

Feed the World -- and Boost Returns

Donald Coxe, Global Portfolio Strategist, BMO Financial Group

By **ROBIN GOLDWYN BLUMENTHAL**

AN INTERVIEW WITH DONALD COXE: He's convinced that we are in the midst of the greatest commodities bull market of all time. His hunger: food.

ONCE A WEEK, LOADS OF INSTITUTIONAL INVESTORS DROP whatever they're doing to tune in to Donald Coxe's strategy conference calls. Small wonder. With a keen sense of history and wry sense of humor, Coxe has helped his followers anticipate some of the biggest shifts in markets, be they in stocks or commodities. As global portfolio strategist for BMO Financial Group, a Toronto-based bank that is among Canada's largest, he now sees real hope for two sectors that have been taking poundings: banks and commodities. Though he launched the Coxe Commodity Strategy Fund this past summer, right before commodities took a nose dive, Coxe remains convinced that we are in the midst of the greatest commodities bull market of all time. For his reasons, please read on.

Barron's: *What's your take on the monetary scene?*

Coxe: The Fed has doubled the debt on its balance sheet in five weeks. We don't know how long they are going to be carrying out these policies, which would send Milton Friedman spinning in his tomb. On the other hand, they had to do it. I challenged groups this week, saying, if I had said to you a year ago things will be so bad that the Fed will double its balance sheet in five weeks, would any of you have ever invited me back to speak to you? And, of course, the reaction was the same: Clearly you are stark raving mad.

Are the economic prospects any better in Europe?

The Europeans had thought it was an American problem, but European banks have lent a vast percentage of their capital to these Slavic countries, with even worse demography than Europe. Emerging markets are such a powerful asset class because each generation is bigger than the next, and there is an increasing middle class and a high savings rate. That's the stuff of real economic power, and a terrific investment concept. By contrast, in the OECD countries, each generation is just 60% of the predecessor generation, there's no growing middle class and there's a zero savings rate. The formula across the OECD is for sluggish growth at best.

How should investors approach today's stock market?

If you aren't deeply in the equity market, this is not a time to be committing large amounts of money. Stocks are cheap but they can get cheaper; we know that. We got back to the Dow having a multiple of 5.9 in December of '74, which was the foundation of Warren Buffett's wealth because he started buying at that level. The Dow isn't anywhere near 5.9 [its multiple

last week was 11], but some of my favorite stocks are trading at lower P/Es than that. I can tell you they are the fertilizer, oil and agricultural companies.

Tell us some more about those industries.

The core investment concept of our time is that we are living through the greatest simultaneous effervescence of personal economic liberty in history. When people go from abject poverty to dwellings with indoor plumbing, electricity, basic appliances and access to motorized transportation, they have more economic liberty than 99% of humanity enjoys and we are adding 50 to 150 million people a year to that list. The gigantic investment returns are all going to be tied to companies that meet real human needs and do it better than other companies. What a great time to be an investor, because it is not just about the dwellings and the transportation, it is about the high-protein diet. When I came back from a trip two years ago, I said the biggest commodity story is going to be food, bigger than the other ones. It is high-protein food. The way to play that is through the fertilizer stocks, the genetically modified seed stocks and the farm-equipment stocks. [Coxe would not recommend specific companies, citing his firm's compliance restrictions.]

What are the big trends in food consumption?

If you look at areas under cultivation, wheat has only gone up in hectares a little bit in a decade. Rice is flat in a decade. Meanwhile, our need for protein has gone up dramatically because people are consuming more beef and pork. But more important than oil in this decade is milk. In rural India, the kids are getting animal protein and they are going to be physically stronger than their parents. Their brains are going to be better.

But there's still a serious global food shortage.

Until four months ago, when you Googled "global 'blank' crisis" it was the global food crisis. The global food crisis was our big theme. The global financial crisis has pushed the food crisis off the front page at a time when people are actually getting together to say, "How do we deal with this problem?" We have an enormous challenge, but we also have the technology to increase farm productivity. Investors who invest in this are going to make a lot of money, and they don't have to apologize to anybody for doing it. If it hadn't been for [the development of genetically modified crops], corn would have gone to \$10 a bushel [instead of a recent high of \$7.50] and we would have had another 100 million people starving. This is a great investment theme.

Which commodity groups do you like best?

Agriculture is first. We will need more fertilizer. There are only three farm-equipment companies of any size in the world. Terms of entry are difficult. You have to have dealerships. [CNH Global](#) [ticker: CNH] is one of the top three companies in the world in the field. It's a

subsidiary of Fiat and its stock has collapsed, but earnings haven't collapsed. In May it sold for \$45 a share. It's \$17 now. The next group has to be gold stocks. A period of massive deflation always leads to a good move in gold.

Next?

The third group is energy. Despite Obama's plan to spend \$150 billion on alternative energy, each year we still lose 4.5 million barrels of oil a day that we have to replace. Oil is trading now at \$61 a barrel, but oil for delivery in 2015 is trading at over \$90 a barrel. Those with reserves in politically secure areas of the world will do well. Venezuela could solve a large part of the world's energy needs, but not under the current management.

How about base metals?

Those stocks are selling for pennies on the dollar. Take [BHP Billiton](#) [BHP]. It was \$95 in May, it recently fell to \$30, but it's back up to nearly \$40. This is an unrivaled set of assets, a great balance sheet, top-notch management and no scandals.

Is copper worth a look?

Copper is now at \$1.80 per pound, where it was in '05. But as soon as the economy recovers, copper always doubles in price. It's levered to growth in China and India. They have an increasing percentage of well-off people who use energy and metals, and each generation is bigger than the last. Since 1995, China has had a plan to create 200 cities of more than one million people. The investment strategy should be tied to areas of the world that are growing the fastest in the next five years.

As for stocks in general, when will we know that they're ready to rebound?

In every bear market since 1972, when the banks went through a period of at least six weeks where they outperformed the S&P, it was over. But we can't use the rule this time because of the TED spread, which has a 100% forecasting record in all bear markets.

You have our attention.

The TED spread is the spread between the front-month T-bill contract and the front-month Eurodollar contract, because the Eurodollar contract is uninsured deposits in banks around the world in dollars. Therefore it is the measure of risk in the system. It reached a high of 500 after Lehman Brothers collapsed. The highest reading we have ever had up till then was 415 when Continental Illinois bank went bust in 1984 and got saved in order to save the system. The only reason they knew they had to save it was because of the spike in the TED spread. I know that from having interviewed the people involved. I used it to predict the crash in 1987. Then there was a long period where my knowledge of the TED spread was useless.

What does TED tell us now?

The spread has fallen to a little under 200 because of the various bank-rescue programs, and it could easily get to 140-145, which signal that banks are in a position to start lending again.

Does that favor any particular sector?

As they put this money into the banking system, then the oddity is that when the bear market ends, the bank stocks will be among the leaders in the rally that will come. This is based also on the principle of redemption and religion, which holds that when you have redeemed your sin you can come into heaven. When the bankers have stopped sinning and have gone through enough penance, then...

How do we know this will happen?

The TED spread certifies for bankers collectively they are entitled to go to heaven because it indicates they have gotten their balance sheets in order and the system is working again and money is flowing more freely.

Which banks are you buying?

We like those that show that they actually had a pretty good risk culture beforehand, but a couple of mistakes were made. The system is shot through with corrupt practices.

Thank you, Don.