (%)
2001/02	- 23.73	-1.2%	+0.5%	+10.6%	-4.4%
2002/03	- 95.22	-5.2%	+15.8%	+37.8%	-5.3%
2003/04	- 68.63	-3.6%	+30.4%	+35.2%	-3.7%
2004/05	+50.96	+2.5%	-18.5%	+3.4%	-28.0%
2005/06	+6.53	+0.3%	+14.2%	+19.9%	-5.2%
2006/07	- 54.89	-2.7%	+14.9%	+32.4%	-3.9%
2007/08	-9.61	-0.5%	+63.1%	+101.8%	-3.9%
2008/09	+95.04	+4.2%	-28.8%	+19.6%	-40.7%
2009/10	+30.64	+1.4%	-0.5%	+23.1%	-2.9%
2010/11	-31.42	-1.4%	+81.4%	+94.3%	-4.3%
2011/12	+16.58	+0.7%	N/A	N/A	N/A
2011Apr-Dec	N/A	N/A	-18.5%	+6.3%	-25.3%

**Chart 1: Production Surplus/Deficit of global agricultural commodities (Blue Line: Production, Red Line: Utilization)**



Sources: FAO, Arcadia Research

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