FARMLAND VS S&P 500: HAS FARMLAND DEMONSTRATED ITS VALUE AS A PORTFOLIO DIVERSIFIER IN THE CURRENT RISING RATE/INFLATIONARY CONDITIONS?

ABSTRACT:

Farmland has a historically low correlation to traditional financial asset returns and a positive historical correlation with inflation making this asset class a useful diversification tool and an inflation/stagflation hedge worth considering. These farmland investment characteristics can been seen in a comparison of the performance of farmland against stock market returns in the stagflationary period of the 1970s and also in recent market conditions (2019-2022) which may represent the early stages of a prolonged inflationary/stagflationary period resulting from expansionary fiscal and monetary policy combined with global supply disruptions.

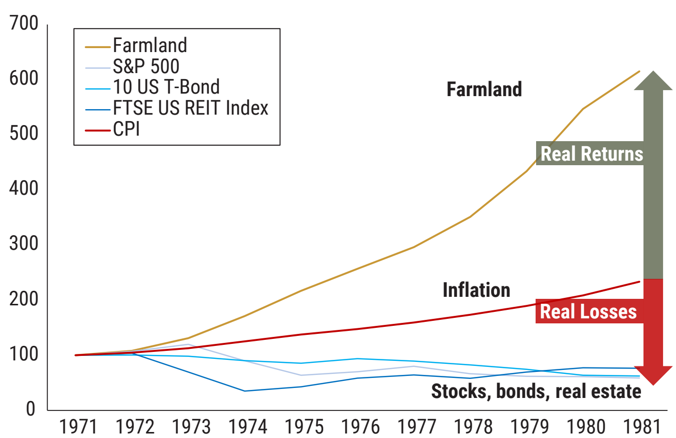
KEY WORDS: Farmland, inflation, correlation, diversification, volatility

THE CASE FOR FARMLAND AS AN INFLATION HEDGE:

Farmland has a materially positive correlation with inflation and as such has been considered an inflation/stagflation hedge. Think of farmland as inflation insurance for your investment portfolio, like fire insurance for your home. In fact, Veripath Partners view it as better insurance than gold because farmland produces positive cash flow while protecting against the deleterious effects of inflation. With regard to inflation, consider that the U.S. is the world's largest debtor and its government and central bankers have a structural incentive to create inflation, whether through deliberate conduct or the unintended consequence of well-meaning policy. This is, of course, also true of Canada and every other nation-state, but careful attention must be paid to the US dollar as it is the world's reserve currency.

The graph below compares the performance of farmland against the S&P 500, bonds and traditional real estate portfolios in the inflationary/stagflationary decade of the 1970s, which was caused by US expansionary fiscal and monetary policy combined with the OPEC oil price shock. The data shows the materially positive correlation of farmland price increases with inflation.

Farmland outperformed CPI, S&P, CRE and Bonds during 1970s stagflation



Sources: Canadian farmland data-FCC, CPI Statistics Canada, SP500 10yr Bonds Macrotrends, FTSE REIT Nareit, Veripath analytics

ARE WE IN THE EARLY STAGES OF STAGFLATION?

With the period of the stagflation in the 1970s a distant memory for many investors, do portfolio managers risk heading into another inflation/stagflation era with poorly constructed portfolios? It is no longer possible to ignore the current inflationary impact on our lives, and the current macro-economic conditions seem undeniably similar to those of the 1970s – expansionary fiscal and monetary policy combined with global supply disruptions due to Covid and the Russian-Ukraine conflict. With this in mind, the chart below compares the performance of the Veripath Farmland (R) Fund against the S&P 500 Index from 2019-2022. The data shows the low correlation of farmland to stock market returns.

S&P 500 Index vs Veripath Farmland (R) Funds

	S&P 500	Veripath
Q4 2019	8.28%	3.62%
Q1 2020	-20.34%	1.07%
Q2 2020	24.11%	0.62%
Q3 2020	8.28%	2.49%
Q4 2020	10.93%	1.82%
Q1 2021	5.53%	2.86%
Q2 2021	7.63%	2.26%
Q3 2021	0.16%	0.84%
Q4 2021	10.40%	1.64%
Q1 2022	-5.18%	2.08%
Q2 2022	-16.63%	3.50%
Q3 2022	-5.17%	2.41%

SUMMARY:

In general, farmland is an attractive long-term investment that offers current income, capital appreciation and diversification benefits. In addition, there is evidence that farmland can be a superior inflation hedge to other asset classes.

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 volatility and frequent declines in the value of their public equity investment portfolios. However, those with an allocation to Canadian farmland would have benefited from lower overall portfolio volatility and returns to offset losses from the other asset classes during inflationary/stagflationary periods.

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