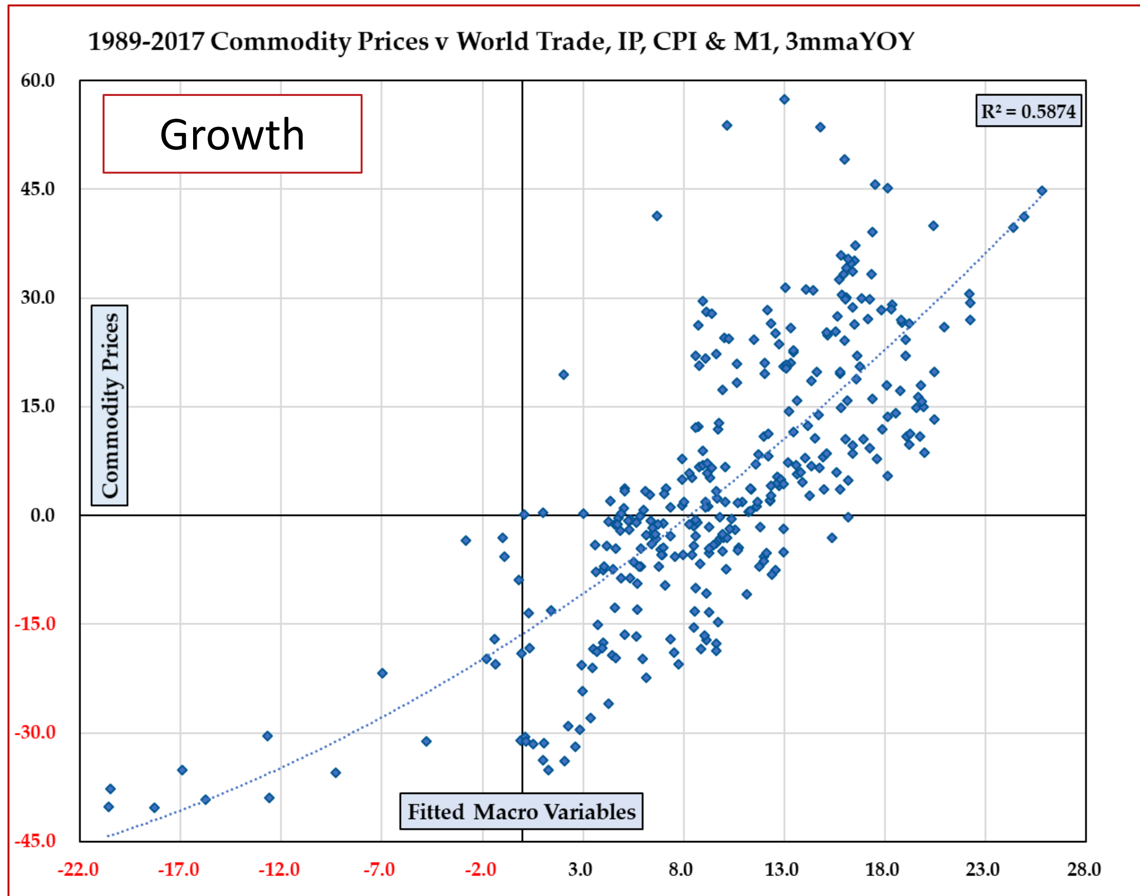
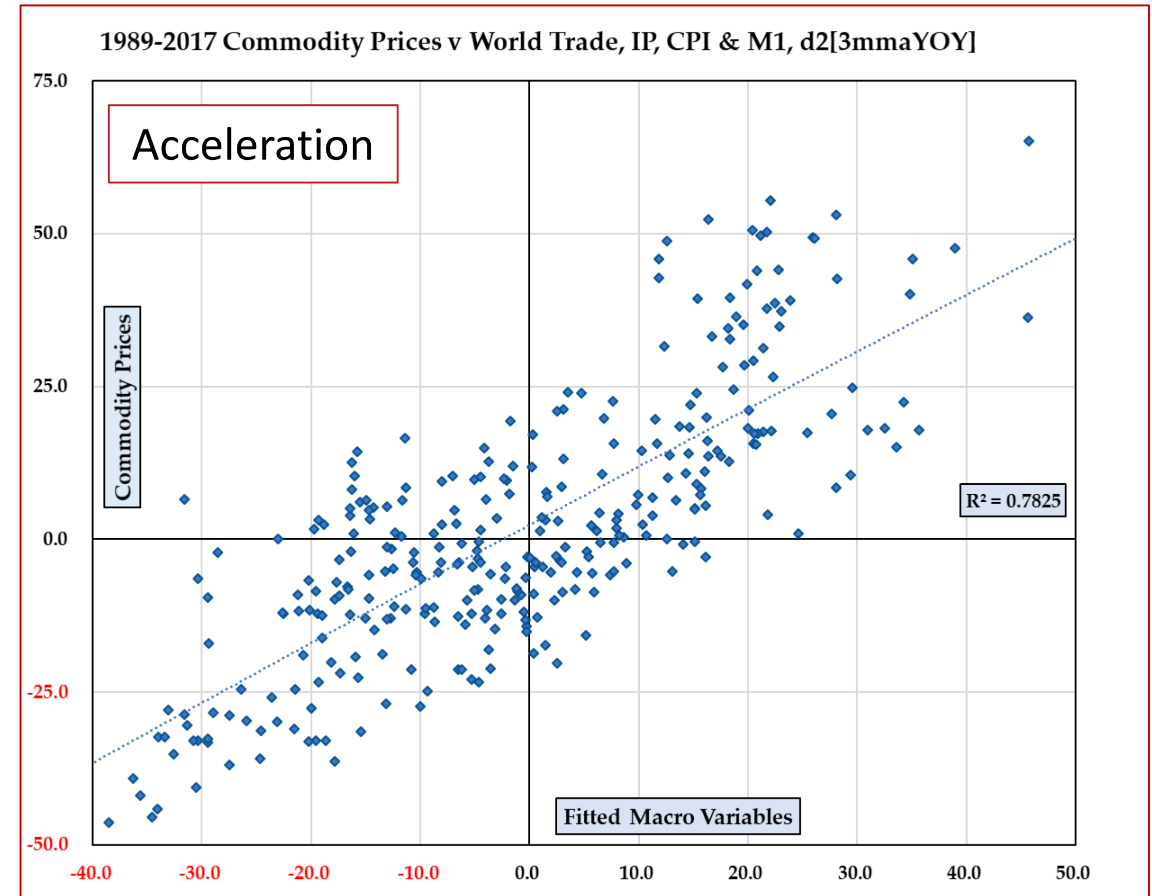
Why commodities?

They reflect real world trends

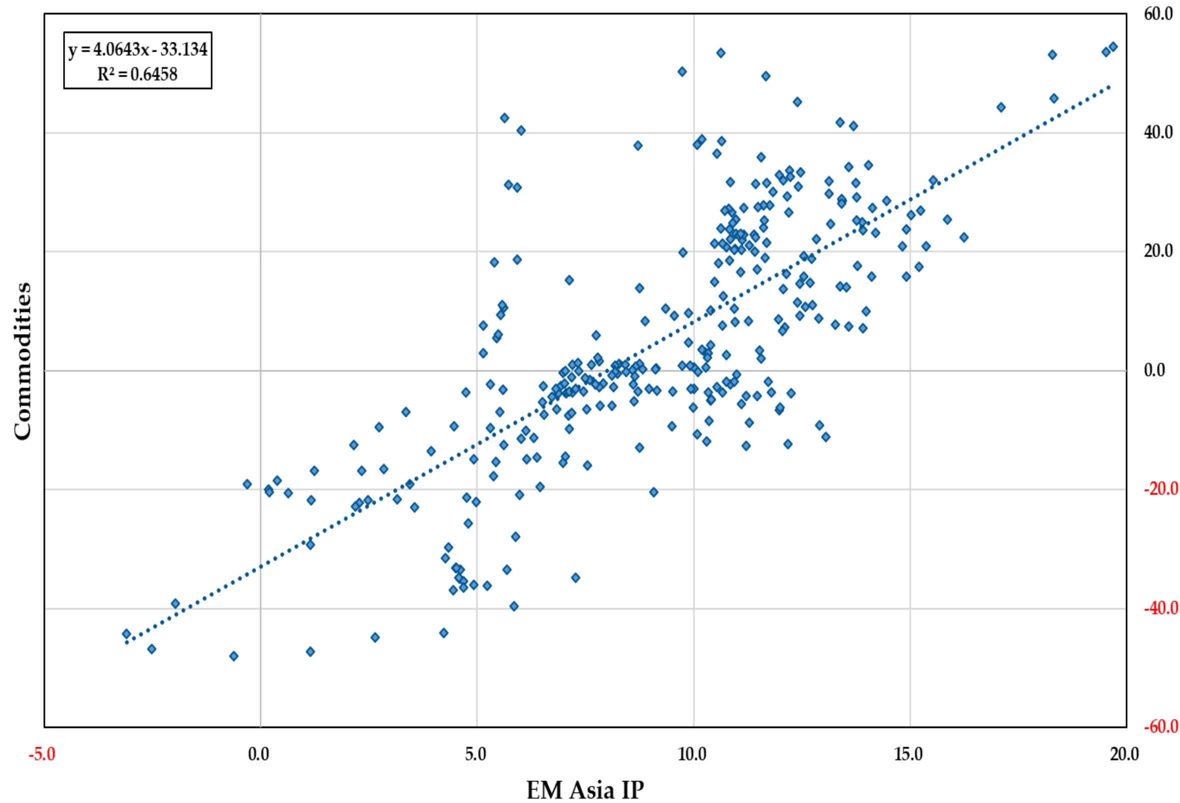


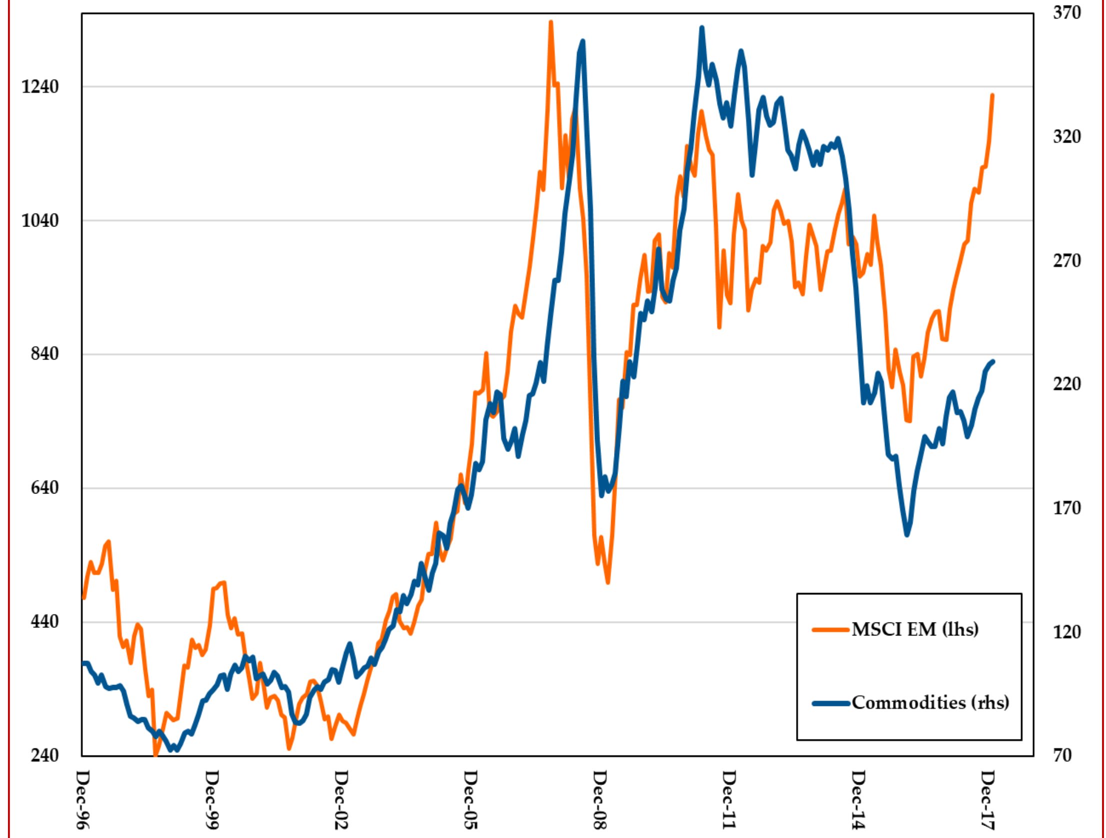


Economic growth can hardly take place without some increase in the demand for commodities, even if entrepreneurial search and technical innovation may eventually find ways to make a given quantity go further. Increases – and especially *accelerations* – in trade, industrial output, consumer prices, and the supply of money and credit by means of which to exchange their fruits are all intimately interlinked with commodity prices.

Why commodities?

They mirror the rise of Asia

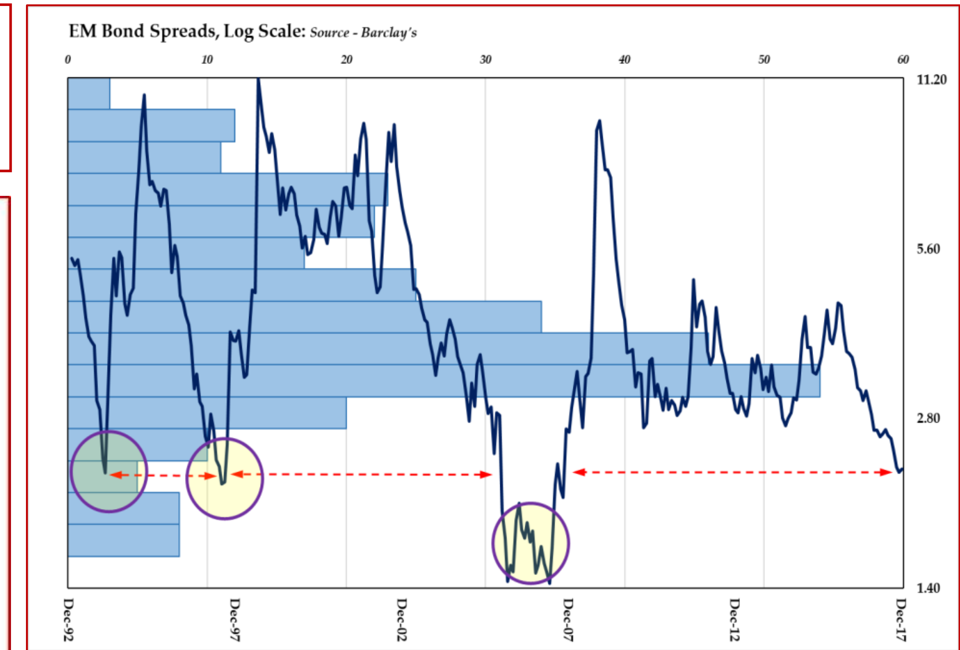


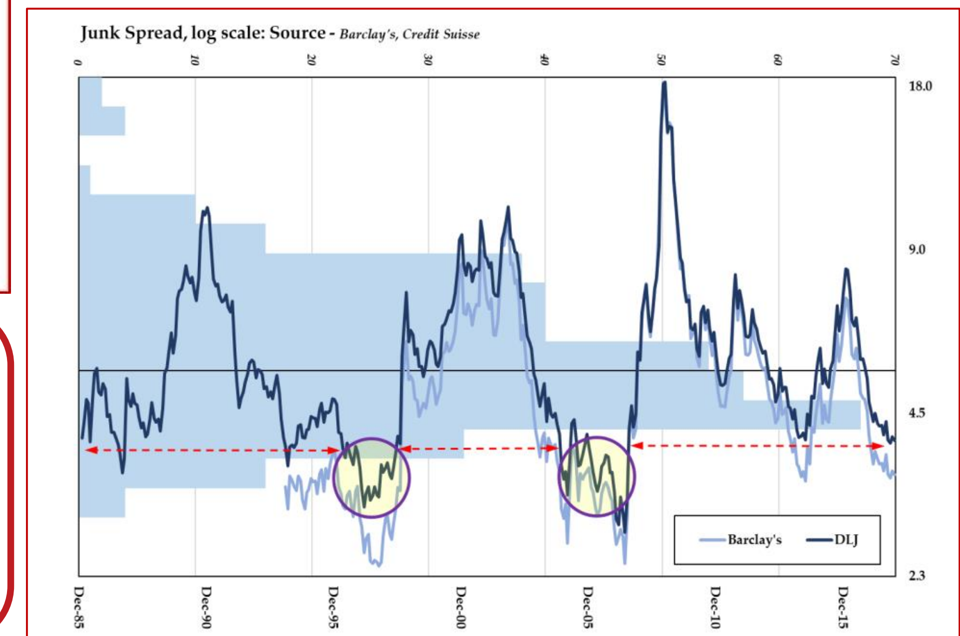


Mainstream investors have devoted increasing amounts of both time and money to the attempt to profit from the rising economic importance of Asia and other EMs. With the consumption related to the heavier kinds of growth concentrated in the former region and a preponderance of producers being found among the latter, commodities naturally have tended to mirror developments in these centres of widespread attention.

Why commodities?

They are not bonds: Pt I

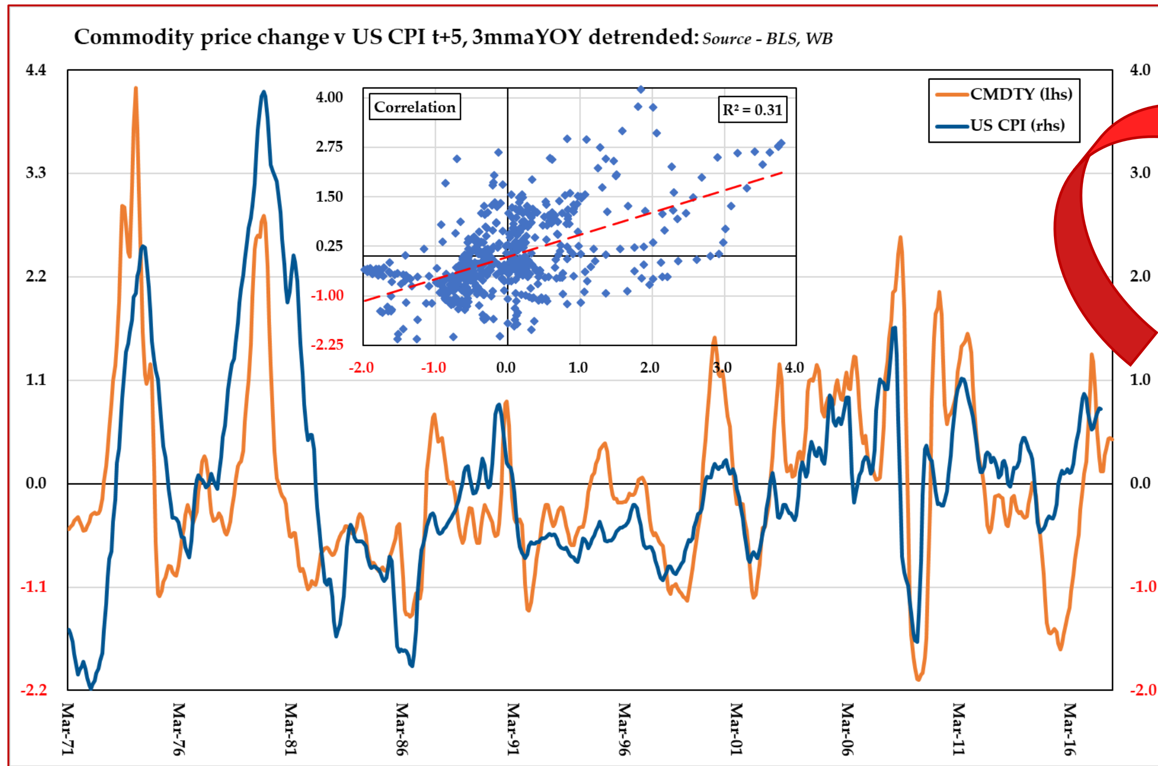


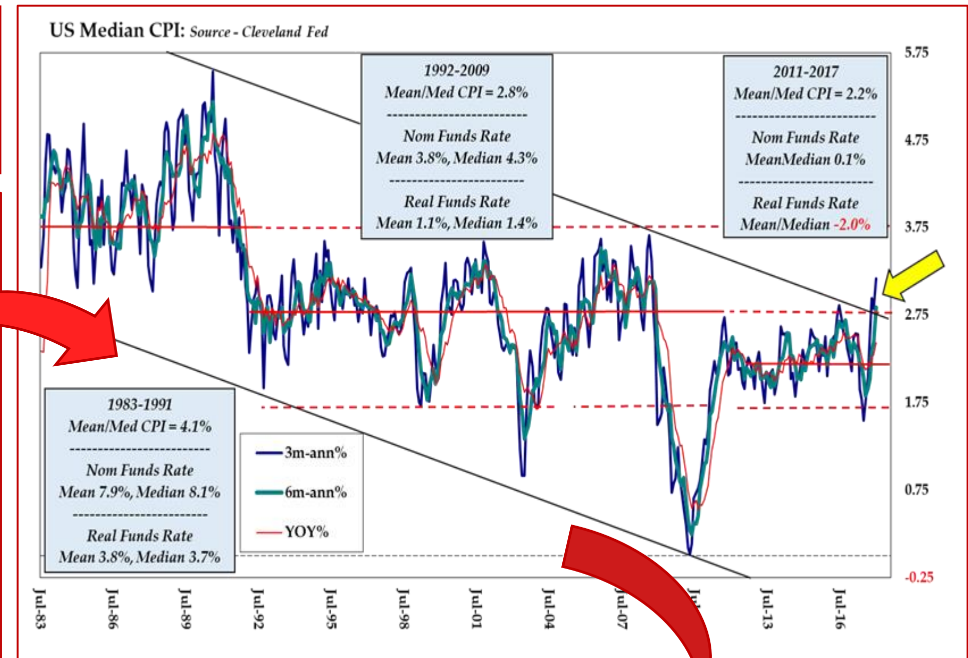


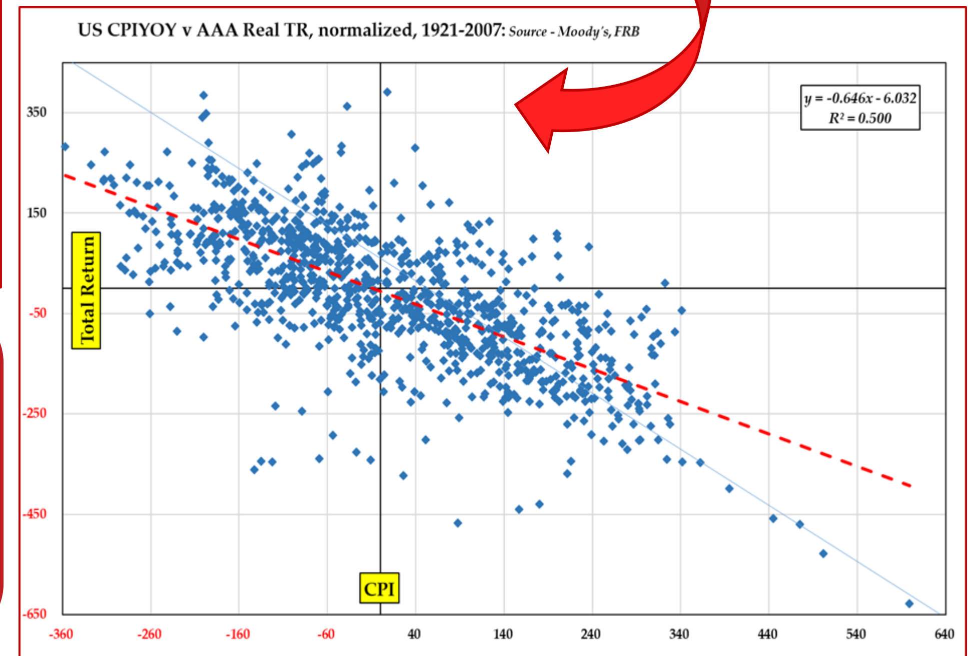
The long process of quantitative easing has slowly eroded many of the distinctions between traditional assets while greatly increasing their valuations. This combination means that returns are only to be had by accepting unusually high levels of risk (albeit, given the ongoing decline in the market's estimate of volatility, a risk not yet being openly expressed). Starting from extraordinarily low yields and spreads, the bond market – whose artificial pricing lies at the root of most other distortions – can hardly fail to disappoint, even absent a disaster.

Why commodities?

They are not bonds: Pt II





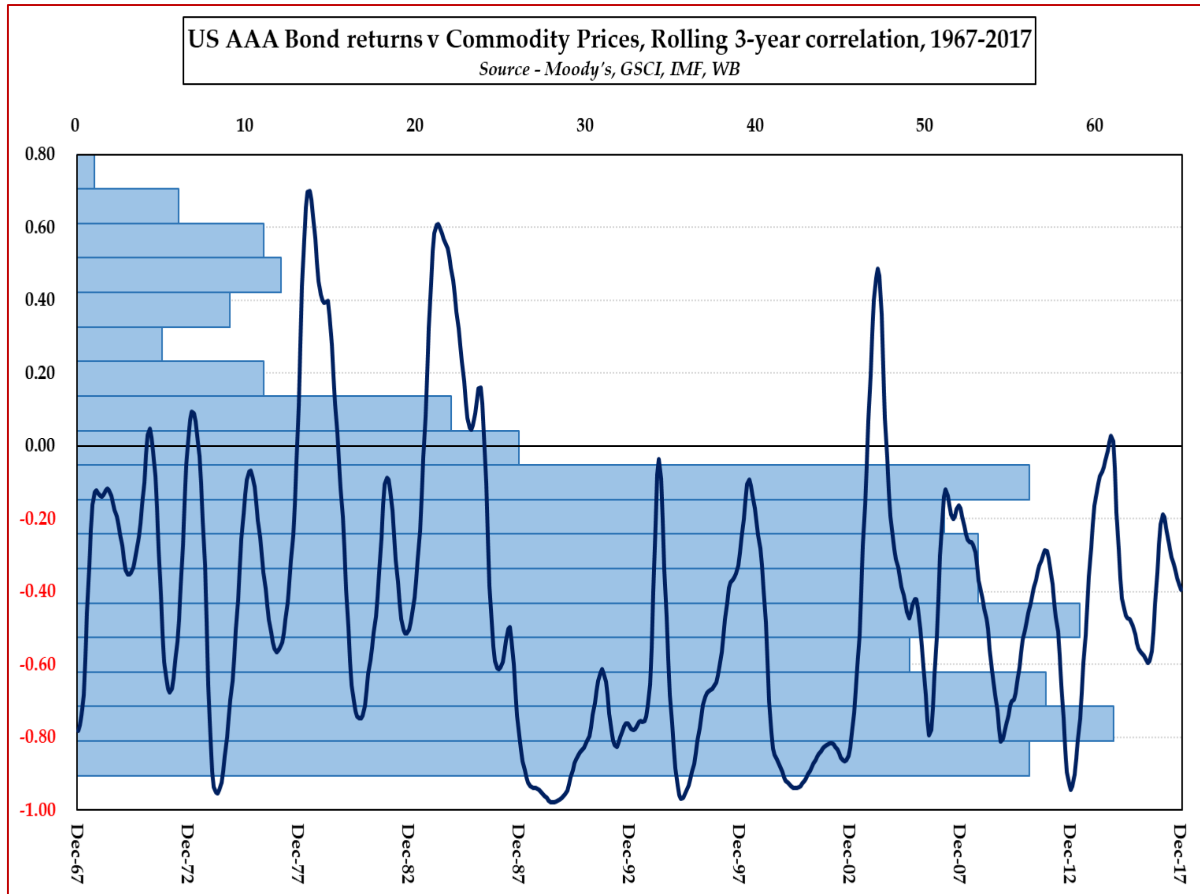


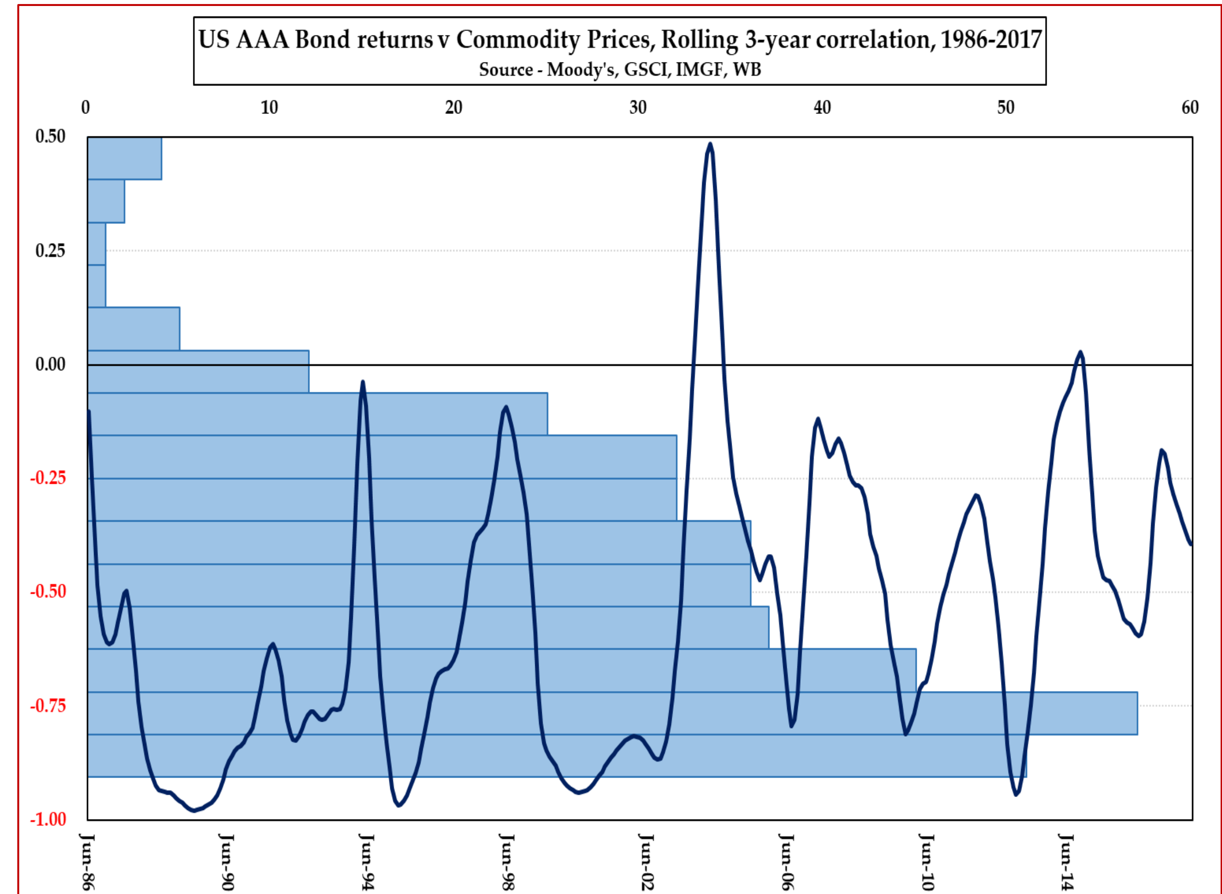
As the extraordinary support offered to bond prices by central bank activity at last passes its peak, there is far less of the 'Widow Maker' about fixed income markets, which are instead being left to face up to the other consequences of monetary laxity: gradually quickening consumer price rises (more closely linked to commodity trends than some might imagine) and greater levels of activity.

Is it any wonder anxiety is rising?

Why commodities?

They are not bonds: Pt III

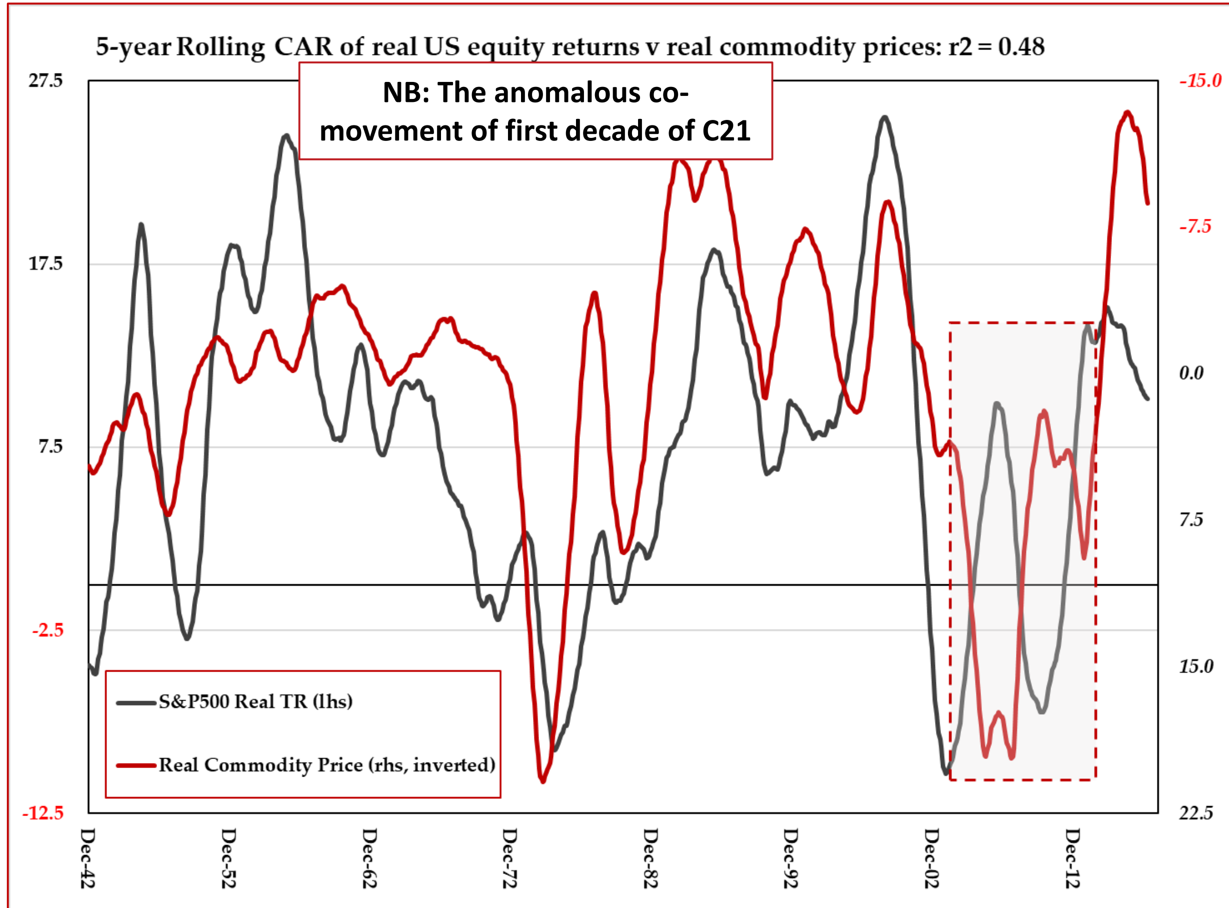


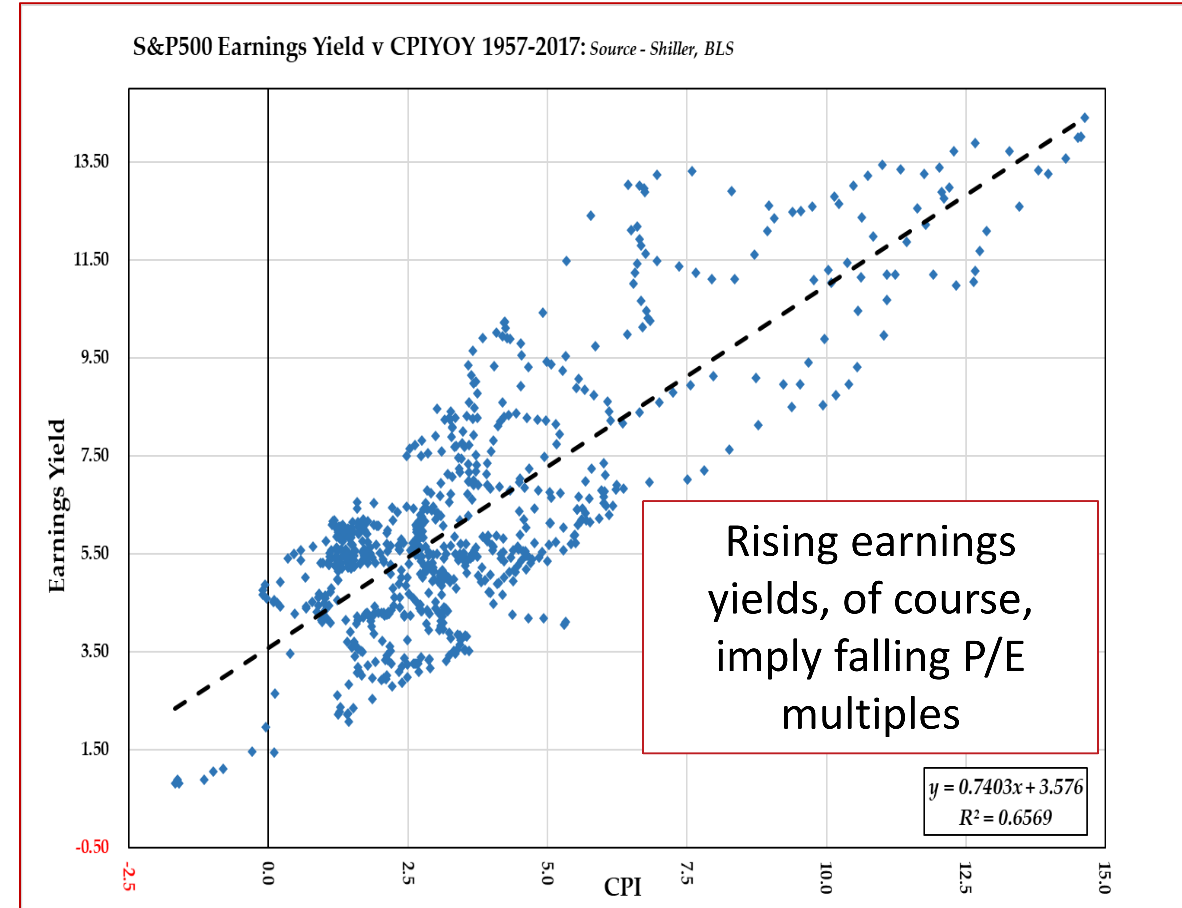


The primary consequence of the forgoing is that on only on three occasions in the past half-century - and only once in the past three decades – have commodity prices and bond returns moved in the same direction. If the relationship continues to hold – as logic suggests it should – commodities offer a perfect foil to the damage effected on portfolios by rising bond yields as their strong, negative correlation comes into play.

Why commodities?

They are not equities

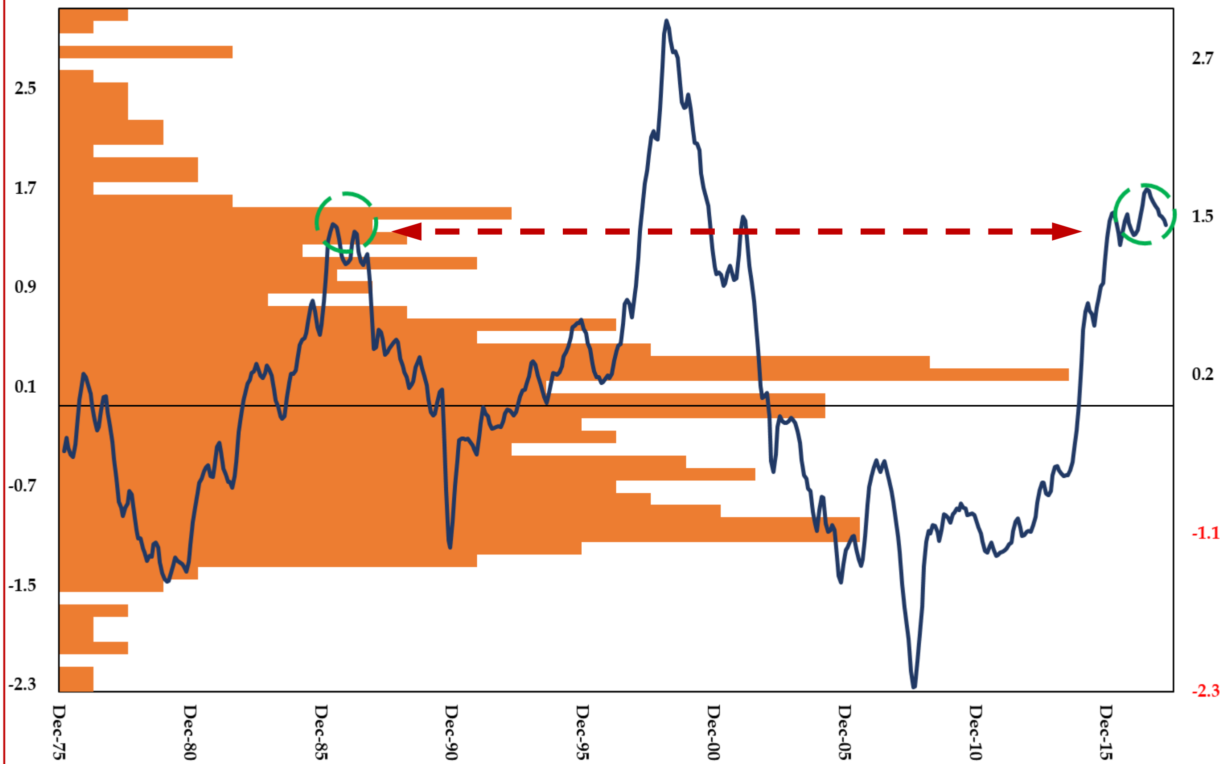


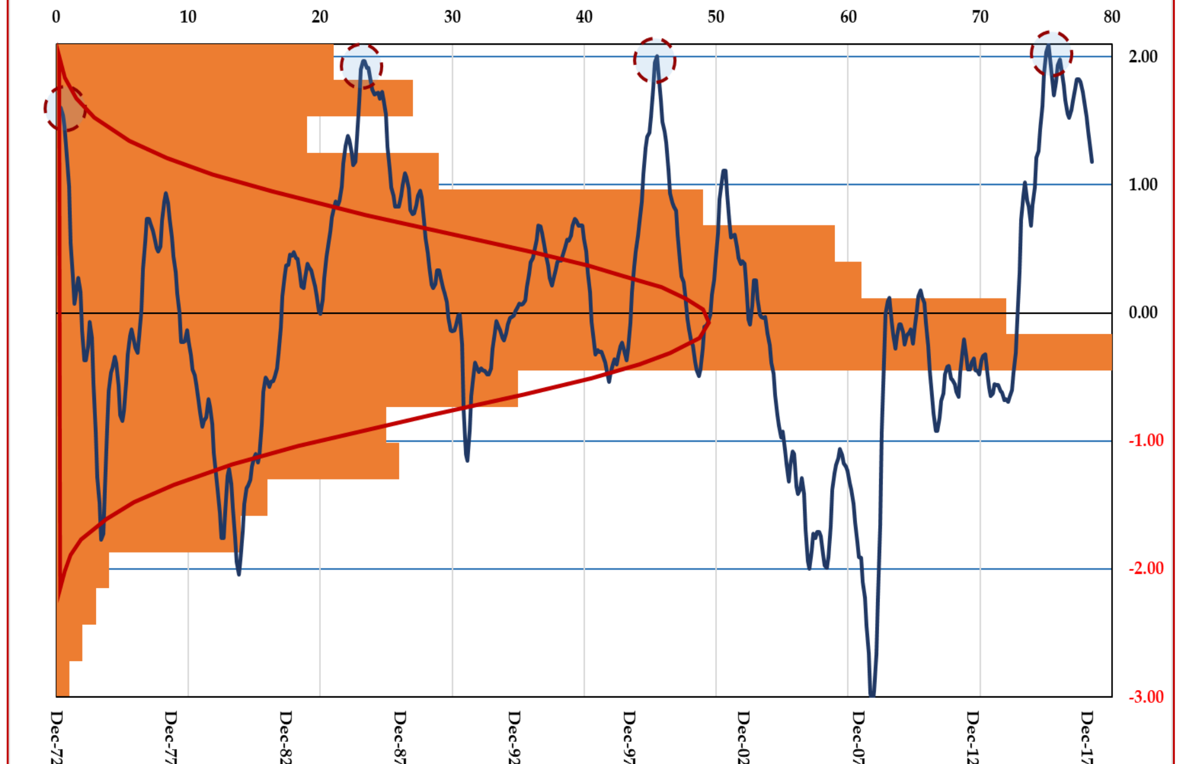


If we consider the whole post-war history, whenever commodity price have risen faster than – and, by implication, driven – changes in overall CPI, equities have tended to lose ground to such inflation. Further, be aware that the rise in general prices to which commodities are a major contributor limits equity performance principally by reducing multiples – which may therefore fall more than inflated revenues and earnings rise, leaving equity prices themselves in limbo.

Why commodities?

They are cheap to trend





US stocks – in terms of total returns – are as expensive as they have been in the modern era, vis-à-vis stocks in other developed markets despite these also setting new highs, Similarly, equity returns are at the extremes of their ranges with regard to bonds, while the latter are slowing and even turning negative (especially in inflation-adjusted terms). Both main asset classes are also far beyond the norms of their long-term trends relative to commodities with some sign that a measure of mean reversion has already set in. Timing may be very propitious, therefore.

Why commodities?

That trend may be reversing

Mar-07 Mar-11 Mar-15 Mar-19 Mar-23 Mar-27 Mar-31 Mar-35

Ratio 1990-2018 in grey (lower scale)

230.0
205.0
180.0
155.0
130.0

Ratio from 2007 to date in **red** (upper scale)

S&P500 Ex-Financials v Industrial Commodities
Log Scale: Source - S&P, WB

Mar-90 Mar-94 Mar-98 Mar-02 Mar-06 Mar-10 Mar-14 Mar-18

Note the similarity of the past decade's relative price performance to that which culminated in the Tech Bubble top. Note also that this relative move peaked then some 18 months and ~25% before the broad equity market itself topped out.