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*Ruminations of*  
**The Contrary Investor**

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### **Seeds of Change**

Anyone paying even the slightest attention to global commodities' markets and prices, whether precious metals, industrial metals, rubber, grains — essentially all raw materials and resources — has witnessed what many call a “supercycle” of increased demand, driven in large part by China and India. The Contrary Investor believes this is a trend that will continue for many years to come. Greater demand for consumer goods, food and fuel is being supported by gains in per capita income, particularly in developing countries and markets.

One area experiencing ongoing substantial growth is in genetically-modified (“GM”) seeds and crops. Between 1997 and 2009, the total surface area of land globally cultivated with GMs had increased by a factor of 80, from 17,000 km<sup>2</sup> (4.2 million acres) to 1,340,000 km<sup>2</sup> (331 million acres). Although most GM crops are grown in North America, in recent years there has been rapid growth in the area sown in developing countries. For instance in 2009 the largest increase in crop area planted to GM crops (soybeans) was in Brazil (214,000 km<sup>2</sup> in 2009 versus 158,000 km<sup>2</sup> in 2008). There has also been rapid and continuing expansion of GM cotton varieties in India since 2002. (Cotton is a major source of vegetable cooking oil and animal feed.) In 2009 84,000 km<sup>2</sup> of GM cotton were harvested in India (87 percent of cotton produced in India was based on GM cotton).

In the US, by 2009/2010, 93 percent of the planted area of soybeans, 93 percent of cotton, 86 percent of corn and 95 percent of the sugar beets were genetically modified varieties.

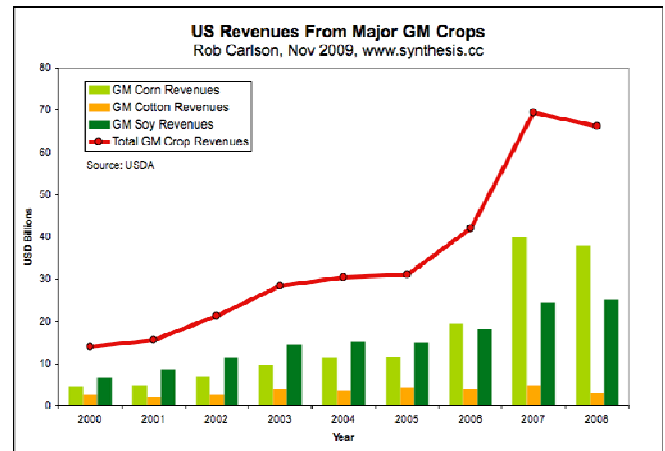
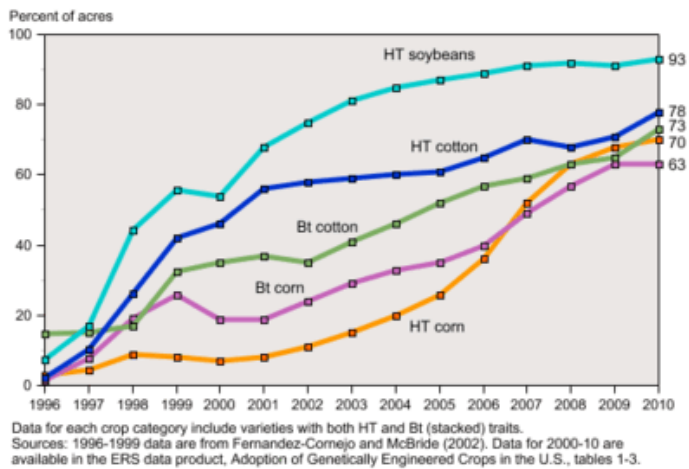
Genetically modified soybeans carried herbicide-tolerant traits only, but maize and cotton carried both herbicide tolerance and insect protection traits.

The benefits supporters of GM seeds and crops offer include higher yield, increased nutritional qualities, lowered use of pesticides, and better profitability, among others. But the movement is not without its detractors. Some scientific studies have concluded that GM varieties do not produce higher yields than normal crops, and that herbicide usage actually increased. The political hot potato becomes even more controversial as the discussion turns to world food shortages as the result of poor distribution of existing food supplies — essentially, many believe we have enough food in the world, but it is not getting to the people who need it most due to politics and distribution practices, not production.

One significant challenge to increased planting of GM seeds is that they are “transgenic”, or non-renewable, meaning new seeds must be purchased for each planting. Farm-saved seeds from conventional crops can be re-used year after year. But one simple example of the comparative economics illustrates the situation on the ground. Farmers in India earned about \$150 more per acre by buying GM cotton seeds for about \$4 per acre — a clear cost/benefit win. The fact remains that the trend toward the use of GMs is huge and not likely to go away.

The two biggest players in the global GM space are Monsanto, the world's largest seed producer, and DuPont, through its subsidiary Pioneer Hi-Bred. Both companies are investing significant R&D dollars, and are expanding aggressively into Africa, India, and other areas where farming remains the way of life for the populace.

### Rapid growth in adoption of genetically engineered crops continues in the U.S.



How big is the market for GM seeds? Monsanto operates in two segments - 1) Seeds and Genomics, which includes the company's global seeds and related traits business, as well as biotechnology platforms, and 2) Agricultural Productivity, which consists of the crop protection products and lawn-and-garden herbicide products. The company is now focusing more on the lucrative seeds business, which is less competitive.

Net sales of seeds and genomics for the quarter ended June 30th increased 5 percent to \$2.36 billion from \$2.25 billion in the year-ago period. Corn seed and traits net sales were flat with the year-ago period, while soybean seeds and traits sales edged up slightly. Cotton seed and traits sales increased 26 percent, while sales for the vegetable seeds business declined slightly. \$2.36 billion worth of seeds sold in a three-month period is a lot of seeds!

And rising prices for commodities have inevitably led to the ability of seed producers to raise their prices. In 2008, total GM seed sales were about \$4 billion, with the total spent on GM crops and seeds topping \$85 billion. In 2007, food and crop prices hit short-term peaks, but have since resumed their inexorable climb as demand regained traction.

Microsoft founder Bill Gates, who is a pretty smart guy, threw the support of his foundation behind GM seed projects in Africa beginning in 2008 (though not without protests from environmental groups).

The Contrary Investor is not taking a position in what has always been an issue surrounded by highly-charged emotions, and one where both sides of the issue have basically agreed to disagree. But the simple forces of supply and demand for food are working in overdrive as economies will continue to develop. Investors may want to plant a few seeds themselves.

□ Alex Seagle

¡Muy Bien!

Hispanic spending power in the US is leading the way, and predicted to only increase in the coming years. In 1990, Hispanic buying power stood at \$200 billion a year. In 2007 Hispanic spending power stood at \$860 billion a year according to that the same study source. In 2011, Hispanic spending power is estimated at \$1.2 trillion a year according to the U.S. Census. By 2010, Hispanic spending power is expected to represent 11 percent of the total spending power of the US population. And Hispanic wealth is growing at all levels. In 1995, 11.5 percent of Hispanics earned over \$100,000 a year; by 2000, it was 16.5 percent. Interestingly, 25 percent of Hispanics control 93 percent of the US Hispanic wealth market – a much broader distribution than the US at large.

While the American economy floundered, and consumers as a whole tightened their belts, the growth in Hispanic spending was twice the growth in general market spending, according to a

December 2009 analysis of consumer expenditures and corporate growth strategies by the Latinum Network. The Latinum analysis shows that non-Hispanic consumer spending from 2005 to 2008 grew only 2.9 percent, while Hispanic consumer spending increased 6.4 percent in that same period. The Latinum report is the first in-depth analysis of the latest figures from the U.S. Bureau of Labor Statistics on spending behavior as it relates to the Hispanic community.

The Latinum report reveals that significant commercial opportunities exist in major categories where Hispanic consumer spending growth far outpaced the general market. The major categories include cereals, computers, education, fees and admissions, food away from home, laundry and cleaning supplies, major appliances, vehicle finance and insurance, women's apparel, and a range of other categories. For example, from 2007 to 2008:

US Hispanic consumers were responsible for 30 percent of the \$40 billion growth in the food business;

US Hispanics spent 58 percent more on education compared to a much more modest increase of 9 percent for non-Hispanics;

US Hispanics increased their entertainment spending on fees and admissions by 14 percent, as compared to a 7 percent decline for non-Hispanics.

In this economic environment, categories such as these provide opportunities for brands to grow 'organically' by maintaining or increasing their share of an expanding pie. At the same time, savvy companies are investing in the development of categories where Hispanic spending has been relatively low but is poised to take off.

Latinum's analysis also shows that the highest spending power among U.S. Hispanics is concentrated among those who are increasingly upwardly mobile, yet still influenced heavily by traditional cultural norms. "As companies look to accelerate growth in 2010, brands that ignore, or misread, the impact of cultural factors on purchasing behaviors may leave the lion's share of US Hispanic buying power on the table. This

segment within the Hispanic market represents an attractive growth opportunity for many companies which have traditionally targeted their incremental investments on the "unacculturated" consumer. They're growing in number, they have the most money to spend, they behave more like general market customers in terms of what products they buy and how much they spend, yet they still respond well to culturally-relevant messages," according to the report.

Latinum Network is the first-ever business network devoted exclusively to helping corporations penetrate the U.S. Hispanic market. It is dedicated to providing its more than 20 member brands including Clorox, H&R Block, Kraft Foods, Mazola, McDonald's, Nestle, Sara Lee Corporation, 7-Eleven, Splenda, and Subway with market insights that enables them to evaluate their opportunities, and accelerate their performance in the market.

Companies — and investors — that ignore the Hispanic market do so at their peril. Demographic trends are powerful forces. Those that understand the subtleties of the Hispanic market are likely to outperform their competition. Hispanics are very loyal and very distinctive in their buying habits. As a completely unscientific, anecdotal example, consider when was the last time you sat next to an Hispanic family at a Thai restaurant. Hispanics' spending on at-home food is off the charts compared to their Caucasian and African-American counterparts. Hispanic women spend far more on cosmetics, and the makers of high-end makeup are realizing this and accommodating the trend. The key to understanding the Hispanic market is to realize that as it grows, its members are not merely blending into the American melting pot. They are remaining true to their heritage and traditions.

Salsa is the best-selling condiment in the US, and the margarita is the number one cocktail. Don't tell me this trend is going away any time soon!



□ Alex Seagle

*El Sombrero*

## Smelling Like a Rose

Water continues to be a subject of great interest, increasingly so as it pertains to investment opportunities, and with good reason. A liter of bottled water is more valuable – or at least more expensive – than a liter of oil. Water is one of the rare "fugitive resources," that is, a different good at different stages of the hydrologic cycle. At times (when in the form of a cloud, a river, or a lake), water is an open-access resource; at others (as reserves in a dam or as sewage), it is a public good; at still others (as tap or irrigation water), it can be privatized and sometimes even marketed, say, into bottled water.

There is one unmentionable side of water: sewage. Industries around the world have long recognized the economic and environmental benefits of reusing water, but the public utilities have lagged behind. Even after it is treated, sewage water is usually considered something that should be disposed of in the least harmful manner. Treating sewage is also costly. In the United States alone, according to Peter Rogers and Susan Leal, the authors of Running out of Water, a recently published book, investment in sewer infrastructure falls short by more than \$20 billion every year. Once the infrastructure is in place, it is hard to maintain, and compared to developing more water supplies, building and keeping up sewers is a difficult sell to policymakers and users.

As Rogers and Leal argue, however, sewage is waste only so long as it is treated as waste. It can be a resource. Some of their book's most interesting cases are about how to turn wastewater into an asset. Treated sewage is increasingly becoming a low-cost alternative to more traditional water supplies. It has been used to recharge ground-water reserves in Orange County, California, and to help generate geothermal power in northern California. Japan is arranging to send its sewage water to Australian mines to supplement scarce local water supplies. And in Singapore, wastewater is so thoroughly treated that the high-tech industry uses it in processes that require highly pure water.

The book also implies that if bold action is necessary and sometimes requires huge investments and large

projects, it also calls for more than that. Engagement on the part of the public, especially the people who will foot the bills for increased usage and buy the public bonds that will finance new sewerage infrastructure, is also needed. Whether in California or Singapore or elsewhere, government agencies thus need to explain to the public what problems need fixing, why, and how.



Aerial view of a typical wastewater treatment plant

So where to look to invest in sewage? Water and wastewater facilities are broadly grouped in municipality-run and privately-run entities. The private providers are known as PCIs, or

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“private, commercial and institutional” facilities. As has been seen so many times in the recent history of water investing, smaller, more focused companies that are successful are gobbled up by larger corporations. An example is PCI Membranes, a specialist in filtration and separation systems critical to meeting the stringent requirements for wastewater discharge quality in industries including food, pharmaceuticals, chemicals, textiles and petrochemicals, as well as tackling the growing challenges in drinking water treatment. The company was launched in 1967, and was acquired by ITT Corporation in 2003.

ITT is an interesting company with about one-third of their revenue coming from the “fluid technology” division, an \$8.5 billion market cap, and a healthy dividend. There are, of course, much more speculative companies trading outside the US markets like Hyflux and Sembcorp. Virtually all the players in wastewater are very much global in their reach, from the US to Asia and Africa and South America. The technologies utilized are incredibly sophisticated, with names like “Thermophilic Membrane Bioreactors,” but at the end of the day the process involves the removal or treatment of organic and inorganic contaminants in the sewage.

Perhaps a better play on this theme is Chicago-based Nalco Holding Company (NYSE: NCL). NCL has over 70,000 customers in 130 countries. Warren Buffet’s Berkshire Hathaway recently increased their original stake of 8.7 million shares, purchased in 2009, in the company by 150,000 shares, which is never a bad indication. As an aside, Nalco’s Corexit product is an oil dispersant that was widely used in the oil spill disaster in the Gulf of Mexico. In 1964 the company was publicly traded on the New York Stock Exchange under the name Nalco Chemical Company until a French company, Suez, purchased it in 1999. After a name change to Ondeo, Nalco Company then underwent another change in ownership in 2003 and came public as a separate entity again, returning to the NYSE in late 2004 under the name Nalco Holding Company.

Nalco is the world’s largest provider of industrial water treatment services, but came onto the radar screen of many investors only as a result of their selling about \$40 billion worth of oil dispersants to address the BP oil spill. In a normal year, dispersant sales account for only about \$2 billion or 1 percent of profits for the company. But NLC would prefer to clean up water rather than oil.

Wastewater treatment, and the infrastructure associated therewith is clearly going to garner a bunch of money going forward, and the Contrary Investor would urge those interested to drink the Kool-Aid.

□ Alex Seagle

## A Note On Contrarian Investing

It seems that over the past decade or so — rightly or wrongly — contrarian investing has morphed from Jim Fraser and Humphrey Neill’s original notion of independent thinking and the identification of overlooked and under-appreciated trends into a synonym for “deep value” investing. About the time this issue of *Ruminations of the Contrary Investor* was going to press, Monsanto (see the first article “Seeds of Change” herein) shares plunged on reports that their highly-touted SmartStax corn seeds had failed to meet expectations. We won’t argue whether or not deep value equals contrarian, as we have gone through those gyrations for some time now. But for those who do buy into that notion, Monsanto might have just become a pretty good value play with a much higher dividend yield as a result of the bad news.



□ Alex Seagle

## Words to Consider

I had no idea how much I liked fishing until I realized all the shopping involved.

~ Niles Crane

There can be few literary works in any language as poetic as a room-service menu. It is rare, however, to spend a night in a hotel and order anything other than a club sandwich.

~ Alain de Botton

It is easier to forgive an enemy than to forgive a friend.

~ William Blake

A good film is when the price of the dinner, the theatre admission, and the babysitter were worth it.

~ Alfred Hitchcock

Man is the animal that intends to continue to shoot himself out into interplanetary space, after having given up on the problem of an efficient way to get himself five miles to work and back each day.

~ Bill Vaughan

Most of the change we think we see in life is due to truths being in and out of favor.

~ Robert Frost

A judge is a law student who marks his own examination papers.

~ H. L. Mencken

Human beings are the only creatures on earth that allow their children to come back home.

~ Bill Cosby

### *A Blatant Plug*

*In case you didn't know, Fraser Management Associates manages money for individuals and institutions on a fee-based platform, utilizing the thematic philosophy espoused in this newsletter. Despite the ramblings presented in this humble missive, we think we're pretty good at it. It would be our pleasure and honor to provide information on our holdings, history and performance for anyone interested in an alternative to more traditional and mundane offerings. Since present management took over the reins from Jim Fraser in 2004, our focus and commitment has been to preserve, protect and hopefully enhance every aspect of the wonderful legacy our founder began many years ago. Give us a call at 802.658.0322, or shoot an email to alex@fraser.com.*

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