

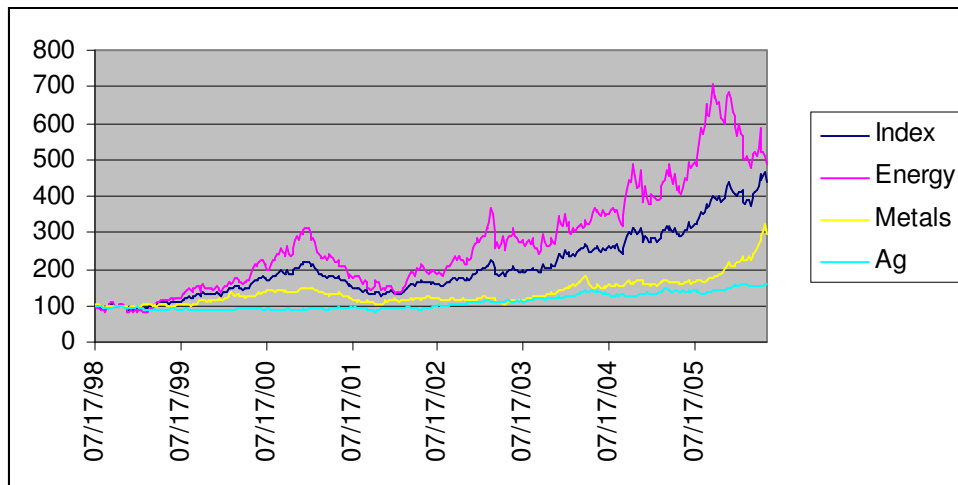
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## Seeking Value In Commodities

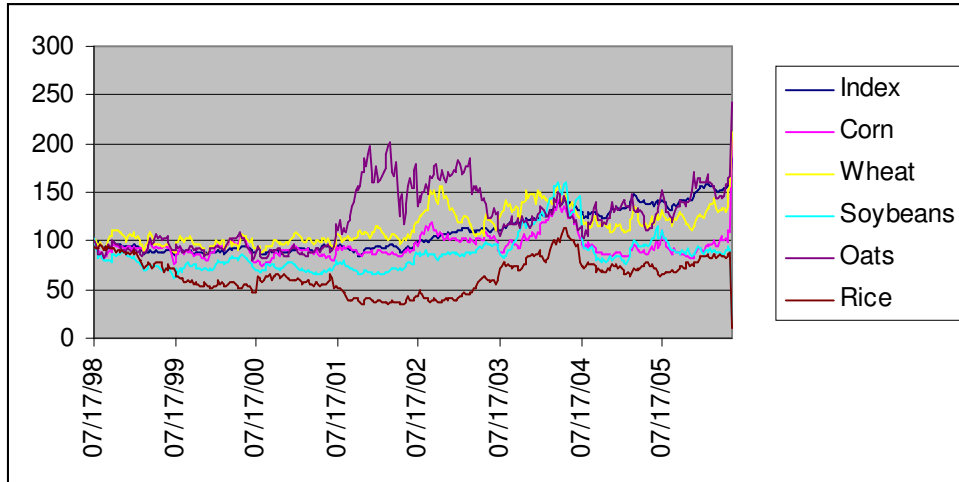
By Rich Posson

With the impressive increase in value of commodity indexes, crude oil and metals the investor must consider what is the next sector for investment. Where is value? A majority of commodity indexes are biased toward the energy market. Some indexes are focused on some form of economic weighting as for “importance” of markets contained within the index. But a majority of investors could care less as to the economic importance of a market and care more of “what will move next?”

I developed the Traders Ag Index along this line of investor thinking in that all markets are the same economically (all commodities are important) and what matters most is which market performs the most. The Traders Ag Index is a group of 14 US futures markets representing primary commodities. Primary in the sense that soybeans are included but soymeal and soyoil are not. These latter two markets are derivatives or products of soybeans. The index begins in 1998 at a value of \$100 of the commodities.



The chart shown above displays the Traders Ag Index alongside similar indexes of metals and energy plus a composite index of the three sectors. Note the energy index shows stellar performance to the Traders Ag Index and yet there is correlation. Traders Ag Index is less volatile but still with worthy appreciation in that the index is currently at 155 versus a base of 100 for a 55% return. Adjusting for inflation the current base should be 126, so this group of agriculture markets has a return over inflation. When seeking value one should consider that bull markets start with low volatility and migrate to high volatility. The Traders Ag Index versus broad-based commodity indexes suggest the next bull market trend may be in agriculture.

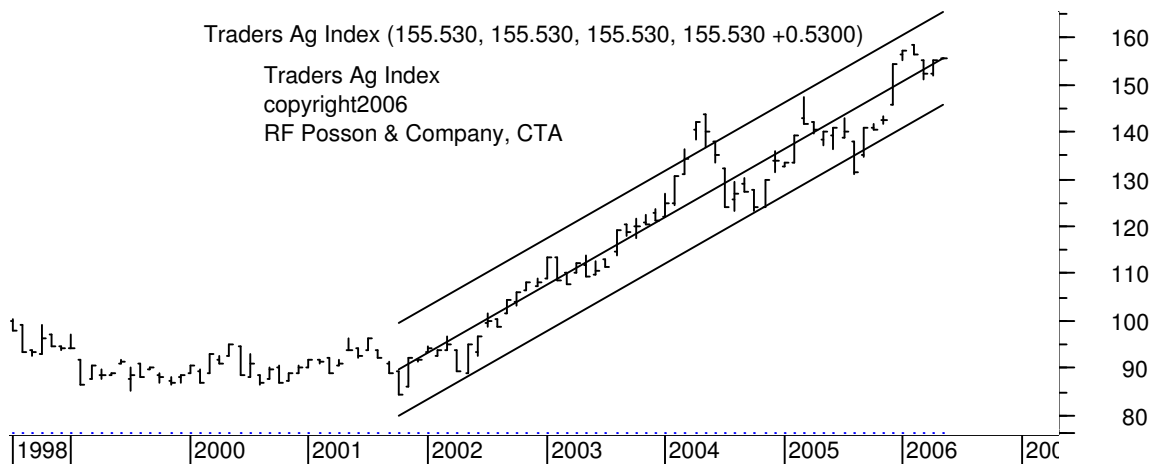


Creating indexes for each of the commodities comprising the Traders Ag Index allows for isolation of potential value based individual markets. The chart shown above displays the grain markets of the index and it can be seen that the grains have under performed the Traders Ag Index. Sugar has been the strongest market of the index, which has assisted in the cover up of a correction trend of the other commodities within the index. And a majority of the index components are below the 126 inflation adjusted base, which means these markets have not kept up with inflation. To the contrarian the two charts suggests one should look at sector rotation into the agricultural markets and in addition into the “crop” markets.

Another form of contrarian value assessment is to rank the markets in terms of highest price as reflecting the better long-term performance. And likewise the lower priced markets can be the next long-term buy and hold trades. A ranking of the index components from highest price to lowest price are:

Sugar, oats, orange juice, wheat, hogs, lumber, cattle, corn, cocoa, coffee, soybeans, rice, milk and cotton.

A study of sectors versus individual markets is only a starting point in creation of the investors shopping list. A simple but enlightening starting point.



Past results are not necessarily indicative of future results.

