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We are agriculture bulls

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Corn and soybeans may not generate a lot of headlines, but they can be exciting for those of us who cover the agriculture industry. Agriculture has been a cyclically depressed industry, facing many challenges since its last super-cycle, from 2010 to 2013. However, we believe the macroeconomic environment for agriculture is now quite promising, as evidenced by significantly higher prices for crops like corn and soybeans. Our longer-term outlook for agriculture is the most bullish it's been since early last decade.

After agriculture's multiyear downcycle, investors generally agree that higher crop prices are a good sign for the industry. Not everyone, however, agrees about the durability of the industry's rebound. We believe that we are only in the early innings of a multiyear upcycle for the global agricultural economy. This is due to a combination of supply shocks and strong demand that has left crop inventories quite lean, in our view.

Supply shocks

- China has experienced several consecutive years of weak corn harvests.
- In August 2020, a *derecho* — an intense, damaging wind storm — swept across the midwestern United States, resulting in U.S. corn and soybean production that was well below expectations.
- In response to the Covid-19 pandemic, several countries imposed export quotas, taxes, and bans on wheat, rice, and corn to protect their domestic food supplies. This disrupted typical trade flows.

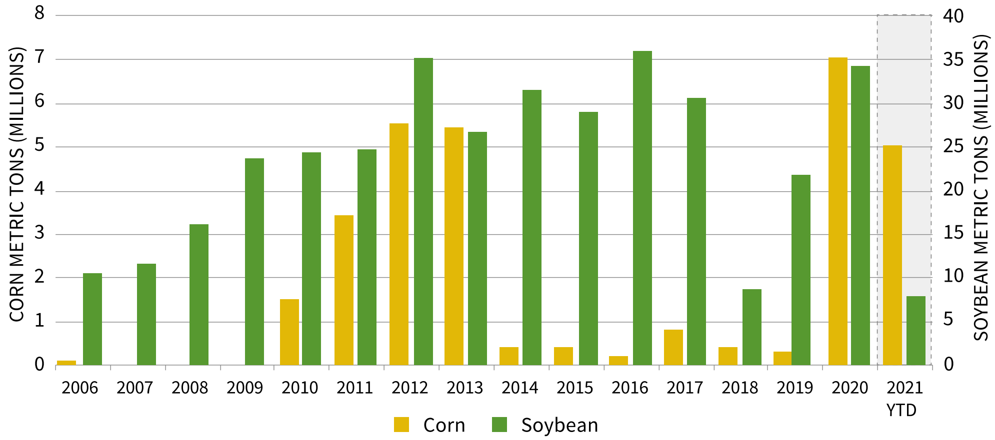
While those supply shocks are in the rear-view mirror, we expect that tightening regulation for chemical use on crops will lead to more supply shortfalls as farmers struggle to produce high yields without their usual tool kits.

Demand growth from China

- After settling the trade war with the United States, China has resumed buying U.S. corn and soybeans.
- China is attempting to restock its stores and rebuild its hog herd after the African Swine Flu epidemic of 2018.
- In 2020, China purchased more corn from the United States than it has in any year since 2006. It is also on pace to exceed that amount in 2021.
- Chinese soy purchases from the United States in 2020 were the highest in any year since 2016.

China is buying more U.S. crops

U.S. corn and soybean annual exports to China



Source: United States Department of Agriculture. Year-to-date data as of 4/22/21.

Demand for renewable diesel

- Soybeans are a major feedstock for renewable diesel, which is fuel made from resources such as animal fats, used cooking oils, and vegetable oils.
- We expect a 44% compound annual growth rate in U.S. renewable diesel capacity from 2020 to 2024.
- Currently, 31% of domestic production of soybean oil is used in biodiesel, according to the World Agricultural Supply and Demand Estimates (WASDE). This percentage of production is expected to increase significantly over the next four years.
- As a result, we expect global demand for soybeans to be structurally higher going forward.

The investment opportunity

In our view, a wide range of companies with exposure to agriculture are positioned to benefit from these trends. One advantage should be higher farmer income as a result of higher crop prices. In addition, agriculture-serving companies have implemented major improvements to their businesses during this multiyear downturn. We believe this will enable them to exceed expectations as the industry recovers. On the flipside, higher crop prices will drive food inflation, which is likely to put downward pressure on margins for packaged food companies and the low-margin grocery store industry.

These are some companies we believe are poised to benefit:

Deere and Company (DE). This Illinois-based machinery company manufactures and distributes agriculture and turf equipment and related service parts.

- We like Deere because it has driven major operating efficiencies in its manufacturing that should result in higher margins as demand grows.
- The company's new suite of digital agriculture products uses technology to enhance farmer productivity. Demand is growing rapidly for these products, which have significantly higher margins than traditional machinery products.
- Deere's construction machinery segment will benefit if the U.S. government passes the recently proposed large-scale infrastructure bill.

CNH Industrial NV (CNHI.IM). This European company designs, produces, and sells agricultural and construction equipment.

- We believe CNH is an attractive turnaround story.
- The company is in the process of spinning out or selling its commercial vehicle business, allowing it to focus more on agriculture and construction machinery.
- The company's new CEO has experience in driving operational excellence initiatives. He has the opportunity to do the same at CNH, which has a large margin gap to Deere, its primary competitor.

Corteva (CTVA). This Delaware-based company, which was spun off from DowDuPont in 2018, is a global supplier of seeds and chemicals for a number of crops.

- We find Corteva attractive because its new soybean seed product, Enlist E3, is stealing share of the U.S. soybean market.
- Corteva will also launch a number of other new seed and crop protection products over the next few years.
- The company has potential to improve its margins through productivity programs and by shifting from relying on other company's biotech traits to using its own.

The S&P 500 Index is an unmanaged index of common stock performance.

The Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by consumers for a basket of consumer goods and services, such as transportation, food, and medical care; the CPI is used for identifying periods of inflation or deflation.

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