Is the food bubble next?

Bruno Estier compiled a technical market outlook for agricultural soft commodities for the Swiss Derivatives Review. He analyzes whether a food bubble could occur even before the infamous debt bubble burst out, while global slower economic growth is keeping "official inflation" at low levels.

In the late spring 2009, the CME Group invited me in Switzerland to talk on its commodities road-show, where I mentioned, based on chart 1 of May 15 that Bridge/CRB Futures Price Index, at the time 399, displayed a secular uptrend since 2002 after its secular downtrend from 1981 to 1999. Our contention was that the decline, which had started in the second half of 2008, was only a cyclical bearish correction which had ended in January 2009. Then a cyclical bull market was resuming sustaining the secular uptrend on a multi-years basis.

Five months later this index is at 508, a plus of 25%. Indeed we had pointed out that the seasonality of Agriculturals, typically weaker in June and July, would offer a late summer opportunity to "buy the dip" for the sub-index Reuters-CRB Grains & Oilseeds, which seemed to be lagging the other energy, raw materials and precious metals indices.

The evolving composition of the Reuters-CRB Continuous Commodities Index (CCI) suggests reviewing the issue with the help of the Reuters-CRB Grains & Oilseeds index, including in particular wheat and corn futures. Then we will review soybeans, which we frankly do not know, whether it is food or fuel. A look at coffee may tell us if the investment community is so anxious about the future of the world that it has gone on a consumption binge of that stimulating substance. Finally we look at a chart of the Agriculture Powershares DBA (Powershares DB Multi-Sector Commodity trust Agriculture Fund) on NYSE, which could be an investment vehicle, if convictions would crystallize.

In any case we remind the reader that we have no background in the fundamentals underlying these commodities, one should consult a specialist in the field before investing. We merely propose to use a Technician's eye on charts, while estimating potential targets for the developing moves, as well as defining risk levels, which may invalidate those trends.

Chart 2 illustrates the commonalities over 10 years between the chart of the Reuters-CRB Grains & Oilseeds Index and the individual chart of corn or wheat: all display a recent price rise after rebounding on a floor last month. That floor appears to be a classic horizontal support on the index, but close inspec-

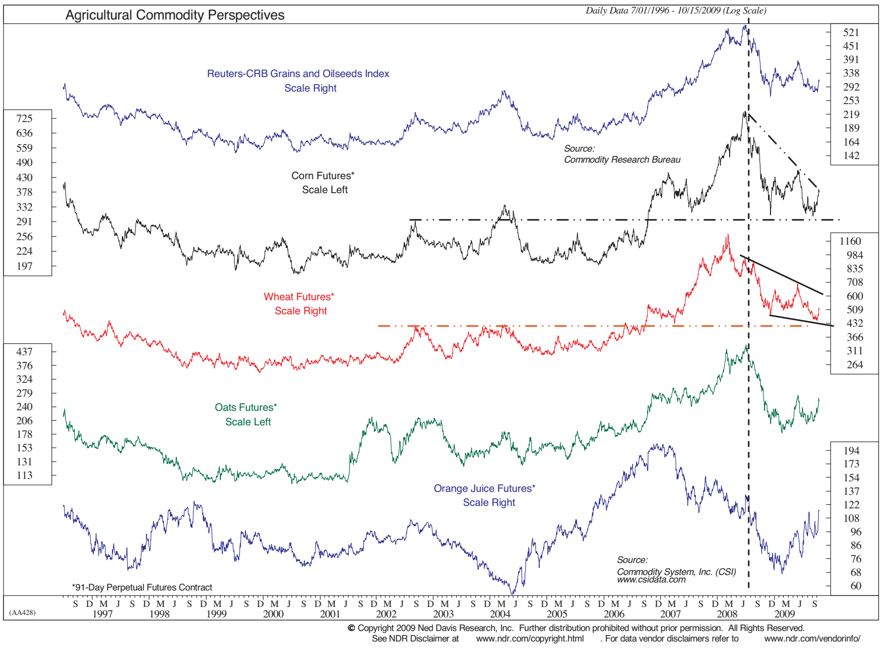

Chart 2 – Agricultural commodity perspectives (data source CSI, courtesy Ned Davis Research).

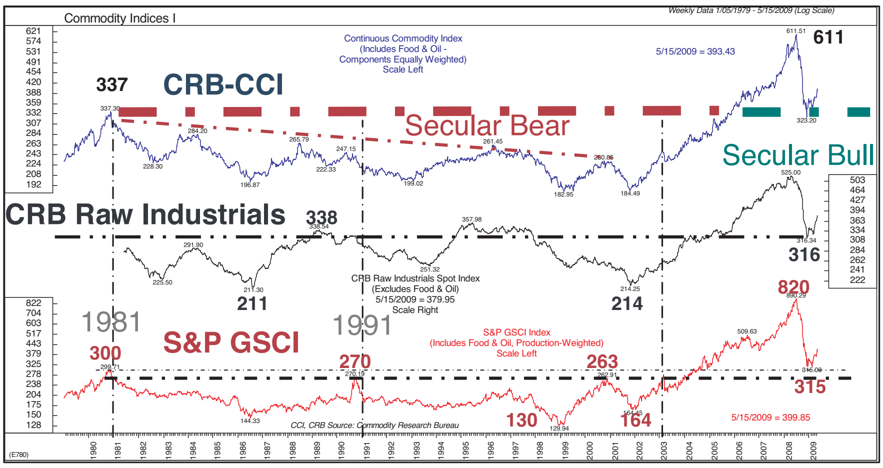

Chart 1 – Commodity indices from 1979 to 15 May 2009 (courtesy Ned Davis Research).

tion of the corn and wheat futures chart reveals some differences in price pattern. Corn futures built a base during August and September just above the spike low of late 2008 near 300, namely an important wide 330–300 cents per bushel support area, because it was a former ceiling in 2002, 2004 and also in 1997.

Chart 3 displays the flat 200-day moving average of corn near 377 on 15 October 2009, while the price of the 91-day perpetual futures contract seems to find support on its moving average on that day at 376, after having risen above it the previous week. Having broken above a down trendline, joining the peak of summer 2008 and late spring 2009, the nearest target for corn futures is envisioned near 420–450. If corn futures manage to hold above that level, a potential rise toward 600–620 could develop. For a chartist's eye the current uptrend would be in jeopardy, if a decline below 330–350 is seen.

One should be aware that the seasonality of corn futures' relative strength versus a more global commodity index is usually rising between October and February. I would suspect that medium term automated technical models are already kicking in to fuel a further rise.

Wheat futures however made a lower low near 450 in the fall of 2009 versus its previous spike low near 470 in December 2008. Its bottoming 200-day moving average near 545 is still above the closing of 512 on October 15. For sure during early September 2009, with a rise above 470, wheat futures have broken out of a descending wedge suggesting a pullback toward the 580 area.

Such a rally would allow prices to move above its 200-day moving average. At that stage, a technical target around 900 could be envisioned. The current relative strength of wheat futures versus a global commodity index is making a base, but it is departing from its historical one-year seasonality, which should

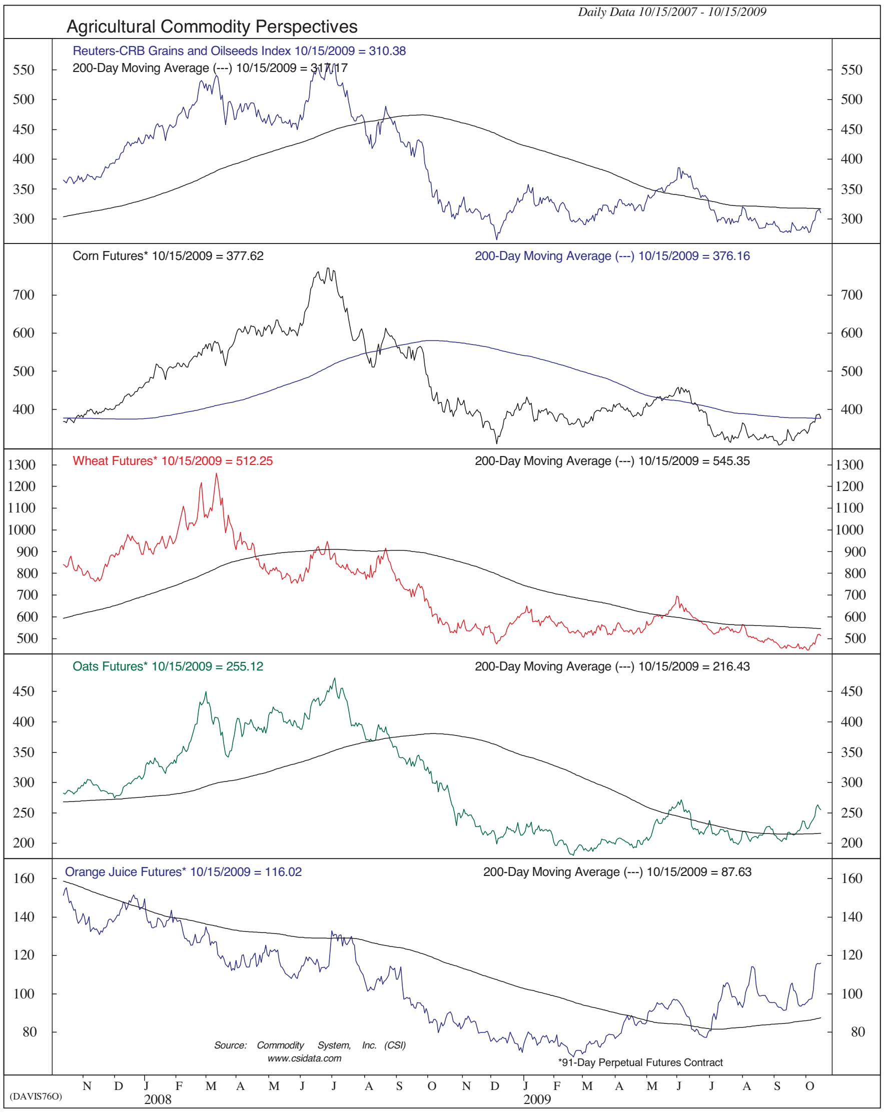

Chart 3 – Agricultural commodity perspectives: 200-day moving averages (courtesy Ned Davis Research).

have bottomed already in August and tends to top in January. Of course the current weaker technical situation of wheat futures would suggest that medium term automated technical models have not yet kicked in. As the train has not yet left the station, wheat futures could present a better risk reward situation, if we assume that the risk to reverse the current uptrend would be seen, if wheat futures would decline below 450–485.

Soybeans: Food or Fuel?

Besides an excursion in 2008 above the former wide range 1025–440 cents per bushel between 1989 and 2009, soybeans futures have moved back below

Chart 4 – Agriculture Powershares DBA and Agriculture GSCI (courtesy Stockcharts.com).

that former ceiling and made a double rebound on support near 900. Currently near 980 on October 15, they are rising near 1000 to retest very soon this important barrier at 1025–35, which will be tough to crack again. Should that happen; the width of the former range would be the measure for a 1610 minimum technical target.

Seasonality of the relative strength should be favorable from mid-October to mid-February, but as mentioned, soybeans may be facing a long-term structural change concerning its usage, possibly making past seasonality obsolete. Shorter term we suspect that the recent rise above a down trendline at 960 has already attracted automated shorter term buy signals. A move below 880 would break the emerging uptrend and reinstall the previous downtrend started in June 2009.

Ambitious targets for coffee

The coffee futures chart could be very exciting from a short term technical viewpoint. It is just breaking out at 144 on October 16 out of a five month triangle, which developed after making a base from November 2008 to April 2009 between 105 and 115 cents per pound. If prices are able to hold above 144, then a target is located near a former ceiling 180–194 in 2006 and 2007. Further a sustained move above 194 would break a major downtrend dating from the first quarter of 2005 and 2008. At that point very ambitious technical targets between 200–220 and even 270 could be formulated. But for those we all better start to drink a lot of coffee.

Agriculture Powershares

To come back down to earth, let's browse at the Agriculture Powershares DBA (Powershares DB Multi-Sector Commodity trust Agriculture Fund) on NYSE, which could be an example of an investment vehicle, assuming one would bank on a rise of such a fund. An analysis of the fund's performance reflects also the ability of its managers. Assuming due diligence in this respect done, the following technical comments could be elaborated:

Chart 4 is displaying the Agriculture Powershares DBA on NYSE, the Agriculture Goldman Sachs Commodity Index, the relative strength of DBA versus the S&P500 index and two weekly momentum indicators of DBA price performance, namely a weekly stochastic and a MACD. On October 16, DBA has closed the week just above 26, breaking hereby a descending trendline joining the high in mid-2008 near 42 and the more recent top in June 2009 near 29.

On the upper panel of the chart shown in orange dash line, the Agriculture Goldman Sachs Commodity Index at 325 is also breaking a similar descending trendline, opening a test of the weekly upper Bollinger band near 336. As these bands have been narrowing since June 2009, a weekly close above 336 would open technical targets toward the 395–402 area, which represents a two third retracement from the decline 496 to 245.

In the center panel, Powershares DBA clearly is well correlated with the Agriculture Goldman Sachs Commodity Index (GSCI). If such a correlation holds, then a rise of DBA above the weekly Bollinger band near 27 may open a further ascent above the recent high near 29 to reach toward 32. From a technical viewpoint it is interesting to note that the consolidation between 23 and 27 since January 2009, is suggesting a theoretical Point & Figure target (3 box of 1 point) near 38 once it closes gain above 28.

The weekly stochastic has not yet moved above the 50% area, and the weekly MACD is still in negative area, but just below the zero line, while the DBA price has moved already above the 20 and 40-week moving averages sitting near 25. The sharply rising bars of volume in the last 2 weeks suggest some keen interest induced by the recent price rise. Obviously a failure to rise above 28 and a move back down 24 should be seen as the short term risk level, below which the former downtrend since 2008 would be extending further.

As the theoretical upper target of 38 is still way below the former peak near 42 of 2008, it would appear that it is really premature to speak of a food bubble. Currently the pattern of the Agriculture GSCI is more similar to a basing pattern as envisioned at the CME road-show in May 2009. Now it is very far to display characteristics of a typical commodity "Blow off Top". While this is valid for the index, that does not preclude some of its individual components to go wild at times. Thus it seems that the selection of a vehicle similar to the DBA, would offer some diversification against such risk. Further in inter-market related terms, it should be noted that the relative strength line of DBA versus the S&P500 (shown in black in the upper panel of chart 4) is flattening, stopping soon its steady underperformance since March 2009 by slowly making a base. This may as well represent an interesting short-term element of diversification versus the S&P500, which has been rising more than 50% since March 2009.

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