What Going Off the Fiscal Cliff Might Mean For Ag Markets

The election is over and all attention is on Congress and the "Fiscal Cliff".

As the Dec 31st deadline draws near, the probability of continued deadlock raises the likelihood of automatic tax changes and spending sequestration.

Here at Beeson & Associates, Inc. we like to rely on past market actions before we make claims about future events. This method results in an informed recommendation based on more than just a feeling.

The Big Unknown:

The US "Fiscal Cliff" which has hit newswires in full force after the presidential election refers to the combination of two events that will occur in late 2012 and early 2013:

- Implementation of federal budget cuts resulting from the compromise to extend the US federal debt ceiling in mid-2011. Many will remember the compromise last August which outlined these cuts.

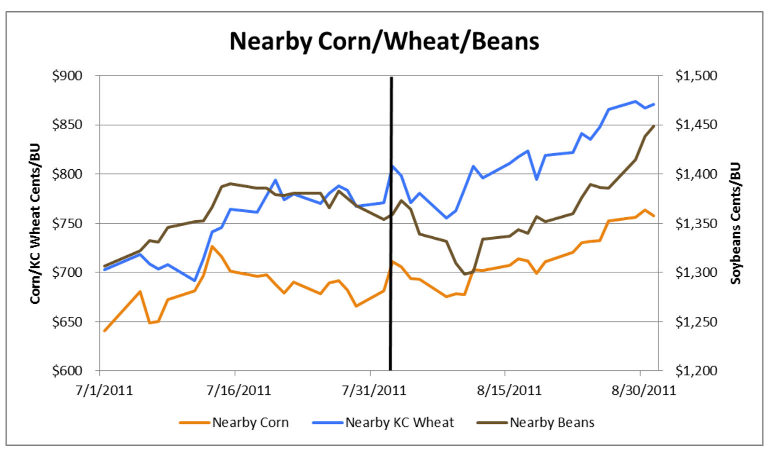
- Expiration of many of the tax cuts enacted since 2000, commonly referred to as the "Bush Tax Cuts". The name, "Fiscal Cliff," stems from the widely-held concern that these 2 actions may cause an economic recession.

First Look at Historical Patterns:

How have agricultural markets reacted to similar events in history? The most obvious example was the unexpected debate last summer about raising the US debit limit, which culminated in a deal which effectively "kicked the can down the road" forcing one credit agency to down grade US credit.

Below is a chart of nearby corn, KC wheat and soybeans in the month around the time of the Aug 2nd 2011 credit downgrade announcement (marked by the black line).

One important note is that commodity markets across the board were supported due to fundamentals drivers. However, once the news of a downgrade was printed, ag markets fell for the next two weeks with volatile sessions. Overall, the market adjusted rather quickly to this news and continued rising on trend well into the summer months.



	% Change in Price from US Credit Downgrade				
	1 Day	*3 Days*	*5 Days*	*15 Days*	*30 Days*
Nearby Corn	-1%	-3%	-5%	-2%	7%
Nearby KC Wheat	-1%	-3%	-7%	-2%	8%
Nearby Beans	1%	-1%	-2%	0%	7%

If anything can be learned from last year's debt ceiling debacle… it is that bullish fundamentals kept prices moving higher amid a short period of uncertainty.

If We Go Over the Cliff, What Will Ag Markets Do?

The Bull Case

- Due in part to the record breaking drought this summer, ag fundamentals across the board remain bullish well into 2013.
- Should dryness persist into the spring growing season, markets will rally on a 2nd year of bad crop yields.

The Bear Case

- The 2012 Farm Bill may be diluted in further talks as various forms of farm safety nets disappear and nutrition programs are renegotiated.
- Farm tax breaks may disappear, including various forms of crop insurance and favorable asset depreciation rules.
- Lower gas and oil prices due to the economic slowdown which will reduce demand for bio fuels and ethanol.
- Rising interest rates as the dollar continues to depreciate and creditors demand a higher return on US reserves.

Currently, most markets around the world do not believe that the US will go over the "Fiscal Cliff". The downside to the economy would be too great too fast. While lawmakers all agree on the negative outcomes of such indecision, headway on the solution seems to be at a stalemate. Unlike last summer, the potential for a much higher upside (a deal is made and fundamentals remain strong) or much lower downside (US economy falls back into recession) for commodity prices appear to be in play. Managing volatility is the best strategy for the majority of our customers. Take the guessing game out of large market moving events with a purchasing strategy that matches the risk tolerance of your business. While this answer is not exciting, no one can predict, with certainty, what type of compromise our government will have in the near term. With such large headline risk in the market today, prices move on rumors rather than fact. Learning to manage input cost to preserve gross margins effectively, rather than timing the market, yields better results over time.

It takes dynamic commodity research to make informed decisions. That's where Beeson & Associates, Inc. can help. We provide unique research based on price history and trends. We distill the information and provide you with the exact analysis you need.

We achieve these goals through weekly updates, monthly strategy reviews, regular outlooks and ad hoc studies. Each piece of research is customized and tailored to your specific needs.