Soft Commodity Note

Record-breaking 2007… Where to from here?

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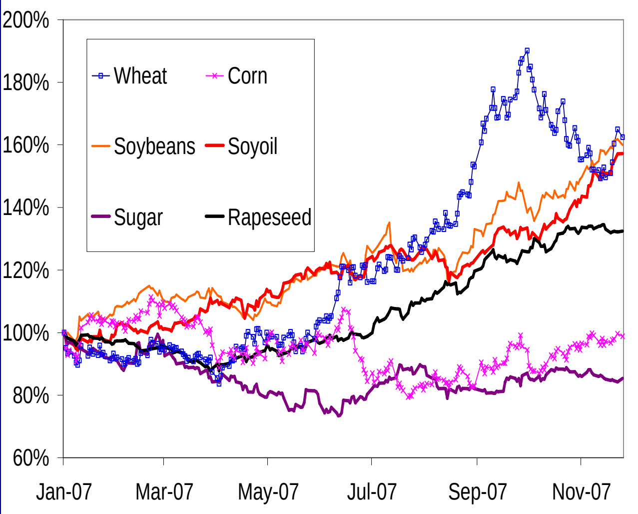
2007 in Review

The past twelve months have seen unrivalled volatility in global agricultural markets. Prices for grains, oilseeds and dairy products have all reached historical highs and volatility in most markets has been extreme, providing significant opportunities from an investment viewpoint. Meanwhile, world sugar and cotton markets have underperformed, weighed down by bearish fundamentals and an overhang of stocks on the world market.

Figure 1 Commodity price movements 2007 (ytd)



Source: Bloomberg, Rabobank, 2007

Buoyed by a structural change in commodity demand with the emergence of a growing global biofuel sector, grain and oilseed prices have increased significantly and in some cases more than doubled in the past 12 to18 months alone. This additional feedstock demand has attracted new investor money into the space, both directly into the biofuel industry and indirectly into the longer term soft commodity markets.

In addition to the 'new' demand created by the developing biofuel industries, continuing strong economic performance in both India and China have also created a solid platform for international demand conditions. Rapidly increasing disposable incomes coupled with westernisation of diets in these countries have created a demand-driven pull for agricultural commodities, akin to what is being experienced in the metals and energy markets more generally.

Further, inventory levels were low entering 2007, with the notable exceptions of sugar and cotton, and as such new demand has had an immediate impact on prices.

Significant supply side shocks – drought and or/flood conditions in various key production areas have impacted on both the 2006 and 2007 crop years, limiting the ability of the market to meet demand requirements and thus having an explosive impact on prices. The key question looking ahead to 2008 is: can there be a sufficient supply side response to higher prices: through acreage expansion and a return to more "normal" seasonal conditions, to meet this strong food, feed and energy demand.

Outside markets have also created a positive environment for soft commodity prices with a recent rally pushing crude oil prices to record levels and increasing the focus on alternate energy sources such as ethanol and bio diesel.

Figure 2 NYMEX – WTI crude oil

Source: Bloomberg, Rabobank, 2007

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Investment flows in soft commodity markets have also continued to increase rapidly over the past year, with soft commodities becoming a 'hot sector' for funds and other investment vehicles. Agricultural markets have offered investors an effective way of diversifying risk, particularly with the recent global credit market problems caused by the U.S. sub-prime issues.

Prices

Average prices for wheat, corn, soybeans, soyoil (CBOT) and Rapeseed (EURONEXT) have all outperformed historical averages.

In most cases 2007 season lows have been higher than the 5-year averages. Sugar has been the obvious underperformer (Figure 1), with the 2007 (ytd) average price sitting 33% below corresponding year earlier levels.

That said, the sugar market has not been without its supporters in recent months, with the current NYBOT No.11 contract sitting in quite a steep forward curve. Many are expecting brighter prospects for world sugar prices towards the end of 2008 as production cycles change and an assumption that stock levels in India will fall from very high current levels.

Figure 3

Commodity Price Movements Averages						
	5 yr.	10 yr.	2006	2007 ytd	high ytd	low ytd
Wheat	401	341	405	613	953	419
Corn	264	242	263	371	434	310
Soybean	682	596	595	840	1104	665
Soy Oil	26	23	25.11	35	47	28
Sugar	9.75	8.69	14.63	9.86	11.51	8.45
Rape Seed	249.7	NA	254	305	394	249

Source: Bloomberg, Rabobank, 2007

Grains

Corn

Entering the 2007/08 season the majority of the markets focus was on U.S. corn supplies and fears of supply shortfalls due to increased ethanol usage. As a result, corn prices spiked by 68% in Q42006 in a move that encouraged U.S. farmers to plant corn at the expense of soybeans, wheat and cotton, increasing corn plantings by 19%, year-on-year.

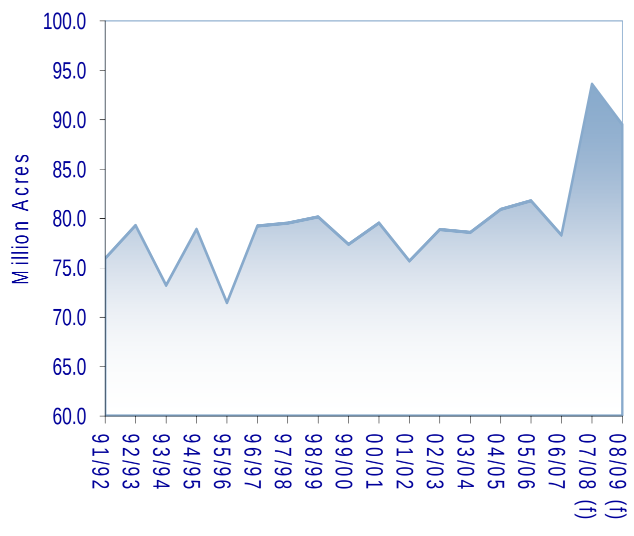
Favourable growing conditions combined with these record plantings have resulted in a forecast 26% production increase in U.S. corn in 2007/08.

Despite the massive jump in production, U.S. corn prices have remained resilient, due to surging outside markets and corn's new-found linkage to the energy sector. However, domestic infrastructure and logistical bottlenecks in the U.S have constrained profits and limited the ability of the ethanol industry to effectively compete against higher oil and subsidiary prices.

Looking ahead to 2008, current market dynamics suggest further extreme volatility in the corn and ethanol sector.

Relative U.S. gross margin comparisons indicate corn returns remain highly competitive, despite the rally in soybean and wheat prices and the sharp jump in input costs this season. As such, new U.S. corn crop plantings are expected to maintain a significant share of this season's acreage gains. However, small acreage losses, around 4%, are expected in areas where double cropping of soft red winter wheat and soybeans is achievable.

Figure 4 U.S. corn plantings



Source: , USDA, Rabobank 2007

Another key driver for the corn market moving into 2008 is expected to come from the energy market and the performance of ethanol relative to gasoline prices. While a significant share of this performance will be linked to government support decisions, prices will need to regain some competitiveness after a significant underperformance in 2007.

Overall, corn price expectations for next season are biased to the downside from current levels with extreme volatility likely to continue. Based on Rabobank forecasts of high carry-in stocks following 2007's record production and on

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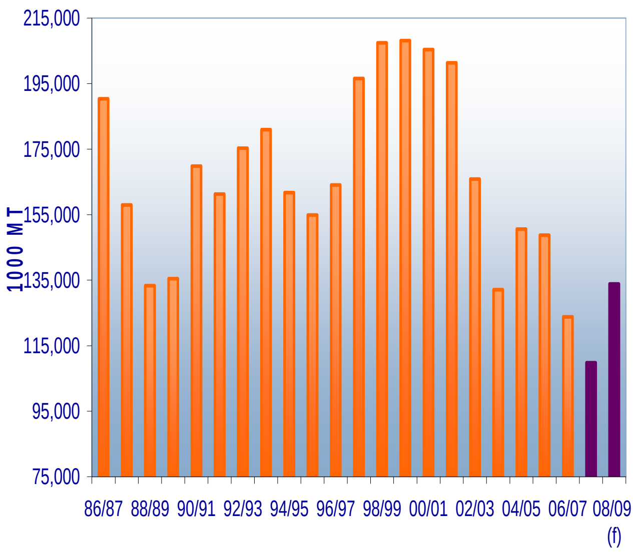
the assumption of normal seasonal conditions next season, stock levels of U.S. corn are expected to increase again in 2008. However, prices are likely to retain the weather premium they currently have factored in until next harvest, and outside markets will remain highly influential, particularly given the energy link.

Wheat

Global wheat prices have soared to historical highs in 2007, with tight inventory levels severely compounded by numerous weather-induced production issues throughout the year. This combination has also resulted in extreme price volatility, encouraged and to some degree driven by outside investment money.

Figure 5 World wheat stocks



Source: Rabobank, USDA, 2007

Reduced plantings in some regions, such as Canada, due to lower comparative returns, coupled with poor seasonal conditions in the U.S., EU, Black Sea and drought-affected Australia have seen the world wheat supply situation reach critical lows in 2007.

Compounding the extremely tight global supply situation, demand has remained robust throughout 2007 despite the record prices. Strong import programs from North Africa and India due to domestic supply shortfalls have underpinned world demand this season.

Tight global supply combined with solid demand has combined to push world inventories to their lowest level in over 30 years (Figure 5).

Looking ahead to 2008 there are a number of possible scenarios, depending largely on weather.

Based on current price levels, significant acreage expansion is expected in 2008, albeit there are a number of competing factors. For example, wheat acreage in Canada is forecast to be lower again in 2008 due to the weaker relative returns versus other cropping alternatives, such as canola and soybeans.

That said, further wheat plantings are expected in the U.S., the EU, (due to the relaxation of the set-aside program), North Africa, the Black Sea, India and Australia.

Given the tight inventory levels and the uncertainty of weather, a significant price correction is not expected until the middle of 2008, when the northern hemisphere crop conditions will be known. Until then, there may be some downside given the current lofty price levels. However, prices are expected to remain at a significant premium-to-average level based on the uncertainty of supply.

Based on expectations of plantings, and given a scenario of normal seasonal conditions for the northern hemisphere wheat crop, prices are expected to retrace a significant portion of this season's gains, moving more in-line with historical price relativities versus the corn market by the end of the year.

That said, the scenario of continued tight supply conditions for another couple of years appears equally plausible at this point in time. Further supply side shocks in 2008 coupled with lower plantings in some countries may even push prices to new highs in 2008, especially given 30-year low inventory levels entering the year.

As a result of the current uncertainty, price volatility is expected to remain high, providing investors with opportunities on both sides of the market.

Oilseeds

Tight inventory levels, lower plantings in the U.S., a close linkage to the energy sector and, more recently, bullish demand from China, have seen oilseeds provide a significant opportunity for investment in soft commodities over the past 12 months.

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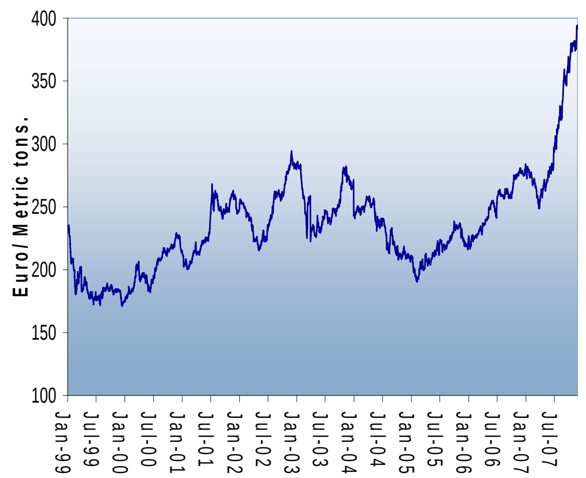
Figure 6 EU rapeseed

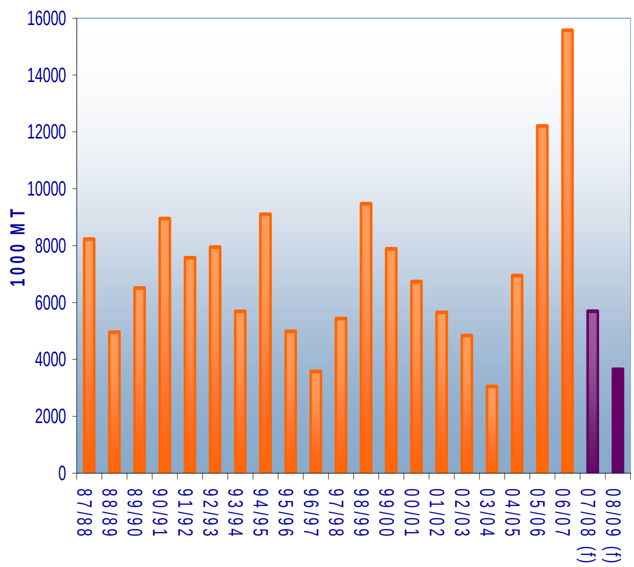


Source: Bloomberg, Rabobank , 2007

Oilseed prices have increased sharply in all parts of the world, largely driven by a close link with the energy sector and Chinese demand. This year average U.S. soybean and soy oil prices have increased 41%, Malaysian palm oil prices are up 54% and EU rapeseed average prices are 20% higher, year-on-year.

Reflecting this year's dynamic market conditions, U.S. soybean year ending inventory levels are forecast to fall by

Figure 7 U.S. soybean ending stocks

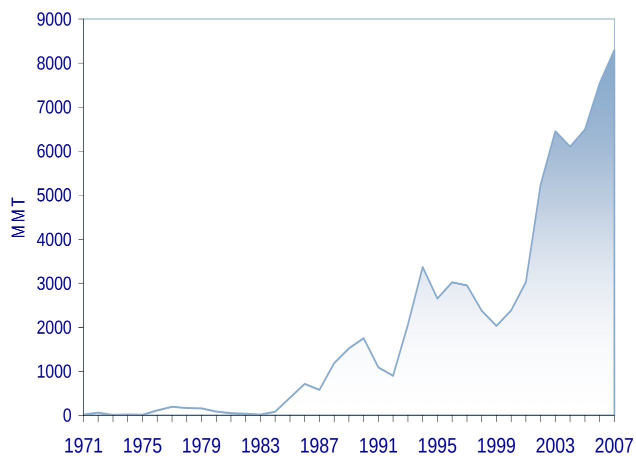


Source: Rabobank, USDA

76% - driven lower by a fall in production, robust internal demand and a strong export pace.

Chinese imports of soy and palm oil have increased 58% in the past five seasons driven by a decline in domestic production, government policy surrounding corn usage in biofuels and a rising demand from the biodiesel industry.

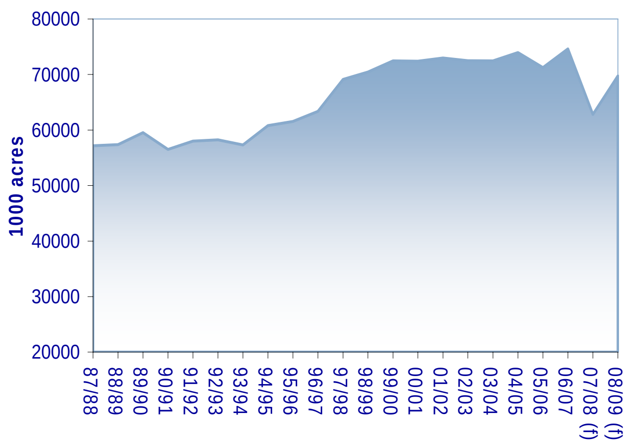
Figure 8 Chinese soy and palm oil imports



Source: Ag Resource Co., Rabobank, 2007

Not surprisingly, farmers both in the U.S. and globally are expected to respond to the rapid increase and record level of oilseed prices by increasing plantings significantly in 2008. U.S. soybean acreage is forecast to increase by 11%, year-on-year.

Figure 9 U.S. soybean acreage



Source: Rabobank, USDA

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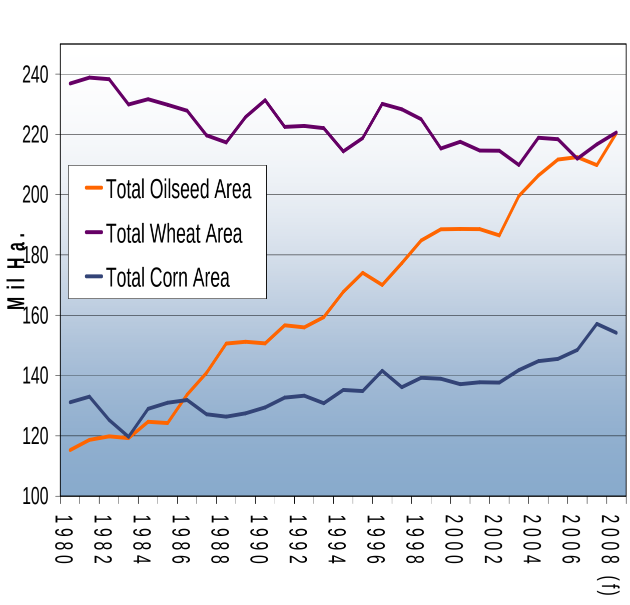
Outlook 2008

A significant supply response is expected in the grain and oilseeds markets in 2008, following a year of record breaking prices. Pressure will be on in all regions of the world to secure enough acres to solve the current supply shortages. Based on current expectations, wheat and oilseed look set to recapture acreage from corn in 2008.

Figure 10 World crop acreage changes



Source: Rabobank, USDA, 2007

Given the increased importance of weather over the next 12 months, price volatility is expected to remain extremely high, particularly in view of the tight stock levels in most markets.

Overall, prices for grains and oilseeds in particular are expected to remain well above long term averages, until a supply response is assured. While there are obvious recent examples of soft commodity price collapses following a spike (e.g. sugar) it is unlikely to be as sharp a retracement in grains and oilseeds given the current markets. Increased demand from the biofuel sector, coupled with a significant increase in investment money in the soft commodity markets are likely to help support prices over the short to medium term.

In addition, supply in the grain in oilseed markets are significantly more fragmented than in the sugar industry, where a supply response in two countries can weigh on the entire market.

There will need to be 'normal' seasonal conditions in a number of regions over the next 12 months for supply levels to increase sufficiently to meet on-going demand requirements.