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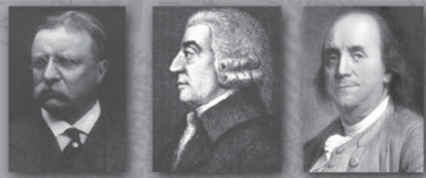

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OCM News | February 2009

The Placebo Effect

BY RANDY STEVENSON
PRESIDENT

The rhetoric on the so-called stimulus bill has heated up. The longest recession we have had since World War II lasted for eighteen months. If the recession we're in right now lasts that long, it will be almost over before most of the money authorized by Congress under the stimulus bill begins to be spent. When it comes to government operations, things move very slowly. Still, in a strange way, the passage of the stimulus bill may have a beneficial effect before a dime is spent. While the fundamentals of market supply and demand are undeniable, a great deal of the market depends on psychology. Perhaps we could more accurately call it the expectations of the market. Whatever the widespread expectations of the market participants are, the market takes that direction.

The market, as well as the economy, responds to psychological effects.

In the past, when the country was in the midst of recession, Jimmy Carter complained of a "general malaise" that had descended on the country. In contrast, Ronald Reagan announced that it was "morning again in America." Without regard to the policies actually implemented, the optimistic statement of Reagan benefited the economy more than the pessimism of Carter.

In a similar vein, one of the quickest and best things President Obama can do for the economy would be to help spread optimism. He has not. That doesn't mean that he should just tell us that everything is fine. He should definitely be realistic or he will sacrifice his credibility. But at the same time he should be telling the truth that not all economic indicators are bad; the slowdown may not last very long. Some who have the means may decide to make a major purchase based on shared optimism. That would help us all.

There are definitely some things wrong with the economy. But the quickest part of the cure is not necessarily so drastic.

History teaches us some lessons. Economic downturns have not always been referred to as recessions or depressions. Originally, they were called "panics." That highlights the fact that the public response to the situation at hand was overblown. That assumed that there was a psychology of fear

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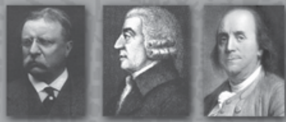
WHAT'S INSIDE



Market Concentration; the root of the problem

by FRED STOKES
Executive Director

Lord Acton's observation that "Power corrupts and absolute power corrupts absolutely" is a widely accepted truism. It is also equally true that market concentration conveys power; market power and that this market power is ultimately used to the advantage of the holder. Nowhere is this more evident than in agriculture.

The agricultural economy can be divided into four sectors: input suppliers, farmers, ranchers and growers, processors and packers and food retailers. The input suppliers, food processors and retailers have all experienced unprecedented consolidation in recent years, surrounding farmers with 800-pound gorillas that are able to put the squeeze on farm income. (The farmer buys from a near monopoly and sells to a near monopsony.)

Family farmers and ranchers

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How to maintain a monopoly

BY KEITH MUDD

A few months back I wrote of the tactics Monsanto used to create a monopoly. In addition to selecting takeover targets based upon market share or dealer network strength, Monsanto decided early on that some companies were more desirable not because of current assets but potential projects in the pipeline. That isn't unusual you might say, but Monsanto didn't acquire this potential technology to develop it, no, they bought the technology to kill it.

So, if that is how you establish a monopoly, how does one go about preserving it?

You need a compliant partner. Someone who will sell your product at the expense of your competitor's merchandise.

According to the lawsuit filed by Texas Grain Storage against Monsanto that wasn't a problem. Quoting from the suit – "Monsanto's dealers and distributors are subject to a variety of restrictive conditions that limit their ability to sell competing glyphosate herbicide products, and many of which in fact penalize them for selling non-Monsanto herbicides or not enough Roundup. These restrictive conditions include, for example, minimum percentage sales requirements that typically require a dealer's Roundup sales to constitute 80% or more of the dealer's total glyphosate herbicide sales."

To establish sales goals is one thing, to rigorously penalize those who fail to meet them is another. Once more, from the suit, "Under Monsanto's arrangements with dealers and distributors, if a dealer's or distributor's total sales of Roundup herbicides fall below the stipulated percentage, the dealer or distributor forfeits all, or a substantial portion, of the rebates otherwise payable on all of its Roundup sales." Pretty big hammer, wouldn't you say?

But wait, there is more. If you're aware of what's expected its one thing, but what if you don't know what Monsanto expects in the way of Roundup sales?

The court document goes on, "In some instances, Monsanto is deliberately vague as to the percentage of glyphosate sales that must be Roundup (sometimes called "black box" rebates), so the only way a dealer or distributor can be sure that it will not lose any rebates is to make Roundup its exclusive glyphosate herbicide."

As anyone who works with a cooperative will tell you, profits from herbicide sales are hard to find most years. Margins commonly run only a percentage point or two. The profit comes back in the application of the herbicide and that rebate check from their suppliers.

A lot of small, local cooperatives suffered when their regional cooperative failed. They had become dependent on the regional's patronage refund to show a profit at the local level. Without this influx of cash at the end of the year, most local cooperatives would have been out of business. They often supported the parent cooperative, even when less expensive options were available, just to preserve their patronage.

Now it seems to me, they may be doing the same dance with a different partner.

Just as a bull market has to be fed with fresh fundamental news and new buying, a monopoly needs tending too. Could it be that this monopoly is consuming its own (although reluctant) partners?KM

Now it seems to me, they may be doing the same dance with a different partner.

David Kruse
President, ComStock Investments

During the 1980's and 1990's, commodity markets suffered from disinflation and deflation, which meant that the only interest investors had in trading commodities was in selling them if values ever temporarily stuck their heads up. Corn contracts would sometimes set highs as initial trade began and spend the life of the contract in downtrending bear markets. Commercials dominated the futures trade through the delivery process. The "big money" was not interested in buying-selling commodity funds, as professionals focused on equity markets creating bubbles in tech stocks. The CRB Index trended lower for a protracted time as commodity markets struggled. Commodity producers suffered too from chronic overproduction and lack of real investment interest in owning commodities.

Cycles cycle and a combination of fundamentals reversed two decades of deflation as this decade became the decade of emerging markets, globalization, and fund investment. Bullish commodity market fundamentals were real. New commodity demand was a physical, not virtual reality. It was also logical that investors, seeing a trend, wish to partake in it, ride the wave so to speak.

That sparked new interest in commodity markets, commodity funds and commodity trading that brought capital to the commodity sector that had been invested elsewhere during the deflationary economic trend. Investors look for opportunity and found it in commodity markets, circumventing commercial traders as the dominant force in trading exchanges. Anytime an existing hierarchy is challenged, the old guard will be stung and resentful. Commercial interest didn't appreciate surrendering their role as market leader to commodity investment funds.

Considering the scope and magnitude of the change in macro-economic fundamentals, publicly traded commodity derivative platforms handled the inflow of capital relatively well. They also handled the exit of much of this capital in a very short period of time well too. Those who participate in industries represented by futures markets tend to believe others trading derivatives of what they do for their bread and butter, to be carpet baggers. They don't like others trading 'their' commodities "on a good day." When commodity prices got cheap in the 1980-90's, most in Congress thought that it was a good thing because the consumers that they represent could buy food, fuel and fiber at low prices requiring a shrinking portion of consumer disposable income for necessities, leaving more cash for discretionary spending. When the commodity cycle reversed and China drove a global bull market for commodities, suddenly high commodity values became evil and speculators who owned them became practitioners of evil. Funds became the devil.

Rising commodity prices became seen as unfair manipulation, enriching speculators. I took such criticism as sour grapes. Many who were complaining loudest had enjoyed a couple decades of cheap commodity prices able to buy commodities below the cost of production as government subsidies sustained producers financially to keep producing. Many complaining of higher prices failed at risk management after becoming complacent from years of letting the government manage their risk. Cries for heightened commodity market regulation turned up in volume as commodity markets climbed.

Commodity markets represented real shortages that developed after decades of inadequate investment in new production capacity that coincided with a surge of global demand. Markets provided the incentive to move capital where it is needed to generate production of what is needed. I suspect that this commodity cycle abbreviated prematurely and that capital that should be invested long term into commodity production was sidelined by the credit crisis and financial fallout. This had precious little at all to do with the commodity sector and would tame down economic growth driving

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David Kruse is president of CommStock Investments,Inc., author and producer of The CommStock Report, an ag commentary and market analysis available daily by radio and by subscription on DTN/FarmDayta and the Internet. CommStock Investments is a registered CTA, as well as an introducing brokerage. Mr. Kruse is also president of AgriVantage Crop Insurance and Brazil Iowa Farms, an investor owned farming operation in Bahia, Brazil. (Futures Trading involves risk. Past performance is not indicative of future performance.) For information on subscribing to the daily CommStock Report, contact: CommStock Investments, Inc., 207 Main St., Royal, IA, 712-933-9400, www.commstock.com. E-mail to: info@commstock.com

Dirt to Dirt

BY RICHARD OSWALD

I'm at the age where I have to acknowledge that I may not live forever. When I was born, the only things my closest ancestors had ever consumed as food came from northwest Missouri soil. When my end of days comes I will be returning to the earth from which I sprang.

You see, my DNA comes from Europe, but the flesh and bone was built from good old Missouri clay.

For 4 generations before I got here, my family ate local. Back in those days they lacked the technology to move fresh food across broad areas of the country; We fed ourselves. My family ate beef, pork, poultry, and dairy raised on their own farms. About a year ago while waiting in a car dealership in Mound City Missouri I browsed a book of local history and learned that in the early 1900's there was a tomato cannery just south of here about 30 miles. That seems almost unbelievable here in corn country. (The 2007 farm bill forbids commercial vegetable production on row crop acres.) Chances are my forebears didn't eat those vegetables then, because they grew their own.

Since I arrived on the scene everything has changed. When I return to my native soil I will leave behind some distinctive foreign residues, because today I eat things from all over the world. If I were to eat nothing but the corn I grow right here, I'd still taint the soil because more and more of the fertilizer I use to grow that corn comes from Russia or China where they avoid adulterating their own nation by mixing into exports poisonous manufacturing by-products like cadmium and lead. I've probably already had a dose of Asian melamine and didn't even know it. Just one month ago we thought Country of Origin Labeling would purify our domestic food from imported. Then, somehow, in the rulemaking USA came to be spelled NAFTA, and a gateway for more foreign competition and contamination was opened.

I may be a dying breed.

Even the power generators just to the north of here where they create electricity from coal are changing the composition of my progeny by adding outland sulfur (good for corn) and mercury (bad for everything) to our fields.

We have a national preoccupation with health and safety, yet we support ever larger corporations in charge of our energy, our health care, and our food. Many of them aren't even US companies. We handed $350 billion to a few big banks. All we got in return was a request for $350 billion more. With small scale food production being labor intensive, I wonder what just half of one percent investment of the banker bailout would do for local food supplies, local renewable energy … and jobs?

It would be exciting for America if the Obama Administration and Agriculture Secretary Vilsack decided to help local food producers establish themselves and compete fairly with big corporate food refiners.

It might even help cleanse the earth a bit before I have to go back.[RO]

commodity demand.

Commodity markets have now punished trend-locked index funds and the global liquidity crisis has removed enormous amounts of capital from the commodity sector as investors move to cash. Economic trends have now become more reminiscent of the deflation of the 1980s-90's minus the rising stock market. This time all asset values are deflating and oppressive over regulation will further depress investment only making it worse. I warned those complaining about fund investment in buying commodity markets on the way up that we would miss them if they were regulated out of the market.

Those looking to "fix" commodity market speculation with regulation, as a whole, don't want higher prices. We want markets that function fairly, seeing the rush to over regulate as a threat. [DK]

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"I believe America has had enough of this corporate tyranny that has written the national agenda for the past couple of decades.

STOKES (continued from page 2)

ultimately derive their income from the agricultural marketplace. These independent producers have always been in a position of weakness in selling their product to large processors and in buying their inputs from large suppliers. Today the position of the family farmer and rancher has become even weaker as consolidation in agribusiness and food retailing has reached all time highs. Farmers have fewer buyers and suppliers than ever before. The result is an increasing loss of family farms and the smallest farm share of the consumer dollar in history.

On the input side, everything is at record prices. Fertilizer, equipment, seed, chemicals, other farm supplies; all highly concentrated industries with prices that reflect their market power derived by concentration. When I retired from the military in 1972 and moved back to Mississippi to make my fortune in the cattle business, calf prices were about where they are today. A number one 450 pound black baldy steer would bring $1.25 per pound. However, barbed wire was $8 per spool, mixed fertilizer was $53 per ton and a new pickup truck was $2,200. These items are currently at ten times that price.

On the output side, four beef packers currently control more than 80% of the market. If the JBS proposed merger with National Beef Packers is approved, these four major packers will be reduced to three, further concentrating an already highly concentrated sector of the market.

There are some who hold that it is the retailer who ultimately determines the price the farmer and rancher receives. They contend that pressure from the powerful retailers compels the beef packer and other processors to beat down farm gate prices. There is substantial evidence to support that theory. The retail price of the beef from a single fed steer or heifer is essentially double the wholesale price. The typical fed animal is 18 to 24 months old at slaughter. The retailer owns the beef for three to five days and has it double in value during that period. That retail margin should make up half of the total price of food is hard to justify.

However, help may be on the way. The Government Accountability Office (GAO) is conducting a big study of concentration in the food industry. This study was initiated by Senator Kohl as Chair of the Antitrust, Competition Policy and Consumer Rights Subcommittee of the Senate Judiciary Committee. OCM representatives have had two face to face meeting with the GAO study group and have provided a great deal of data and information. Dr. Bob Taylor and Dr. Bill Heffernan have also been a party to these meetings and a prolific source of useful information. I am optimistic that this study will reveal that concentration is at the heart of the lack of competition in the agricultural marketplace. I also would expect congressional hearings and some resulting remedy through new legislation of better enforcement of existing antitrust law.

One hundred years ago, this nation reacted to concerns about large, powerful companies by establishing rules constraining such businesses when they achieved a level of market power that harmed, or risked harming, the public interest, trade and commerce. The United States Congress enacted the first competition laws in the world to ensure that commerce remains free and fair. These competition laws include the Sherman Act, Clayton Act, Federal Trade Commission Act and Packers & Stockyards Act.

Over the years, these laws have been neutered by bad court decisions and compliant bureaucrats being planted in enforcement agencies, by the very industries they were supposed to regulate. This problem was underscored by the atrocious outcome of the Pickett vs. Tyson case and the OCM initiated "USDA Inc." study several years back.

However, I believe there is cause for optimism that this situation will improve in this new congress and administration. I also sense a new attitude in the USDA and USDOJ. I believe America has had enough of this corporate tyranny that has written the national agenda for the past couple of decades. Maybe, just maybe, we finally understand that power not only corrupts; it is used to shortchange farmers and ranchers.FS

STEVENSON (continued from page 1)

underlying the poor economic conditions experienced.

Cycles have also been a part of every market throughout history. The laws of supply and demand create cyclic situations normally. The interference of the laws of supply and demand, by restrictions that hinder the proper operations of a competitive market, can aggravate those cycles. Those restrictions come from either government or from private enterprise. Sometimes those hindrances have been the results of attempts to make the cycles cease.

When in the face of normal and desirable cycles, either bureaucrats or monopolists tinker improperly with the market, the downturn will be worse, and the psychology of the market will be most vulnerable.

This has happened with the cattle market. In October of 2006, three major packers announced that they were cutting back on their kill. The announcements were made within hours of one another. The packers stated in their announcements that a kill reduction was caused by fewer slaughter ready cattle, a fact that should have been bullish for the market. Instead, there was panic. The price of fat cattle dropped over four dollars a hundred almost immediately. The packers bought their fat cattle cheaper and killed greater numbers than they had before the announcement. The packers were able to use the psychology of fear and the advantage of a thin market to drive the price down in spite of the lack of fundamental market elements indicating a down market.

The market, as well as the economy, responds to psychological effects. While we work on those features of the marketplace that are broken, while we try to restore genuine competition to agriculture and other enterprises, while we deal with trade cheats, we need to share our optimism with others so that the economy can benefit to the degree possible from our good expectations.[RS] ocm

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