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Food For Thoughts?

Executive Summary

Food Inflation – Increasing trend in food prices is likely to benefit agribusiness.

Demand of agricultures – Demand is likely to rise as countries increase import to tame inflation.

Supply for Agricultures – Supply is affected by weather-related production shortfalls, decreasing stockpiles and hoarding by importers.

Speculation on Agriculture – Speculation can cause volatility in agriculture prices in the short run, but long term fundamentals remain unchanged.

DWS Global Agribusiness A2 – Outperformed in terms of 2-Year return and has lower 1-Year and 2-Year volatility.

Introduction

This month we turn our attention to agriculture-related companies based on three reasons. Firstly, food inflation has been a key issue in our current economy and is likely to benefit agribusinesses. Secondly, several demand and supply factors suggest that food prices are likely to continue rising. Lastly, while we note that prices could be volatile in the short term period due to speculation, we feel that the long term prospects of agriculture are backed by the abovementioned reasons.

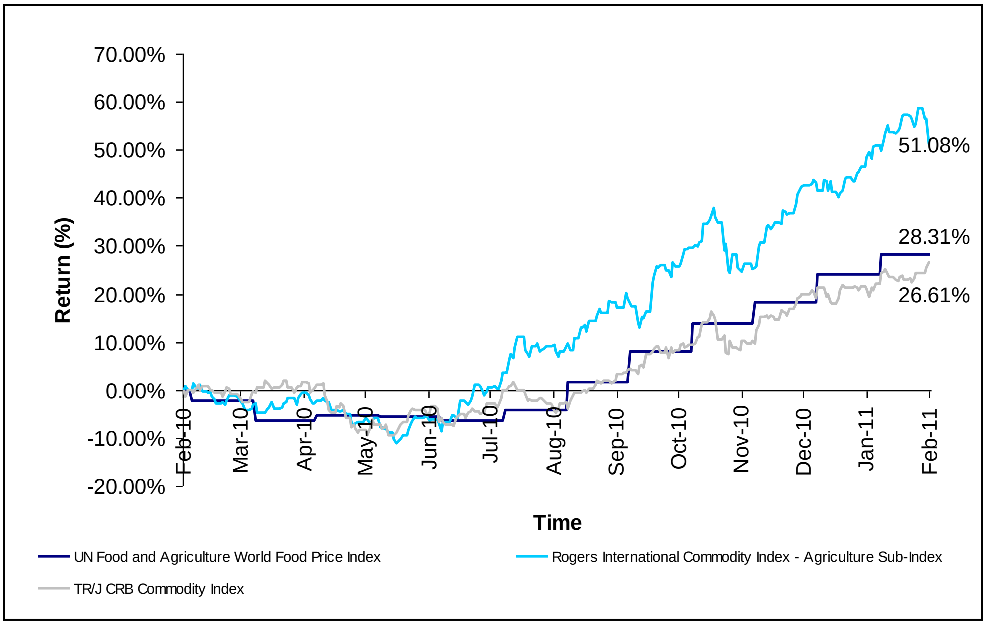
Food Inflation

World food prices, as measured by the Food and Agriculture Organisation of the United Nations (FAO) Food Index, surged to a new historic peak of 231 points in January. As observed in Chart 1, the FAO Food Price Index has increased 28.3 percent in the past year. The current level is 3.4 percent higher than December 2010, and is the highest level in both real and nominal terms since 1990.

Increase in prices are also observed in the Rogers International Commodity Index (RICI) Agriculture Sub-Index and the TR/J CRB Commodity Index. The CRB Commodity Index and FAO Food Price Index both increased by about 27 percent last year but the RICI Agriculture Sub-Index had a 51 percent gain. The increase in price of agriculture products can be attributed to various supply and demand side factors, which would be further elaborated on.

Food and agriculture products, being necessities, have relatively inelastic demand, so increase in food prices is unlikely to cause significant decline in demand for food. Farming and plantation companies will benefit from the increase in total revenue from selling their crops. As for processing companies, they are likely to be able to pass down higher costs due to the relatively inelastic demand for food, and benefit from the increase in food prices as well.

Chart 1: 1-Year Gain



Source: Bloomberg, as of 24 Feb 2011

UN FAO World Food Price Index and the TR/J CRB Commodity Index both increased approximately 27 percent, while the RICI Agriculture Sub-Index increased 51 percent in the last 1-year period.

Demand For Agriculture

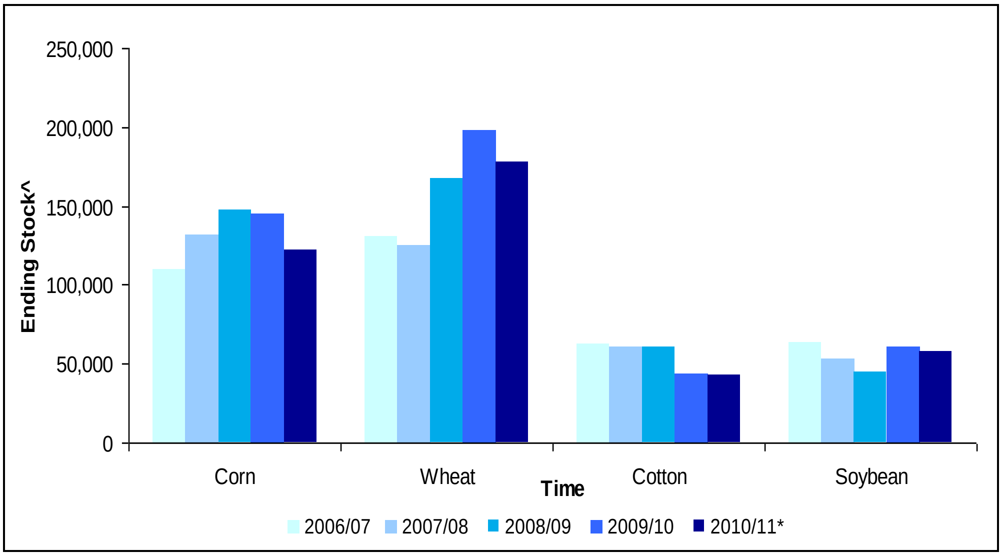
Food inflation is causing social issues in various countries in the Middle East and North Africa region, and governments are stepping up efforts to curb food inflation. Countries across Africa and Asia are increasing imports or releasing supply from state reserves to increase food availability in hopes of lowering prices. As importers speed up purchases of food, demand for agricultural products will likely be sustained or increase further in the next few months. Consequently, Abdolreza Abbasian, senior economist at FAO also expects that the chances of prices staying high or extending gains are stronger than for a decline in the next six months.

Supply of Agriculture

Weather related production shortfall

Various kinds of weather-related shocks are affecting supply of agriculture products throughout the world. The Russian drought of last summer caused its wheat production to drop 33 percent in the 2010/11 marketing year as compared to previous years. And according to Gerald Nelson, International Food Policy Research Institute (IFPRI)'s lead climate change researcher, the floods in Bangladesh and Australia are also causing wheat prices to go up. In addition, Minister of Agriculture, Han Changfu, said in a statement on 9 Jan 2011 that 42 percent of the total area planted with wheat in China's eight major producing provinces has been affected by a dry spell that may continue into the spring. These weather-related issues are causing shocks to production and shortfalls in supply.

Chart 2: World Ending Stocks



Source: USDA, as of 24 Feb 2011
**Estimates by USDA as of 9 Feb 2011*
^Thousand Metric Tons for corn, wheat and soybean. 1000 HA and 1000480-lb Bales for cotton.

World Ending Stocks for various agriculture products have declined for 2010/11.

Decreasing Stockpiles

Aside from the production shortfalls, various agriculture products are expected to have lower ending stocks in the marketing year 2010/2011. (Chart 2) The world corn stockpiles are expected by the USDA to drop to a 4-year low, while cotton stockpiles will drop to a 15-year low. Ending stocks act as buffer against weather-related production shocks and can smoothen price fluctuations due to such unpredictable events. When stockpiles decrease, market tends to become tighter. As a result, price volatility and the magnitude of price changes can be magnified when unexpected events occur.

Hoarding by countries

In Middle East, North Africa and Asia, food inflation has caused economic and social issues and is one of the main concerns of governments. As countries step up in fighting food inflation, it is probable that there may be hoarding in net exporters of agricultural products. Addolreza Abbassian said, “global wheat harvests may trail demand for a second year, spurring ‘widespread’ hoarding and further price advances.” And if this becomes a phenomenon in net exporters of agricultural products, supply could be further reduced and the rise in agriculture prices could continue.

Speculation on Agriculture Futures

Liquidity in the futures market provides opportunities for investors to make speculative bets. Appendix 1 shows the net long position and prices of various agriculture futures. From the charts, we note that net long position and futures prices generally move inline with each other, suggesting that speculation by investors play a part in affecting agriculture prices.

Table 1: Agriculture Futures Contract Returns

Name	5 Day Return	1 Mth Return	3 Mth Return	6 Mth Return	1 Yr Return
Corn Futures	-3.75	6.52	27.33	69.49	84.28
Cotton Futures	-6.99	13.24	53.49	107.88	125.18
Sugar Futures	-3.33	-6.47	8.12	49.90	20.35
Soybean Futures	-5.96	-3.91	5.24	32.08	40.28
Cocoa Futures	5.80	11.23	33.24	32.66	24.67
Wheat Futures	-11.34	-10.02	16.49	16.44	54.01

Source: Bloomberg, as of 25 Feb 2011

1-Year Return for agriculture futures are positive but speculation might have caused short-term fluctuations.

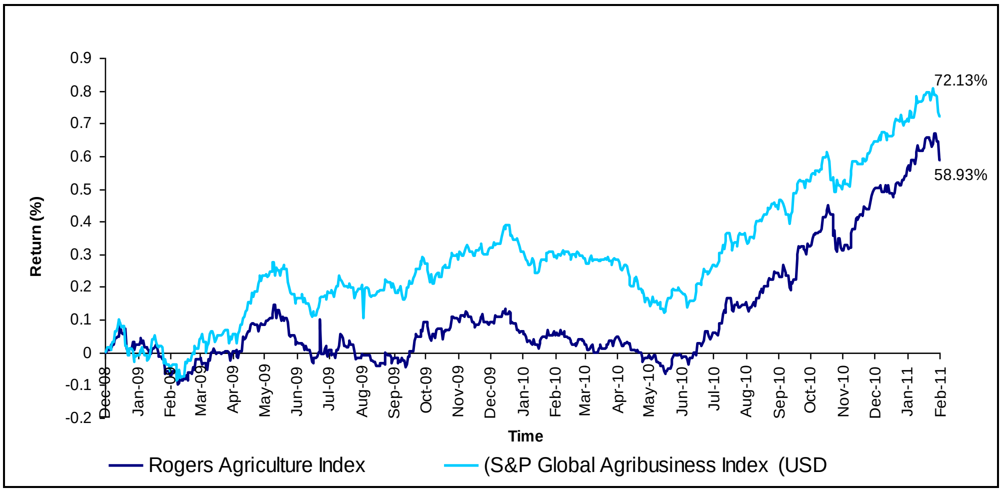
As shown in Table 1, most agriculture futures fell in the past 5 days, with wheat falling as much as 11.3 percent. The drastic fall in corn, sugar, soybean and wheat might be caused by speculation as it is accompanied by a drop in net long positions. As for cotton, recent trend in cotton prices did not move in tandem with the net long positions, suggesting that other factors such as demand and supply issues could be the main driver behind its recent price movements.

According to Bloomberg, some investors exit agriculture futures in favor of energy and financials due to anxiety over political unrest in the Middle East and North Africa . Others felt that the Middle East and North Africa region unrest might slow global growth and cool demand for farm commodities . These speculations can cause volatility in the market, but as the fundamentals are unchanged, our long term view on agriculture remains.

Underlying Agriculture and Agribusiness

One way of gaining exposure to agriculture products is by investing in agribusiness stocks. Agribusiness generally refers to companies involved in the agricultural food chain, such as producers, processors, equipment and materials suppliers and distributors.

Chart 3: RICI Agriculture Index vs S&P Global Agribusiness Index (Since start of data, 24 Dec 08)



Source: Bloomberg, as of 25 Feb 2011

The Rogers Agriculture Index and S&P Global Agribusiness Index have 0.93 correlation since 24 Dec 2008.

The S&P Global Agribusiness Index includes 24 of the largest publicly-traded agribusiness companies from around the world. And as seen in the Chart 3, the performance of agriculture products as shown by the Rogers Agriculture Index and the agribusiness equities as shown by the S&P Global Agribusiness Index generally move in line with each other over the past two years and have a correlation of 0.93.

Fund in Focus – DWS Global Agribusiness Fund

DWS Global Agribusiness Fund invests in opportunities found in the agricultural food chain, from agricultural commodities to consumer products. Some of the areas they invest in include land and plantation, seed and fertilizer, protecting and irrigation, food processing and manufacturing companies.

For peer comparison, we chose BNP Paribas Agriculture, which invests S&P GSCI Agriculture and Livestock index and the Dow Jones-UBS Agriculture Sub index. In terms of exposure, it is exposed to the agriculture prices whereas DWS Global Agribusiness Fund is exposed to agribusiness equities.

Table 2: Peer Comparison

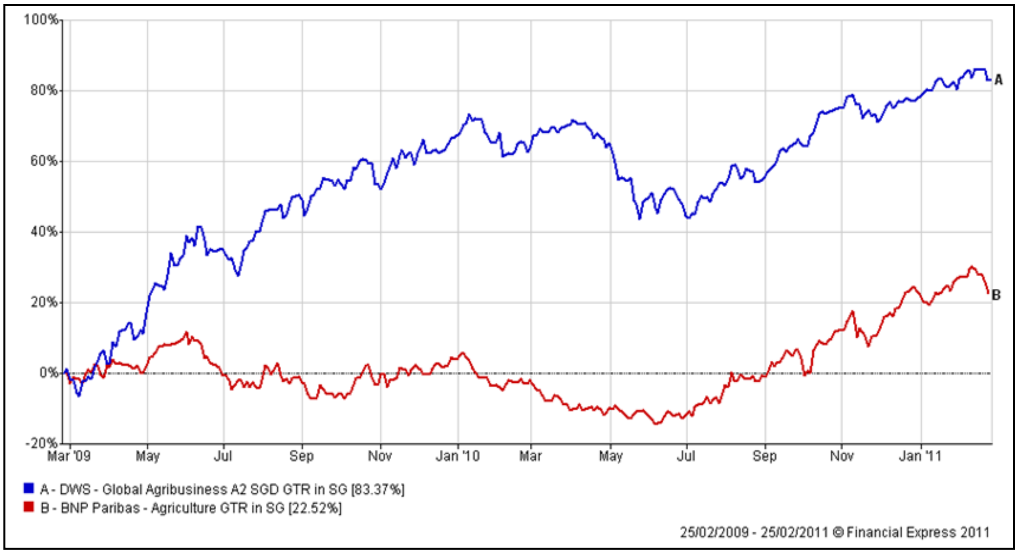
Name	1 Mth Ret	3 Mth Ret	1 Yr Ret	2 Yr Ret (Ann.)	3 Yr Ret (Ann.)	1 Yr Vol	2 Yr Vol (Ann.)
BNP Paribas Agriculture	4.08	15.79	31.48	13.88	---	17.97	17.88
DWS Global Agribusiness A2	1.54	7.57	12.68	35.33	-1.09	13.93	17.16

Source: Financial Express, as of 28 Feb 2011

DWS Global Agribusiness outperformed BNP Paribas Agriculture on 2-year basis and has lower volatility.

BNP Paribas Agriculture outperformed in the 6-month and 1-year period while DWS Global Agribusiness outperformed in the 1-month and 2-year period. The outperformance of the BNP Paribas Agriculture fund in the 1-year period is accompanied with higher volatility and risk. Overall, the 2-year Sharpe ratio, which measures risk-adjusted return, is significantly higher for DWS Global Agribusiness.

Chart 4: 2-Year Performance Chart



Source: Financial Express, as of 28 Feb 2011

DWS Global Agribusiness outperformed BNP Paribas Agriculture on a 2-year basis.

As seen in the chart, DWS Global Agribusiness outperformed BNP Paribas in the long run. The overall return for the 2 year period of DWS Global Agribusiness is 83.37 percent, significantly higher than the BNP Paribas Agriculture return of 22.52 percent.

Table 3: Country Allocation

Rank	Country Allocation	% Weighting
1	USA	31.9
2	Switzerland	8.3
3	Brazil	7.6
4	Canada	7.0
5	France	4.4
6	Australia	3.9
7	Germany	3.9
8	China	2.8
9	Russia	2.7
10	Great Britain	2.6
11	Hong Kong	2.6
12	Others	19.4

Source: Fundhouse Factsheet, as of 31 Jan 2011

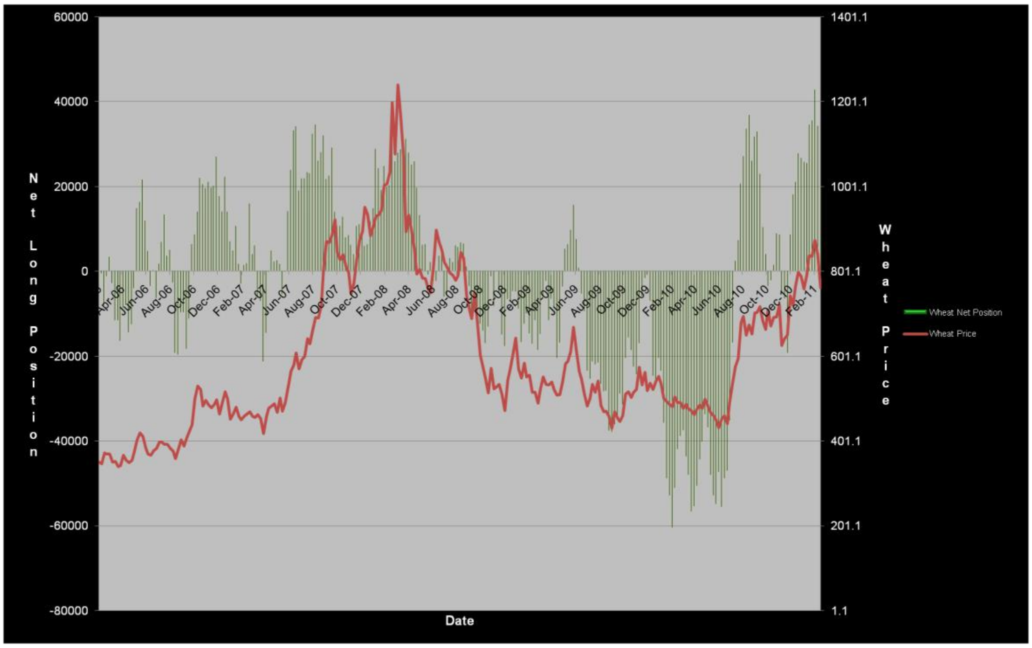
In terms of country breakdown, it has one-third exposure in USA, which is a major exporter for corn, wheat, soybean and cotton. USA exports for cotton, corn and soybean makes up approximately half of the total world exports. With food inflation, agribusiness companies in the USA are likely to benefit from the rise of agriculture prices as their top-line increases.

Conclusion

The fundamentals behind the agriculture industry are increasing demand and supply shortfalls. While we note that speculative activities could increase volatility in agriculture prices in the short term, we feel that fundamentals are likely to overweigh speculative activities in affecting prices in the long run. Overall, we prefer DWS Global Agribusiness as it has lower volatility and is exposed to the entire agriculture food chain instead of purely agriculture futures contract prices.

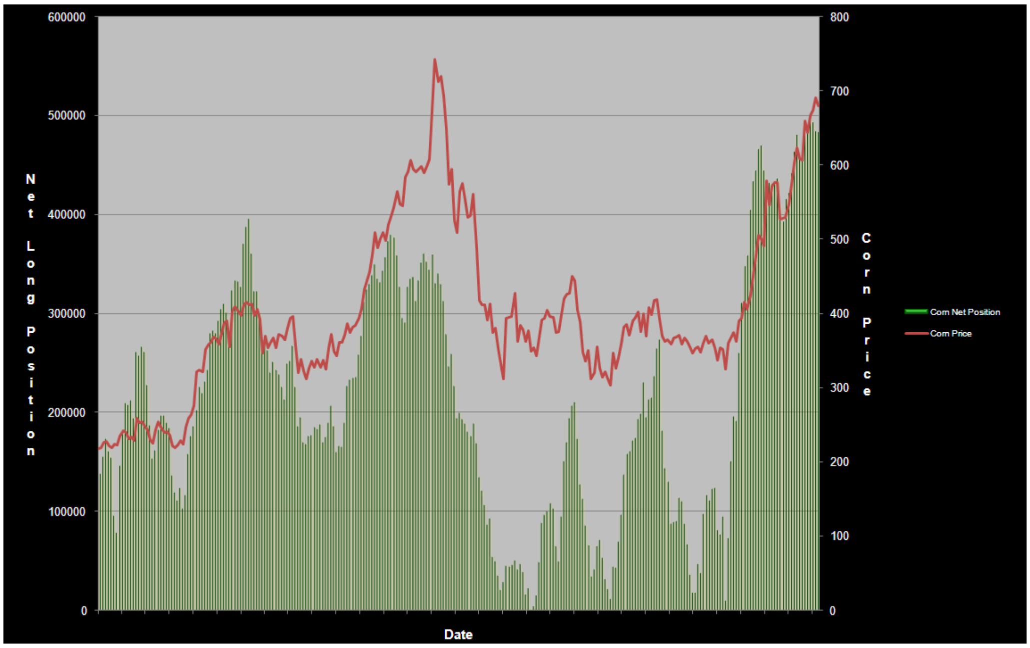
Appendix I

Chart 5: Wheat Future Contracts



Source: Bloomberg, as of 28 Feb 2011

Chart 6: Corn Future Contracts



Source: Bloomberg, as of 28 Feb 2011

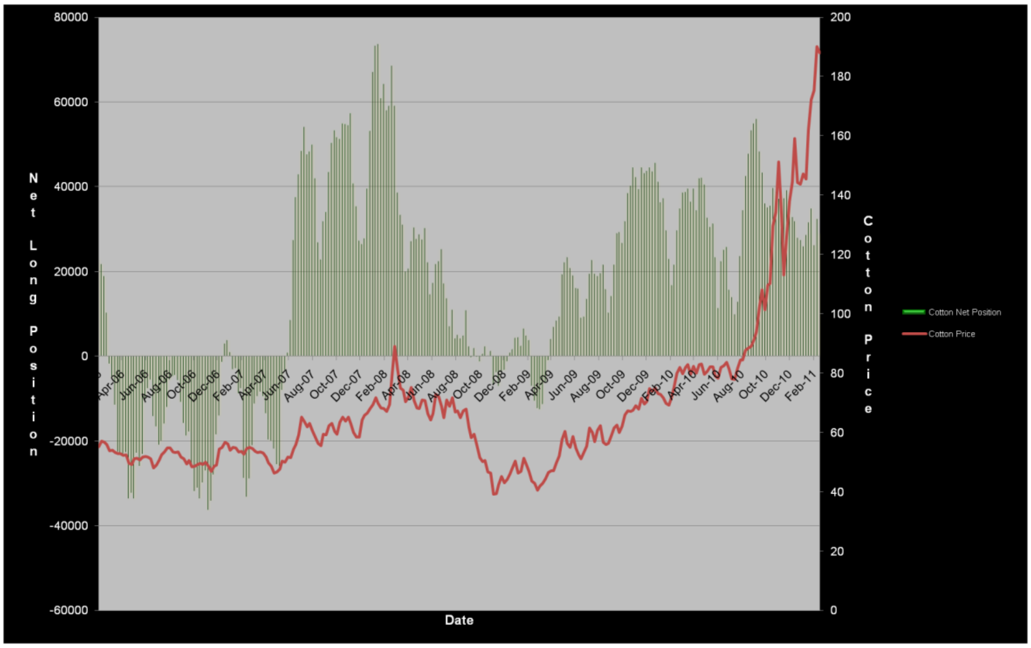
Chart 7: Sugar Future Contracts

Source: Bloomberg, as of 28 Feb 2011

Chart 8: Soybean Future Contracts

Source: Bloomberg, as of 28 Feb 2011

Chart 9: Cotton Future Contracts



Source: Bloomberg, as of 28 Feb 2011

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