Forget El Niño: La Niña Poised to Storm the Markets

As one climate phenomenon peaks, investors brace for the impact on crops of the next disruptive weather pattern

A single soybean plant grows in a field near Salto, Argentina in 2012. Over the 12 months following the confirmation of a La Niña in July 2010, the price of soybeans rose about 39% on the Chicago Board of Trade. ENLARGE

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HONG KONG—As El Niño reaches its peak this winter, investors are already bracing for its sister climate phenomenon, La Niña, to be next to upend weather patterns and potentially wreak havoc on the agricultural commodity market.

Government forecasters in Australia and Japan have in recent weeks said the current El Niño may already have peaked and will ease through the first half of 2016 as temperatures cool on the subsurface of the eastern Pacific Ocean.

By the start of December, this year's El Niño—the strongest since 1997-1998—had caused sea surface temperatures to rise by more than 3.6 degrees Fahrenheit in places, and driven a rally in agricultural commodities such as palm oil, sugar and dairy.

The end of an El Niño event is often followed by the reversal of the phenomenon, known as La Niña, although that isn't a given. While El Niño and its impact might be better known, prices for crops such as soy, corn and wheat can move around 50% more during a La Niña event, based on a measure of the volatility of prices, said Erik Norland, senior economist at CME Group from New York.

"The likelihood that the current El Niño peaks soon and turns into a potentially strong La Niña by late 2016 or early 2017 is something that participants in agricultural markets should track closely," Mr. Norland said.

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La Niña occurs when easterly trade winds strengthen. That cools water across the central and eastern Pacific Ocean, which in turn can upend weather around the world. The severity of the phenomenon is measured by ocean temperatures and changes in wind patterns. It typically brings drier-than-usual weather to some states in the U.S. and South America and causes wetter-than-normal conditions for much of Australia, Papua New Guinea, Indonesia and Central America. It also increases the likelihood of tropical cyclones in the Pacific.

“El Niño gets all the buzz, but La Niña does not get enough credit,” said David Ubilava, a lecturer at the University of Sydney’s School of Economics, who has written on the correlation between climate anomalies and commodity prices. For example, Canada and the U.S. are more likely to get more droughts in La Niña years than during an El Niño year, which can tighten food supplies and push up prices, Mr. Ubilava said.

“A strong La Niña phenomenon could potentially have a greater impact on agricultural markets than El Niño, as it affects weather in several key producers and exporters of a large number of commodities, namely the U.S. and Brazil,” said Aurelia Britsch, senior commodities analyst at BMI Research. BMI Research sees La Niña as posing its biggest risks to corn, soybeans, wheat, sugar, cotton and coffee.

An irrigation system sprays water over a corn field near Los Indios, Argentina in 2012 when La Niña brought hot, dry weather ENLARGE

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Over the 12 months following the confirmation of a La Niña in July 2010, wheat on the Chicago Board of Trade rallied around 21% and soybeans rose around 39%, while the benchmark sugar contract in New York was up 67%.

There remains no way to anticipate whether a La Niña event will occur or how severe the impact will be. However, La Niña events have followed 11 of the last 15 El Niño events, according to the Japan Meteorological Agency.

The impact of La Niña may not be limited to agriculture. The La Niña that lasted from 1998 through to 2000 caused colder-than-normal winters in the U.S. and Canada, sending prices of natural gas higher, according to CME Group.

Adrian Redlich, chief investment officer at Merricks Capital, a Melbourne-based firm that runs a US$350 million soft-commodities fund, said investors could be underestimating the impact of the current El Niño and the possible La Niña.

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—Adrian Redlich, chief investment officer at Merricks Capital

“The option market is pricing very low price volatility for oil seeds versus wheat or sugar. What the market is saying is there is not a huge fear that the price is going to go up dramatically. This complacency represents the opportunity,” Mr. Redlich said.

Palm-oil production in Indonesia and Malaysia and rapeseed production in India are expected to be poor in the first half of 2016. If that is backed up with a La Niña that could impact oil-seed production in the U.S. Midwest, then supply of oil seeds could tighten significantly, pushing prices higher, he added.

The opportunities aren’t limited to commodities, said Michael Underhill, chief investment officer at Wisconsin-based Capital Innovations, which has nearly US$1 billion of assets under management.

With prices of a number of U.S.-grown commodities likely to rise during a La Niña, farmers may have more money to spend on the likes of tractors, boosting the bottom lines of companies such as Deere & Co., which manufactures John Deere products, and AGCO Corp., he said.

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