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Warakirri
ASSET MANAGEMENT

Is it Time to Consider an Investment in Australian Agriculture?

Investment portfolios typically have minimal exposure to agriculture and the primary production of food. This is likely not helped by the fact that the benchmark S&P/ASX 200 equity index has less than 1% exposure to agricultural companies and many of these have limited investments in agricultural real-assets.

In addition to the solid long-term or "secular" demand outlook for agriculture, there are other compelling reasons for investors to consider some agricultural exposure as part of a well-diversified investment portfolio.

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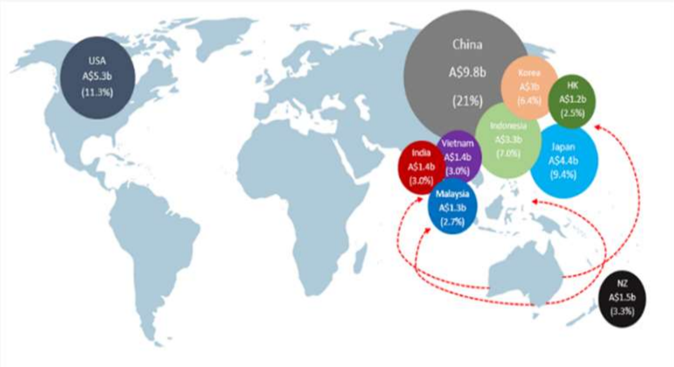
Introduction

Australia is an important part of the global food supply chain. With the world's fastest growing population, Asia, on our doorstep, rising global consumption and good export channels to the rest of the world, the demand for our food is rising. Australia is recognised for its clean, green and high-quality agricultural products, complementary seasons to Europe and North America for many products, free-trade and market access agreements with many important trade partners.

The predicted growth in food demand over the coming decades creates significant opportunities for Australian agriculture. The local industry is in a strong position to meet this rising demand and Australia has a comparative advantage in both the production of many agricultural products and our proximity to key markets.

Like many markets, agricultural prices vary between years and cycles - largely reflecting supply-demand economics. However, underlying demand for agricultural real-assets and food products continues to grow and this trend is likely to remain for years ahead.

Australian Agriculture Snapshot



Source: ABARE

Another key driver which is sometimes overlooked, is the rising corporatisation of Australian agriculture and the demand for, and availability of, capital which is providing investors with significant opportunities to access the sector.

This capital access among other things facilitates an investment in scale and technology which will also help to drive future returns from agriculture.

Agriculture's role in a well-diversified portfolio

In addition to the solid long-term or "secular" demand outlook for agriculture, there are other compelling reasons for investors to consider agricultural exposure as part of a well-diversified investment portfolio.

Irrespective of short-term commodity price movements, investing in Australian agriculture offers investors:

- ✓ **Competitive** risk-adjusted **returns**
- ✓ A **lower** level of **volatility**
- ✓ **Returns uncorrelated** to other traditional asset classes; and
- ✓ **Defensive characteristics** in certain market cycles.

Agriculture, managed well, has a track record of producing competitive risk adjusted returns with relatively low levels of volatility. For the purposes of this paper, we use the example of the returns on one of Warakirri's agricultural investment portfolios[1] as a proxy for the asset class and provide a comparison with index returns across other asset classes over the same period.

Asset Class Returns - 10 Years to 30 June 2021

Asset Class	10 Yr	7 Yr	5 Yr	3 Yr	1 Yr
Agriculture Portfolio[1]	11%	13%	14%	14%	20%
Australian Equities	9.2%	8.9%	11.3%	9.8%	28.5%
Global Equities	14.0%	13.5%	14.5%	14.0%	27.5%
Property	10.2%	10.5%	9.7%	8.2%	33.9%
Infrastructure	4.4%	2.8%	3.8%	5.9%	14.0%
Growth Alternatives	3.8%	3.9%	5.7%	6.0%	16.3%
Defensive Alternatives	3.2%	3.1%	4.6%	4.6%	14.3%
Australian Fixed Income	4.9%	4.0%	3.1%	4.2%	-1.0%
Global Fixed Income	1.6%	1.2%	1.5%	2.7%	-1.7%
Cash	2.2%	1.6%	1.3%	1.0%	0.1%

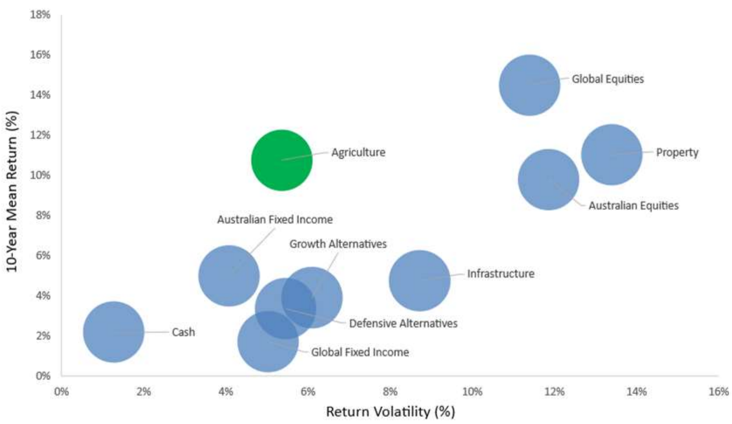
Source: Bloomberg, Warakirri Asset Management

With the exception of Global Equities over the longer term, Warakirri's agriculture investment has outperformed all other major asset classes for the period ending 30 June 2021.

It is also worth noting the relatively strong performance of agriculture versus all other asset classes in FY21/22 which includes the period of high volatility resulting from the COVID-19 pandemic. This was also replicated during the Global Financial Crisis throughout 2008-2010.

And while it can be easy to focus on the headline return figures, the chart below shows that the agriculture portfolio also delivered better risk-adjusted returns than most other asset classes over this period.

10 Year Asset Class Average Return and Volatility (2011 to 2021)



Source: Bloomberg, Warakirri Asset Management

We know that investors should seek low asset class correlations to achieve a sufficient level of diversification. As shown in table 2, due to the relatively low correlation between agricultural sector performance and other asset classes more broadly, some exposure to the agriculture sector offers a good source of portfolio diversification for investors, in addition to competitive returns.

Table 2: Asset Class Correlations

Asset Class	Aust. Equities	Global Equities	Property	Infra-structure	Growth Alts	Defensive Alts	Aust. Bonds	Agriculture
Aust. Equities	1							
Global Equities	0.6	1						
Property	0.14	0.01	1					
Infrastructure	0.68	0.48	0.56	1				
Growth Alts	0.68	0.58	-0.01	0.61	1			
Defensive Alts	0.66	0.55	0.09	0.54	0.96	1		
Aust. Bonds	-0.2	-0.01	-0.71	-0.34	0.19	0.20	1	
Agriculture	0.01	0.06	-0.06	-0.06	-0.01	0.11	-0.32	1

Source: Bloomberg, Warakirri Asset Management

AT A GLANCE: AUSTRALIAN AGRICULTURE

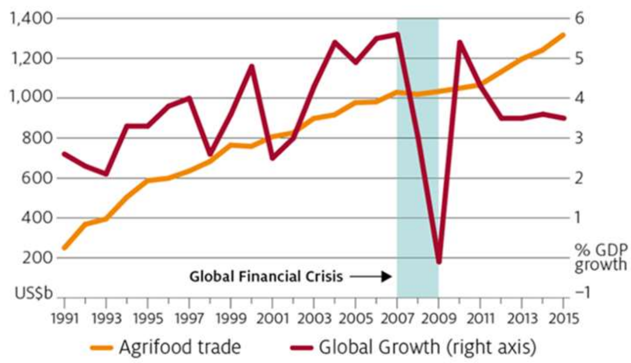
- 3% of GDP at ~$67bn – strong growth target of $100bn by 2030
- 70% of agricultural products are exported ($47bn)
- 11% of Australia's total exports in 2019-20
- 460 million hectares of farmland (55% of Australian landmass)
- >1.6 million Australian jobs
- 86,000 Australian farm businesses

Agriculture in different economic cycles

Agriculture returns also behave differently than traditional asset classes in various economic conditions and can offer important defensive characteristics to investment portfolios. As an example, during the Global Financial Crisis, not only did the prices of some goods fall much more than others – agricultural products experienced the smallest declines while oil and minerals experienced the largest - but global trade in agricultural products continued to grow over the period of the Crisis and beyond (see chart below).

When considering the impact of Covid-19, an investment in agriculture is fundamentally linked to demand for food and staple products. In 2020 and so far in 2021, as in previous pandemic events, this demand has remained relatively stable and resilient amongst other economic pressures.

Global Trade in Agricultural Products during the Global Financial Crisis



Source: Greenville, et al. (2019), IMF
Notes: Trade data discounted by IMF food price index.

On the following page we provide a summary of agricultural return characteristics in the following key economic scenarios:

- Changes in interest rates
- Australian dollar movements
- Periods of high inflation; and
- Global recessions

Economic Cycle Impacts on Agriculture Returns

Economic Cycles	Overall Impact	Positive to Neutral	Negative
Australian Interest Rate Changes	Low	• Low interest rates have historically coincided with higher agriculture returns i.e. 1980-90 and 2012-18. • High interest rates have very little impact on agriculture operating returns, unless AUD also rises which depreciates value of agricultural exports. • Strong export focus so any pressure on domestic household expenditure would have minimal impact on overall demand, particularly for staple commodities.	• Higher interest rates likely to increase financial stress for leveraged farm businesses. • May reduce competition for agricultural land, lowering land values which would impact capital returns but also create buying opportunities for those investors with strong equity levels looking to expand.
Australian Dollar Movements	Moderate	• Agriculture operating returns are sensitive to AUD movements given the strong export nature of the industry. As an example, a 1 cent movement in AUD currency results in a $3 a tonne movement in grain values. • A lower AUD is generally positive and supportive of higher agricultural returns as the value of domestic export product increases. • Increased export values far outweigh the increased price of imported inputs such as fuel, fertilizer and chemicals. • A weak AUD can also indirectly cause inflation.	• A higher AUD is generally negative, reducing the value of domestic export product with reduced price competitiveness of Australian output on global markets.
High Inflation	Low	• High inflation periods typically result in higher agricultural returns as the price of domestic product / goods rises. • If high inflation occurs at the same time as a depreciating AUD, it has the potential to be very supportive of agricultural returns.	• High inflation typically places pressure on wages. However, agriculture is not typically a labor-intensive sector, with wages making up roughly 5-10% of expenses. • High inflation periods often also lead to higher interest rates (refer to above comment).
Global Recession	Low to Moderate	• In general, a global recession has minimal impact on agricultural returns. • Strong examples of this are the GFC and current pandemic, where agricultural returns remained mostly positive and outperformed other asset classes.	• A potential risk for agriculture during financial market shock events is the potential for monetary, credit and trade restrictions / tariffs to increase. These policy changes have a potential negative impact on agriculture returns, limiting market competition and trade opportunities.

Summary

The global thematic of rising populations, increasing wealth and changing population demographics is not new, but the opportunities for agriculture have not always been as clear as they are today. An increasing global demand for food, particularly in Asia, provides an opportunity for Australian agriculture to capitalise on its competitive advantages and future growth prospects to deliver competitive risk-adjusted investment returns.

Access to the agriculture sector has generally been the preserve of large sophisticated investors and institutions due to the need for specialised trading accounts, high minimum investment hurdles and well-developed skills to carefully manage the risks involved.

For institutional investors looking for access to a diversified portfolio of investment grade Australian agricultural assets, the Warakirri Farmland Fund offers a 'Core Agricultural Property' investment strategy, established to buy, develop and lease to high quality agricultural businesses, as tenant partners.

The target assets for the Fund include horticulture (nuts & fruit), viticulture (wine & table grapes), row crop farmland assets and water entitlements. Importantly, the Fund utilises Warakirri's Sustainability Framework and includes, where possible, strategies to measure, monitor and reduce energy use, carbon emissions and improve biodiversity.

For more information please contact the Warakirri team on 1300 927 254 or visit warakirri.com.au

1. Portfolio refers to a private, closed-end diverse portfolio of farms managed by Warakirri.
2. Source: United Nations, The Global Financial Crisis and Its Impact on Trade, September 2010.