

Investment in agricultural commodities

On the basis of its responsible investment policy, PGGM Vermogensbeheer B.V. (hereinafter 'PGGM') has adopted a position on investment in agricultural commodities. Further information on this position is set out below.

PGGM and responsible investment

Responsible investment is an important part of PGGM's investment policy. Responsible investment means that we consciously take account of environmental, social and good corporate governance factors in our investment activities. That may mean we make certain investments but refrain from others because we believe they would violate our responsible investment standards.

PGGM administers the assets of pension funds and implements the responsible investment policy on their behalf. PGGM reports to its clients on these activities and ensures transparency by publishing reports on its website.

Agricultural commodity prices are rising

Prices of agricultural commodities have risen sharply in recent years, and the rises are impacting food prices. That is a problem particularly for people living near or below the poverty level.

PGGM invests in agricultural commodities

PGGM invests directly and indirectly in agricultural commodities on behalf of its clients. It invests on a long-term basis. As an investment category, commodities provide a high degree of diversification relative to equities and bonds. By adding commodities to a portfolio of equities, fixed-income securities and real estate, PGGM expects to lower the overall risk in the portfolio

while maintaining the same expected return. Investing in commodities can provide PGGM a long-term return comparable to that on equities, despite the low to negative correlation. Through the Real Assets Investment category, PGGM invests directly in agricultural land and Agricultural businesses, including in Eastern Europe and Latin America. These investments are made in the actual process of producing agricultural commodities. Sustainable land management is exceptionally important in ensuring the long-term success of these investments in the primary sector. PGGM therefore developed and endorsed the Principles for Responsible Investment in Farmland¹, which were launched in September 2011.

¹ Position Paper PGGM – Investment in agricultural commodities

PGGM invests in commodities indirectly through derivatives² in a commodity index. A commodity index is a basket of futures contracts for various commodities, such as oil, gas, copper, grain, maize, cotton and meat. These futures contracts are traded in the commodity futures market³. The PGGM Commodities fund is a typical index investor; it has a long-term horizon and does not aim to achieve short-term speculative gains. We assess our commodity positions from a long-term portfolio perspective, not on the basis of expected short-term price movements. Our oil positions have the largest weight in our portfolio, 80%. Agricultural commodities and livestock farming jointly make up 10%.

Commodity investments and rising agricultural commodity prices

A great deal of research has been conducted into the impact that financial commodity investors have on rises and fluctuations in commodity prices. The various studies have reached very divergent conclusions. A great deal of attention has been focused particularly on agricultural commodities. On the one hand, there are studies concluding that financial commodity investors disrupt the market in agricultural commodities, leading to rising prices and wider fluctuations⁴, whereas others⁵ conclude that prices of agricultural commodities on the world market are determined by relationships between supply and demand, rather than by financial commodity investors. These studies cite structurally higher demand for agricultural commodities. The main reasons given are as follows:

- The global population has increased and become more affluent, leading to changed diet patterns and particularly rising meat consumption. This has an impact on demand

for grain, for example, for use in animal feed, but also on demand for the livestock itself.

- Factors such as import and export regulations, which may structurally disrupt the supply/demand balance.
- Failed harvests due to drought or excessive rainfall can temporarily reduce supply.

Joint research by the FAO, IFAD, IMF, OECD, UNCTAD, WFP, the World Bank and the WTO commissioned by the G20⁶ describes the complexity of the issue in detail. This Group of international organisations backs the conclusion that agricultural commodity prices on the world market are determined by supply and demand relationships. It is also noted that financial commodity investors are necessary in the futures markets. They play an important role by insuring against risks of large rises and falls in prices.

They provide liquidity by buying and selling futures contracts. That means non-financial operators in this market can find counterparties relatively cheaply in order to enter into contracts. If there were too few financial participants in the market, liquidity would be too low, with the possibility of large seasonal price movements. An excessively large number of financial participants could also result in wide price fluctuations. This is the case when these parties assume that past developments carry information on future price movements, giving rise to trend chasing. This will result in buying after prices rise and selling after prices fall.

PGGM applies a rebalancing methodology which can have a damping effect on the pricing of commodity futures contracts. Under this methodology, the current portfolio weight is reduced each month to the long-term strategic

portfolio weight. If commodity prices rise, the current weight will probably be higher than the strategic weight. The PGGM Commodity fund will therefore sell in rising markets. The reverse applies when commodity prices fall. The PGGM Commodity fund will then buy.

PGGM's position

PGGM is conscious of the international social debate surrounding the role of investors in the pricing of agricultural commodities worldwide, particularly with regard to indirect investments in futures markets. PGGM views this as an important debate, because the protection of human rights, as set out in the Universal Declaration of Human Rights, is an important part of our responsible investment policy. The Universal Declaration includes the right to a standard of living adequate for health and well-being. Food plays an important role in that regard.

Having considered a great deal of research, its own experience and internal discussions, PGGM is convinced that long-term commodity price trends in the world market are determined by relationships between the supply of and demand for physical commodities.

Not having transportation and storage facilities, PGGM can neither receive physical commodities from the market nor deliver them to the market. PGGM is accordingly unable to influence the structural supply of and demand for physical commodities. The long-term commodity price trend is therefore a given parameter as far as PGGM is concerned.

Important information

This document is provided solely for information purposes and does not constitute a recommendation or an invitation to buy or an offer to sell securities or other financial instruments. Third parties cannot derive any rights from this document. PGGM Vermogensbeheer B.V. has taken all reasonable care to ensure the reliability of this material, but accepts no liability for printing and typesetting errors. PGGM Vermogensbeheer B.V. reserves the right to modify this position.

1. http://www.unpri.org/commodities/Farmland%20Principles_Sept2011_final.pdf

2. These are derivative financial instruments, i.e. financial contracts in which the value is derived from that of an underlying asset (e.g. a share, a benchmark price or an index, such as the Dutch AEX). The main forms of derivative are options, futures contracts and forward contracts.

3. For most commodities, there are exchanges on which commodities are bought and sold. These handle more than just buying and selling. Operators can also insure against risks of large rises or falls in prices by buying or selling future commodity delivery 'rights' or 'obligations' in the futures market. This futures market is also used by financial participants such as PGGM to invest in the commodity market.

4. For example Christian Aid, *Hungry for Justice: Fighting Starvation In An Age Of Plenty*, May 2011

5. For example International Food Policy Research Institute, *High Food Prices: The What, Who, and How of Proposed Policy Actions*, 2008

6. *Price Volatility in Food and Agricultural Markets: Policy Responses - Policy Report* including contributions by FAO

(Food and Agricultural Organisation of the UN), IFAD (International Fund for Agricultural Development), IMF, OECD, UNCTAD

(United Nations Conference on Trade and Development), WFP (World Food Program), the World Bank, the WTO (World Trade Organization),

FPRI (International Food Policy Research Institute) and the UN HLTf (UN High Level Task Force on Food Security), 2 June 2011

PGGM N.V.

Noordweg-Noord 150
Postbus 117, 3700 AC Zeist
www.pggm.nl
K.v.K. 30228472

