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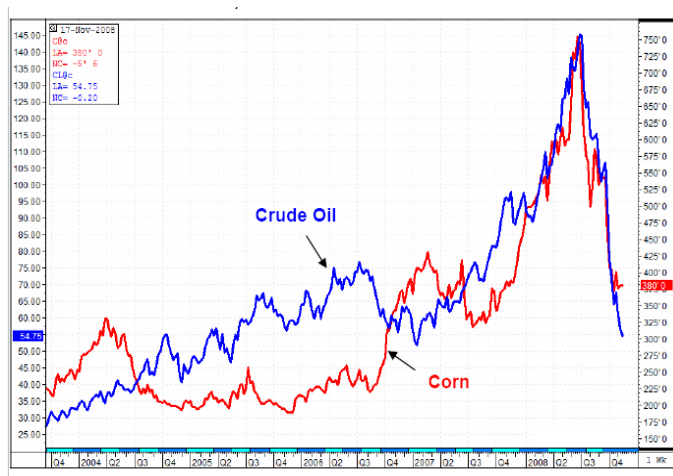
### A Wild Year in the Markets

The year 2008 is finally coming to an end and not a moment too soon. The wild swings in the price of energy, grain, currencies not to mention the near meltdown of the world financial system have all taken a toll on the world chicken industry. The toll was most noticeable this week as the largest chicken company in the world, Pilgrim's Pride Corporation, with a production equal to that of 40% of Brazil went bankrupt. The company will continue to operate with temporary protection from creditors under what is called Chapter 11 bankruptcy in the US. A smaller version of the company is expected to emerge from bankruptcy. Current shareholders in Pilgrim's Pride are expected to lose all of the value of their shares, a total loss of \$3 billion.

Although the future is impossible to predict, there does appear to be reason to hope that 2009 will at least feature calmer markets if not an immediate solution to all financial ills. By 2010 a rebound in the world economy should set the stage for a robust increase in the production, trade and use of chicken meat. This bulletin will take a look back at the markets of 2008.

#### Energy and Corn

As can be seen from the following graph, taken from the Daily Livestock Report of the CME Group, both corn and crude oil made a spectacular round-trip from \$4 corn and \$60 oil to nearly \$8 corn and \$150 oil and back again all in a little over a year. What were the causes of these wild swings in price?



#### Why the Sudden Rise in Grain Prices?

The increase in corn prices from just \$2 per bushel in 2005 to nearly \$8 per bushel earlier this year was caused by four factors of roughly equal importance:

- 1) Rapid increase in demand due to ethanol production
- 2) Worldwide economic growth which led to increased meat consumption
- 3) Drought and world supply problems
- 4) Commodity Speculators

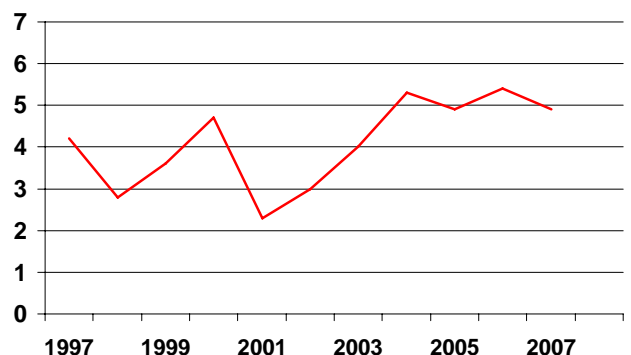
#### Ethanol

As readers of this bulletin are fully aware, there was a surge in the use of corn for the production of ethanol in the United States. That government mandated and subsidized increase in corn use represented 43% of the increase in consumption of all five major world grains between 2005 and 2008 (Foreign Agriculture Service May 2008). Corn went from using 15% of the US corn crop to 33% of the corn crop in just three years. This was a significant demand shock to the world grain system.

#### Worldwide Economic Growth

At the same time as corn use for ethanol was soaring, the use of corn for livestock and poultry was also increasing rapidly thanks to strong worldwide economic growth. The world economy rose at the unusually high rate of over 5% between 2004 and 2007. Higher incomes led to increased meat consumption.

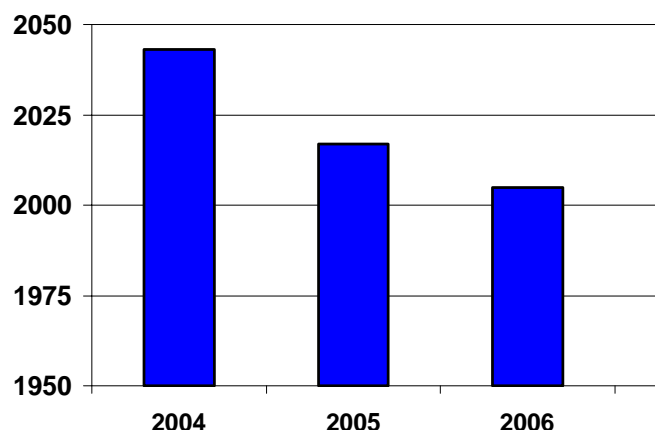
World Economic Growth in %



#### Supply Problems

At the same time as demand for all grains was rising rapidly thanks to ethanol and livestock, total world grain output actually fell. Most of the reduction was caused by drought in Australia and lower production in Western Europe.

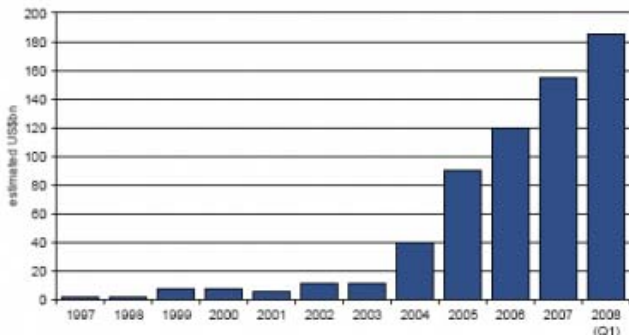
World Total Grain Output MMT



### Commodity Speculation

A period of relatively easy credit in the last few years led to intense speculation in real estate and commodities of all kinds. Hedge funds using a small amount of capital and a huge amount of borrowed money chased after the same relatively small number of commodity plays such as oil, metals and grains. In the following graph from The Wall Street Examiner, it is clear to see that the funds invested in just one part of the commodity speculation game, index fund, rose from less than \$10 billion to nearly \$200 billion earlier this year. Speculation in commodities is calculated in the trillions of dollars and shows a similar climb in the last few years.

**Funds Invested in Commodity Indexes**



With demand rising because of meat and ethanol, supply falling due to the weather and trillions of dollars chasing the market up, it is no wonder that the market reached the peak of \$8 corn and \$150 oil. What happened next, the great collapse of commodity prices, is obvious with the benefit of hindsight but few were able to predict either the magnitude or the timing of the great decline.

### Why Did Prices Fall So Far and So Quickly?

Having risen so far, the inevitable decline set in just a few months ago and brought commodity prices down 50% or more in just a breathtaking few weeks. How did this happen?

The decrease in corn prices from \$8 per bushel earlier this year to less than \$4 per bushel was caused by the great unwinding of the same four factors mentioned earlier:

- 1) Slowing demand for corn for ethanol production
- 2) Slowdown in worldwide economic growth which leads to reduced meat consumption
- 3) A relatively good world harvest
- 4) Credit disappears for Commodity Speculators

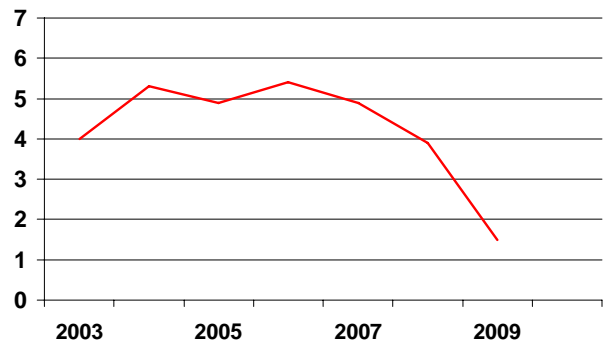
### Ethanol

The falling value of ethanol due to falling oil prices has placed the US ethanol industry in serious economic trouble. Several ethanol companies have declared bankruptcy and several projects have been either delayed or cancelled. The bubble has burst on the ethanol industry and future increases in production will be much more modest than the recent, bubble like behavior of the industry.

### World Economic Growth

An important reason for the sudden fall in the price of oil and grain was the sudden deterioration in the growth of the world economy. Led by the United States and the meltdown in banks and financial institutions, the slowdown has spread to the rest of the world. It is now expected that the world economy will grow by less than 2% next year, the definition of worldwide recession. In a world recession the demand for all commodities including grain and chicken meat can be expected to experience slower growth or decline.

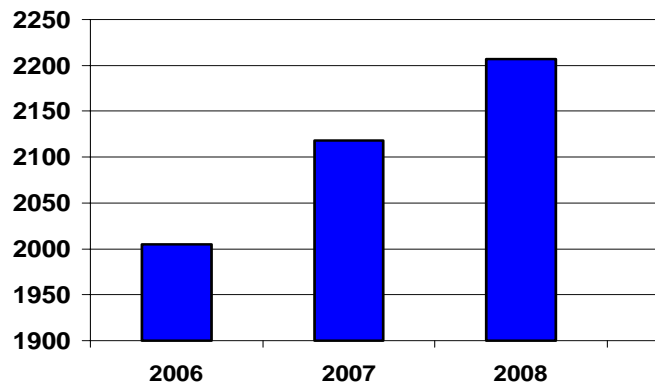
**World Economic Growth**



### Better World Harvest

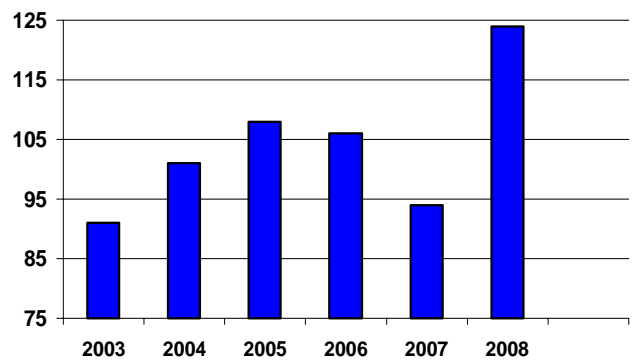
In a bizarre turn of events, the total world grain harvest is now much higher (just when demand is weak) than it was when the world was desperately short of grain. A better harvest coming at a time of weak demand is the recipe for much lower prices.

**World Total Grain Output MMT**



With wheat production rebounding in most of the world an increased amount of wheat can be fed to animals taking pressure off of corn. Wheat feeding which fell dramatically in 2007 rose even more impressively this year as can be seen in the graph below.

**World Wheat Feeding MMT**



### Commodity Speculation

Finally, the game is up for commodity speculators. There is less credit available for speculation, less leverage is allowed and many of the players experienced huge losses when the market turned. As a result, the speculative fever that sent the commodity market soaring is now being de-leveraged.

### What Happens Now?

It is often said that those who don't study history are doomed to repeat it. In a fine tuning of that old saying, the market analyst James Grant says that we are all doomed to repeat the mistakes of the past but those who study history will not be surprised.

History will repeat itself. At some point commodity prices will make another turn and fueled by rising demand and faltering supply, prices will be propelled once again up to unsustainable levels. As to just when that will happen... those clairvoyants who know don't need a job and those who don't know always seem to be the ones making the predictions.