Hedge Against Inflation? Think Farmland

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Over time, no investment matches land as a buffer

Not in every year, certainly, but over time, no investment offers the correlation with inflation that farmland does—not the stock market, not the bond market, not even gold. "Farmland will continue to be a hedge against inflation," says John Taylor, national farm and ranch executive for U.S. Trust, a Bank of America company.

One reason why? A lot of inflation is food, Taylor says. He sees farmland having the potential to increase by an annual growth rate of around 3.5% or more. Most experts don't see inflation rising higher than that, on average, although black swan events, such as an unexpected expansion of the U.S. economy, could potentially ignite inflation, notes Jeff Swanhorst, AgriBank chief credit officer. "Most of the time, land as an investment performs better than the inflation rate," Swanhorst says. He quickly adds that farmland is a good hedge against inflation—except in years when it isn't. He specifically refers to the early 1980s to 1987, when farmland showed a negative correlation with the inflation rate.

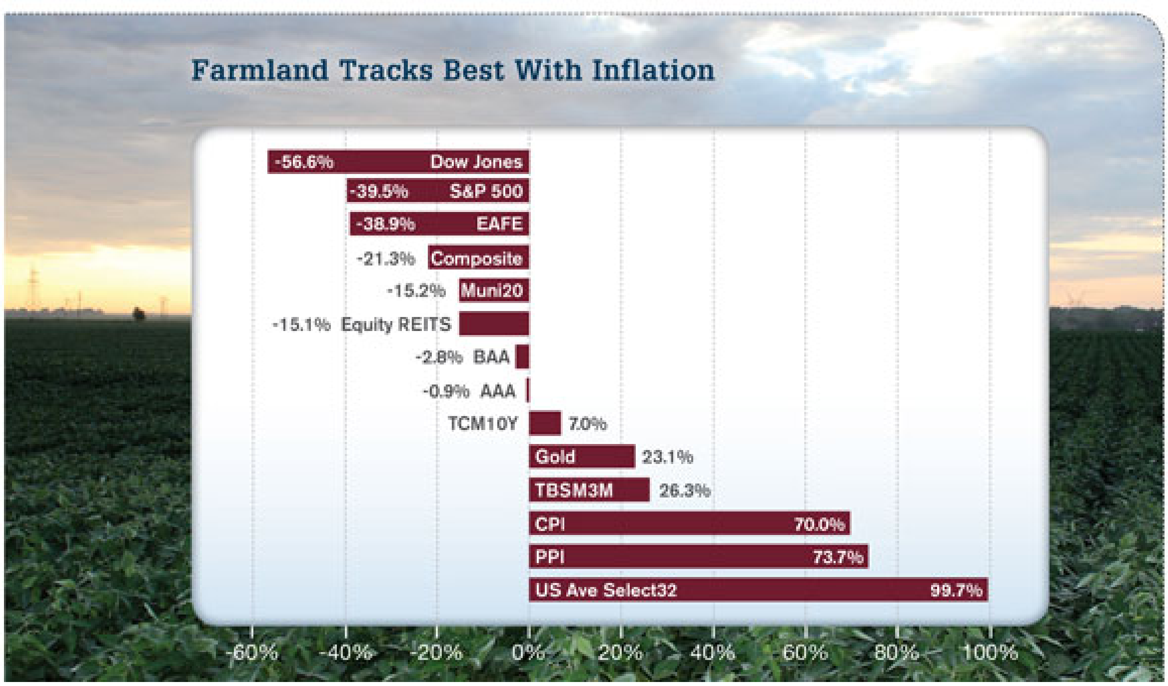
Farmland Beats the Dow. When comparing farmland with a basketful of investments, as well as inflation, land has a 70% correlation with the Consumer Price Index (CPI) and a 79.84% correlation with the Producer Price Index (PPI), the two main measures of inflation, according to the TIAA-CREF Center for Farmland Research, University of Illinois. Nothing is a closer match to farmland than inflation.

For example, Dow Jones has a –42% correlation with farmland; the S&P 500's correlation is –26.4%. Even bonds have negative correlations, although they perform better against farmland and inflation than stocks. Farmland, similar to a bond in many respects, has a –7.5% correlation with AAA bonds.

Ironically, gold—often sought as an inflation hedge—is not as good as farmland, explains Todd Kuethe, University of Illinois economist. Even if a producer bought land in the 1980s, if held as a long-term investment, it still operated as a hedge against inflation and within a few years, values corrected.

Beyond the inflation correlation, the Illinois data raises an important question on why farmland has such a negative correlation with the stock market. The reasons why, Kuethe says, are that when the U.S. economy is strong, both interest rates and inflation can be under pressure, resulting in a stronger dollar. With U.S. agriculture so export driven, this can be harmful.

On the question of whether land values are in for a significant retrenchment, Kuethe is not as concerned. "We'll still be above the baseline the next few years, but instead of 15% year-over-year increases, we'll be going back to 5%. That will seem like a loss," he says. "Farmland investors don't treat their investments as a fad."



On average, no investment offers a hedge against inflation like farmland, although the next closest is gold.

Source: University of Illinois, TIAA-CREF Center for Farmland Research;

Photo: Jeanne Bernick

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