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Asset.tv: Teucrium's Gilbertie Chats with Asset.tv on Investing in Agricultural Commodity Futures

Link: http://www.asset.tv/player/Asset.tv-US-Player/TeucriumGreenScreen/16751

Q: Can you start with an overview of why Teucrium has focused their products in agricultural commodities?

A: We believe that agricultural commodities are a critical component in people's portfolio, or at least need to be. People understand that energy is a vital part of their lives, I think what they don't understand is how important agriculture is in their lives. Agriculture is in or touches everything you do, and the main agricultural products of corn, soybeans, wheat and sugar are so pervasive throughout our economy. People realize how pervasive oil is, it is in just about everything you touch. They don't realize that the grains are that way as well. So, it is very important for people to make sure they have a well balanced portfolio that includes agricultural commodities, not just gold and oil.

Q: What are the primary drivers determining the demand and price of grains, and how does population growth fit into the equation?

{Graphics: 1) World population growth; 2) Land mass of Massachusetts; 3) Historical Global Corn Consumption}

A: I think to begin with, the basic fundamental of population growth. Right now the world is growing at about 75 to 77 million people a year. Each one of those people requires more commodities. And, approximately just to grow the big crops of corn, soybeans and wheat, the population growth each year requires an amount of arable land twice the size of Massachusetts. So, your population globally is growing at about twice the size of the population of California and you require about twice the land mass of Massachusetts in order to provide people just with the corn, soybeans and wheat they need. It is an incredible amount of people and amount of land that is required. So, agricultural commodities can also serve as a proxy; they don't know how to invest directly in land, there is virtually no way to invest directly in water, and agricultural commodities can be a proxy for those two things as well.

Q: How pervasive are agricultural commodities and how does an emerging middle class affect consumption?

{Graphics: 1) Population by Socioeconomic class; 2) Corn Cob Gas Pump; 3) Examples of Corn in the Gas Station Infographic}

A: Well, that's a great question. The emerging middle class globally is enormous. And, what has happened is, as Americans, we have taught people to use a lot of commodities. So, per capita we use a very large amount of commodities per person. And, what happens is, as an emerging middle class comes forward the first bit of disposable income that people get, they actually increase the protein in their diet. Most people focus on automobiles and things like that, that is down the road for an emerging economy. Where you have an emerging middle class, and middle class can be defined as little as ten dollars a day in some studies. So, if you increase the protein in your diet, which is the very first thing people tend to do when they have some affluence, that creates a huge demand for meat, and that actually is corn's number one use globally.

Corn is so pervasive. It's a great example, Corn at the Gas Station. So if you pull into a service station, gas station whatever you call it, your SUV is going to use about a bushel of corn when you are filling up because of ethanol component here in America. Now, that actually globally is corn's second largest use. Its largest use, when you walk into that service station to buy a snack, if it is say a chicken taco, chickens eat corn. They eat grains. The demand for grains is huge. That is the number one use of corn in the world - ~~is~~ to actually feed animals for meat production.

If you reach into the cold case and pull something out of the cooler that is sweet to drink, sweetened with say corn syrup that is corn's third largest use. So, now you have touched corn everywhere. When you go to sign that credit card slip, that sheet of paper is the fourth largest use of corn; which is for starch. Starch makes paper. So, there is no where you can turn in the modern economy globally where you are not touched by corn.

And what happens is because of the fuel-based component of demand for corn that also trickles into soybeans. There is biodiesel, and so soybeans are also used to produce fuel, people don't realize that. Sugar is used to produce fuel, because of ethanol out of Brazil and other places. And, many ethanol plants in Canada, the United States and the U.K. actually can use wheat as a feed stock. So, you've got your big four agriculture products of corn, soybeans, wheat and sugar that are all so ingrained in the global economy and in use by an emerging middle class that uses more of them per capita as they come to fruition with their growing economies.

Q: Can adding commodities do an effective job at providing diversification to an overall portfolio?

{Graphic: Pie Chart}

A: Some years ago Morningstar did a study where they had a very high allocation to commodities. What is significant about the study is they took a 60/40 portfolio, so 60% stocks and 40% bonds: and they took the risk portion of the portfolio, the part that is considered risk, the securities portion, and left the fixed income side alone. They put 28% of the 60% that was in stocks into commodities. And when you look at a study like that and over twenty years, what it does is it reduces the volatility. And so, interestingly enough the risk adjusted returns go up; even though you added a volatile commodity class to your portfolio.

And why is that? Well, stocks and commodities react differently to the same inputs. For instance, if the price of corn goes up, that may hurt the price of meat producers or poultry producers. So, if you are holding those securities, those securities are going to go down. The same input of the rise in price of corn; if you long corn in your portfolio, you win. If you are holding meat processors and meat producers you may lose. The offset is a reduction in volatility. And, what is interesting about the long term study, and we have replicated the Morningstar study here, it is again a twenty year study; it ends in 2013, going from a 40/60 portfolio to a 40/32/28 portfolio, your risk adjusted returns increase. The reason is your returns go up slightly, about 10%. But your risk, your standard deviation, drops about 21%. So, if you take some of the money you have allocated to risky stocks, put it into commodities, that may reduce your volatility and enhance your risk adjusted returns.

Q: Are there strong correlations between the major stock indices and commodities?

{Graphic: 20 year Correlation Chart}

A: They don't correlate very well. There is low correlation to stocks, and that is what makes them a great appeal to diversification. People looking to diversify their portfolio, I think, most often buy gold. There is incredible amount of money invested in gold for diversification purposes. Some of that is for store of wealth purposes, the other part of it is for a diversification to a core stock holding, say the S&P 500. So, when you do a study of the single commodity exchange traded products, and there are no notes here - this is just exchange traded products, fully collateralized, no credit risk, unleveraged - you have thirteen commodities because we exclude gasoline, in the chart. When you take the thirteen exchange traded products of single commodities, and do a correlation analysis to the S&P 500 over long periods of time, and this a twenty year study ending December 31, 2014, what you see is that the big four grains - sugar, corn, soybeans and wheat, the big four agricultural products – they are actually less correlated than gold. And, interestingly enough, as we update this study year after year, it is always the same way. The big four agricultural products are always less correlated than gold. People are surprised by that.

Again, we started by saying how pervasive grains are in the economy. Everybody knows energies are pervasive in the economy; they tend to overweight energy as a diversification component of their portfolio. Many, many people hold gold as a diversifier in their portfolio. And, what people are coming to understand is that if they lack agriculture, their portfolio is probably not properly diversified or at least not as diversified as it could be.

Q: How can an investor use agricultural commodity investments within a portfolio?

{Graphic: Gold/Corn Ratio Chart}

Well, I think the pervasiveness of exchange traded products makes it quite easy for the average advisor and investor to invest directly in agricultural products. They probably are considering a broad basket of commodities in general. But then, you have really got to look and see if your agricultural products are weighted properly.

So, one - see if you have enough of them, and, two - don't forgot to rebalance. Some of the ways to harvest extra performance out of your portfolio is rebalancing. If the gold component of your diversified portfolio is overvalued compared to maybe oil and the agricultural commodities, you may want to reallocate, in certain time periods, annually or biannually, or just when certain value bands are hit. You might want to sell some of that gold and overweight more in the agricultural products. Right now it is interesting because the ratio of gold to corn, the number of bushels that one ounce can buy, is about twice its historical thirty-eight year average. So, some people are considering lightening up a little bit on their gold and increasing a little bit of their corn holdings as well as wheat, soybeans and sugar. Because they are all, almost 100% over their historical thirty-eight year average, and of course thirty-eight years is how long the gold markets have been deregulated here in the United States. So, agricultural products need to be added to a portfolio in a discrete manner, in conjunction with advice from your financial professional. And do make sure that as you allocate, that you rebalance occasionally to be sure that you harvest some of those gains where things have gone up and other things have cycled down.