



FARMLAND, GOLD AND STAGFLATION – THE PERFECT STORM?

ABSTRACT:

"In economics, stagflation or recession-inflation is a situation in which the inflation rate is high, the economic growth rate slows, and unemployment remains steadily high. It presents a dilemma for economic policy, since actions intended to lower inflation may exacerbate unemployment.....Economists offer two principal explanations for why stagflation occurs. First, stagflation can result when the economy faces a supply shock, such as a rapid increase in the price of oil. An unfavorable situation like that tends to raise prices at the same time as it slows economic growth by making production more costly and less profitable. Second, the government can cause stagflation if it creates policies that harm industry while growing the money supply too quickly. These two things would probably have to occur simultaneously because policies that slow economic growth do not usually cause inflation, and policies that cause inflation do not usually slow economic growth. Both explanations are offered in analyses of the 1970s stagflation in the West. It began with a huge rise in oil prices, but then continued as central banks used excessively stimulative monetary policy to counteract the resulting recession, causing a price/wage spiral." Source: Wikipedia

KEYWORDS:

Farmland, gold, stagflation, helicopter money, gold with yield, portfolio insurance, diversification, correlation

INTRODUCTION:

Based on what can only be described as the massive growth of the global money supply in the last 2 months and the apparent willingness of central bankers to create further money to backstop to the economy – it appears we have the ingredients for a period of high inflation. Central bankers are even openly discussing “helicopter money” – simply put printing money and sending checks to every person in the country. Granted though this is only different in name from printing money to bail out the FIRE sector (“Finance, Insurance Real Estate”) helicopter money was considered a

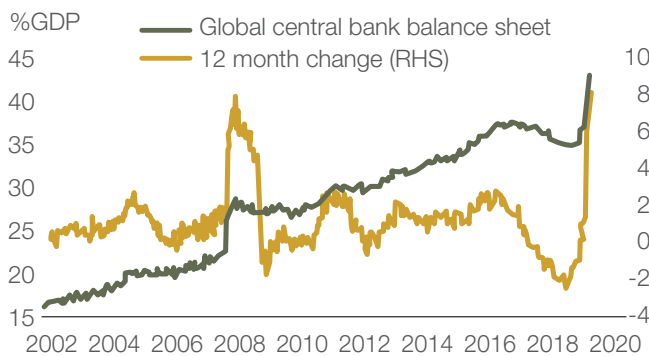
strictly taboo topic in the halls of central banks only a few short weeks ago.

We believe a good comparison for what we are facing now is the 1970s. The term that defined that era was **“stagflation”**. Stagflation has once again become a real consideration. Stagflation is that unfortunate condition in which economic growth slows while prices rise (in the 1970s it was caused by the OPEC oil price shock combined with loose monetary and fiscal policy in the US). It may seem like a counter-intuitive combination, but it has happened.

Examining the 1970s, we see that there was a bout of stagflation during the second recession of that decade. Inflation reached levels over 12% in 1974 combined with 8% unemployment. This created an economic malaise that was difficult to escape for years. Think of stagflation as the result of an expansionary monetary response to a disrupted real economy. The “flation” portion of the “stagflation” is simply an additional ill to an already grave situation.

We believe that what is happening today is not all that different. The response to high unemployment caused by a COVID-19 induced disruption has been a massive and ongoing increase of the money supply and large government deficits. The Federal Reserve’s balance sheet has doubled and is expected to reach over \$7 trillion (Federal Reserve). The US government is running a projected 2020 deficit of 18.7 % of GDP (Reuters).

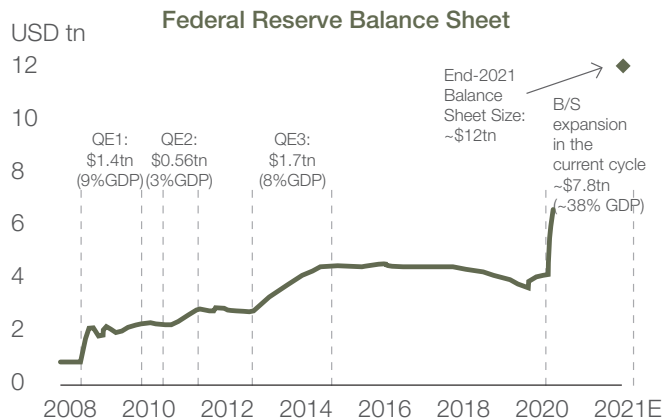
Global Central Bank Balance Sheet 1/



1/ Total assets of the Federal Reserve Bank, European Central Bank, Bank of Japan, Bank of England, Swiss National Bank, Reserve Bank of Australia, Bank of Canada and the People’s Bank of China scaled by the aggregate GDP of these countries in current dollars.

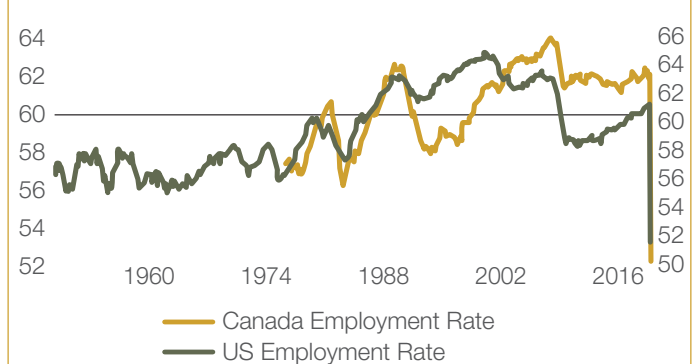
Source: Haver and Bloomberg

Fed’s balance sheet to expand by more than QE1, 2 and 3 combined in this cycle



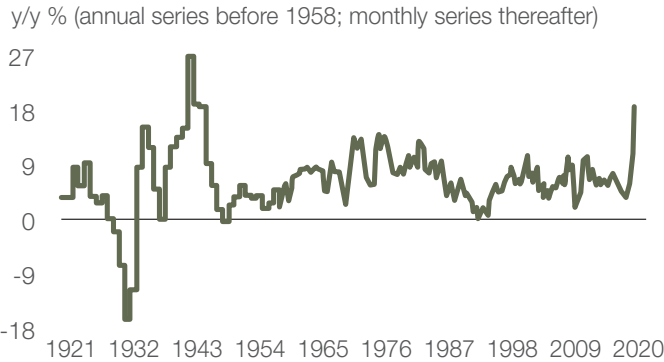
Source: Federal Reserve Board, Federal Reserve Bank of New York, Morgan Stanley Research

Canada and US Employment Rate



Source: Tradingeconomics.com

US Monetary Aggregates: M2



Source: Haver

THE CASE FOR FARMLAND:

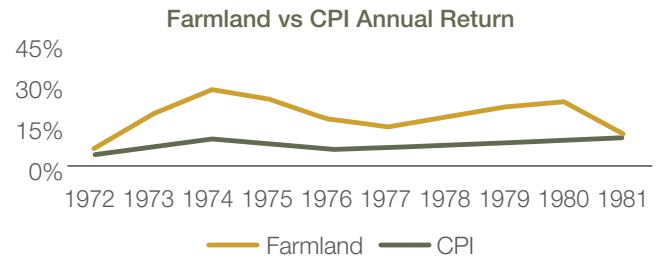
Farmland has a positive correlation with inflation and is considered a classic inflation/stagflation hedge. Think of farmland as inflation insurance for your investment portfolio, like fire insurance for your home.

Many investors view it as better insurance than gold because farmland produces positive cash flow while shielding from the deleterious effects of inflation. Remember that the U.S. is the world's largest debtor and its government and central bankers have a natural tendency towards creating inflation whether through deliberate conduct or the unintended consequence of well-meaning policy.

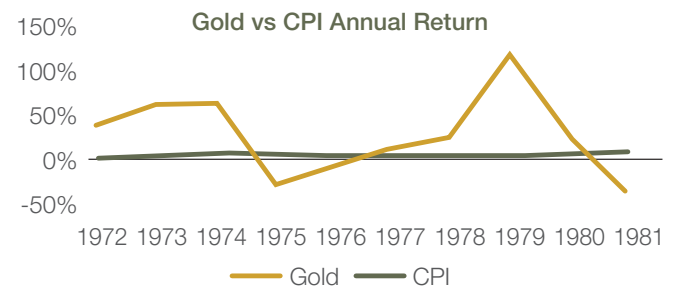
An example of this can be seen in the graphs below. Gold and farmland outperformed during the **stagflationary** 1970s. The price of gold and farmland started to rally early in the 1970s as stagflation started to appear – a combination of expansionary fiscal and monetary policy followed by the US government combined with the OPEC oil price shock. You will also see that farmland was less volatile than gold, a feature we believe is because it provides an income component that gold lacks. Hence the description of farmland as **“gold with yield”**.

SOURCE DATA AND ANALYSIS:

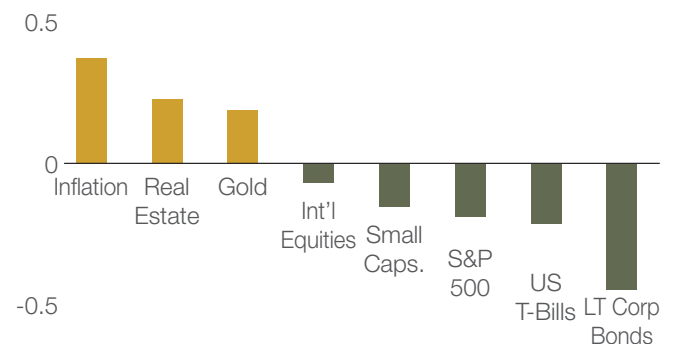
Farmland Outperformed Inflation During the Stagflationary Period of the 1970s



Gold Was More Volatile During the Stagflationary Period of the 1970s



Farmland has low correlation with traditional asset classes farmland cross correlations for period 1970-2009



CONCLUSION:

In general, we believe farmland is an attractive long-term investment that offers current income, capital appreciation and diversification benefits. In addition, it can be a superior inflation hedge.

Since the end of WWII farmland has experienced a steady rise in value with very few down years. At the same time, many investors have experienced wrenching and far more frequent declines in the value of their public equity investment portfolios. However, those with an allocation to agriculture would have benefited from lower overall portfolio volatility and returns to offset losses from the other asset classes.

SOURCES:

Federal Reserve Board, Bank of New York, Morgan Stanley Research, Reuters, Canadian farmland data-FCC, CPI-Statistics Canada, SP500-10yr Bonds-Macrotrends, FTSE REIT-Nareit, Veripath analytics

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