

Bullish Commodities Stocks

Out of their [dismal lows](#) in early March, the stock markets rocketed 27% higher in a single month! After such fast gains, Wall Street remained skeptical. Was this a typical bear rally that would soon collapse? But as the last couple weeks have shown, it didn't. Stocks not only held their rally gains, but they continued moving higher.

The result is the biggest advance since the stock panic ignited. Even more importantly, these recent gains have generally been measured and orderly. This is a signature of new bull markets in contrast to the violent and *short-lived* bear-market rallies. The persistent stock-market strength is restoring hope and leading [ostrich investors](#) back to the markets. They are wondering which sectors have the best potential to thrive.

For a variety of reasons I'll outline in this essay, I believe the commodities stocks will be the best-performing sector in the coming years. Their incredibly bullish fundamentals, combined with dirt-cheap prices driven by stock-panic psychology, have created one of the greatest investment opportunities I've ever seen. This bullish sector deserves a sizable fraction of every investor's portfolio.

In order to grasp commodities stocks' epic potential, you first have to consider the products they produce. Commodities are essential to everyday life. Everything physical in your world, from the home you live in to the energy that moves you around to the food you eat, is made from commodities. Without a never-ending flow of these raw materials, the vast majority of the world's population (everyone without hardcore survival skills) would soon be dead.

Thus perpetual demand exists for commodities. And this demand is growing globally. We in America are used to an incredibly rich standard of living fueled by heavy raw-materials consumption. And at least half the world, primarily Asia, is zealously striving to close the gigantic gap between its own standards of living and those we enjoy in the first world. The unstoppable juggernaut of Asian industrialization alone will consume commodities at levels far beyond anything ever before witnessed.

The resulting secular (long-term) commodities bull has already been exceedingly profitable to [early investors](#) like us. And it is far from over. The more Asians and Africans and South Americans taste better qualities of life for their families, the harder they work to accelerate their rate of material advancement. While their per-capita commodities consumption remains small relative to ours, their *aggregate* consumption is already enormous. Soon it will probably exceed that of the first world, if it hasn't already.

In the stock markets, any company's fundamentals are defined by its future profitability. If it has the potential to grow profits, if demand for its products is

likely to expand, its fundamentals are bullish. And few other companies enjoy such a guaranteed growing market as commodities producers. While demand for the latest technology gadget or pharmaceutical will collapse as soon as something better comes along, the world will always need the basic building blocks of our physical existence such as copper or fertilizer.

Even better for commodities producers, supply is constrained no matter how fast demand grows. Producing more metal is not like adding a factory to make more iPods. It is vastly more challenging. Between exploration for new deposits, planning and permitting mines, financing and building mines, and actually bringing new commodities to market takes over a decade. Sometimes multiple decades! So no matter how fast rising demand drives up prices, the natural supply response takes many years to unfold.

You certainly don't have to take my word for the bullish nature of commodities fundamentals. The best commodities index is the Continuous Commodity Index (CCI). Once known as [the CRB Index](#), it tracks the prices of 17 key commodities. With these components equally weighted and geometrically averaged, the CCI beautifully reflects overall commodities price trends. Here is a chart of the CCI (blue line) since 2001.



Between late 2001 and mid-2008 (just before the stock panic), the CCI soared 235% higher! Over this same span, the stock markets (S&P 500) merely rose 16%. As I predicted [in early 2001](#), commodities have indeed entered a secular bull that radically outperformed the stock markets. And due to the profits

leverage inherent in producing commodities, the commodities stocks have fared even better.

Any company producing a commodity has a roughly fixed cost of production. Consider copper as an example. If a company can mine copper for \$1 a pound, and its price is \$2, it can earn a \$1 profit for each pound it sells. But if copper rallies 50% to \$3, this company's profits don't just march up 50% with copper. Instead they *double*. Still producing at \$1 yet selling at \$3 yields a \$2 profit, twice as high. Thanks to this accelerating profits leverage, profits for producing rise far faster than underlying commodities prices.

As this CCI chart reveals, speculators did flood into commodities in early 2008. After more than 6 years of rallying with little fanfare, mainstream investors finally started getting interested in commodities stocks in late 2007. But in early 2008 commodities grew overbought and due for a correction, and it started last July before the stock panic hit. Yet still in August 2008, the last pre-panic month, the CCI averaged 518 on close, oil \$117, and copper \$3.46. And then the storm of a lifetime slammed into the markets.

It was the first true stock panic witnessed [in 101 years!](#) The key characteristic of a panic is inherent in its dictionary definition. "A sudden widespread fear concerning financial affairs leading to credit contraction and widespread sale of securities at depressed prices in an effort to acquire cash." The stock panic's fear bubble soon engulfed commodities and commodities stocks, as traders dumped both in a frantic effort to move capital out of harm's way into cash.

So instead of merely retreating to its secular support line drawn above (450), the panic selling drove the CCI down under 350. This plunge was the fastest and largest decline in commodities prices ever witnessed, even dwarfing the Great Depression's declines! By the time the dust settled, the CCI had retreated to November 2005 levels. This sounds bad, and it was. But realize the 37-month lows in commodities prices were *nothing* compared to the recent 150-month lows seen in the stock markets.

Commodities prices handily outperformed the stock markets during the epic stock panic. Unfortunately, due to a popular yet misleading commodities index not a lot of traders realize this. The financial media follows today's CRB index (red line above), which was actually created in mid-2005 as a radical departure from CRB history. Now dominated by oil, this new tenth-revision CRB isn't comparable to any history prior to its creation. So please don't be fooled by this misleading new CRB, it is a [false witness](#) to investors.

Even though commodities prices held up better than the stock markets, retracing less ground, commodities stocks were disproportionately hammered. Investors and speculators, scared to death by the stock panic anyway, were further frightened by the plunging commodities prices. Their frantic and mindless selling

drove the stock prices of the biggest and best commodities producers on the planet to impossibly low levels. In some cases, these companies' entire bull markets were nearly erased at the panic's climax!

While painful and frustrating for us existing commodities-stock investors, this once-in-a-lifetime fear bubble drove the greatest bargains I've ever witnessed deep within a secular bull. In early November in our [subscription newsletter](#) we bought and recommended long-term investments in the world's largest gold miner, one of its biggest and best copper miners, an oil major actually discovering massive new oil finds, and one of the most elite silver producers. These investments soon thrived even while the stock slump lingered.

The stock markets carved their initial fear-driven panic low in late November, but they slumped to a secondary despair-driven low in early March. The flagship S&P 500 stock index was down 10% over this span. Yet commodities stocks thrived while general stocks languished. Unfortunately there aren't any excellent *general* commodities-stock indexes yet, so I have to use individual stocks to illustrate this.

Over the exact stock-market low-to-low span, BHP Billiton, the world's largest miner, rallied 48%. The elite oil major Petrobras climbed 78%. Giant copper miner Freeport-McMoRan surged 84%. Elite gold and silver market darlings Goldcorp and Silver Wheaton powered 48% and 140% higher. These gains were to the very day of the lower S&P 500 lows, very impressive. In the interest of disclosure, we have long-term investment positions in each of these companies, and have recommended our subscribers do the same.

So even in early 2009, a very difficult time in the stock markets, commodities stocks have already been performing exceedingly well. Both in an absolute sense and certainly relative to the general markets. But the opportunities have not vanished. The price anomalies in commodities and commodities stocks created by the stock panic's unbelievably intense fear still persist to this day. In fact for most commodities and their producers' stocks, not even half of the panic anomalies have yet been erased.

As many on Wall Street argue, there is no doubt we live in a different world since the panic. It might be years yet before we see commodities prices return to their lofty summer 2008 levels. But commodities-stock prices are still so beaten up that they don't need to see those stellar commodities prices again in order to thrive. And commodities prices will establish new post-panic equilibriums *above today's levels*.

Why won't today's low commodities prices persist? There are many reasons but several major ones more than make this case. Long-term commodities prices must exceed their costs of production, enormous monetary inflation is baked into the pipeline, and the ascent of the developing world will continue.

Like any business, commodities producers need to operate at profits. If they can't produce their commodities at a profitable price, they'll slow or stop production at their key operations. Many commodities today are trading near or *under* their average global costs of production, so producers are reacting accordingly. And unlike building new mines, it only takes months to scale back production. This natural free-market mechanism soon reduces supplies which results in higher commodities prices.

Like everything else, commodities prices are also affected by the supply of money. When money supplies increase faster than commodities supplies, commodities prices rise as relatively more money bids on relatively less commodities. Across the globe, governments have been ramping monetary growth *tremendously* in their attempts to fight the financial panic. In the US alone, the Federal Reserve has *doubled* our monetary base in less than a year! [Big inflation](#) is coming, which will result in higher commodities prices as always.

And the panic's slowing impact on demand won't persist for long. Even before the panic, governments around the world were spending hundreds of billions on building infrastructure. This has accelerated dramatically since the panic as governments try to goose their economies. And around the world, hard-working ordinary folks like you and me haven't given up on their dreams of a better life for their families. The developing world will continue its long-term trend of greater per-capita commodities consumption.

Because of these factors and many more, commodities prices are not doomed to forever languish near their panic lows. They have already started rising back up towards a new equilibrium. I'm not talking lofty summer-2008 speculation-driven levels of course, but some happy medium between there and the panic lows. I suspect it will end up within the CCI's secular uptrend, say around 500 on this index. This is 35% above today's levels.

Commodities stocks' reactions to this normalization of commodities prices to underlying global supply-and-demand trends should be impressive to say the least. Their famous profits leverage will come into effect, with the best producers' profits growth (and hence stock prices) multiplying the underlying gains in the commodities they produce. But first over the near term another extremely bullish factor will come into play.

Thanks to the horribly pessimistic psychology of the stock panic, many commodities stocks are not even reflecting today's prevailing commodities prices let alone future ones. In the heart of the panic their stock prices were driven far lower than commodities prices warranted, and they have not yet recovered sufficiently to close this gap. Thus even if commodities prices flatlined going forward, commodities stocks are generally too cheap. Gold stocks are a fantastic example.

For 5 full years prior to the stock panic, the flagship HUI gold-stock index averaged just over half the price of gold. And the resulting 0.51x ratio of the HUI level to the gold price was established in a [tight and consistent](#) secular trading range. But the stock panic temporarily blew this relationship between the gold stocks, and the metal they produce (which drives their profits and hence stock prices) all out of whack.

In the depths of the panic, the gold stocks were sold off so aggressively that the HUI reflected a gold price of \$350! Yet gold itself never fell below the low \$700s in the panic. This decoupling phenomenon occurred in many commodities stocks, where irrational fear drove them to levels far below what then-prevailing commodities prices warranted. While this anomaly is gradually being rectified, it still persists even today.

In gold stocks' case, so far in April the HUI has been reflecting a gold price of \$585. Yet gold itself has averaged \$885 this month! Gold stocks are still far too cheap relative to gold today, let alone where it goes in the future due to soaring worldwide investment demand and unprecedented fiat-currency inflation. Many producers of other commodities share in this panic-induced undervaluation, they have far to rally merely to reflect *today's* commodities prices.

For all these reasons, commodities stocks have great potential going forward. I suspect that a year from now, 2 years from now, investors will look back at this still-neglected sector and marvel at its stock-price appreciation since. And this is really saying something, since the best years stock markets ever witness in history occur immediately [after the worst years](#). So after the disastrous 2008, 2009 is due to be a huge up year (approaching 50%) for the general stock markets. Commodities stocks should easily double, triple, or quadruple these already large stock-market gains!

If you are interested in riding this accelerating post-panic commodities-stock rally, the resumption of this sector's secular bull, you'd love our work at Zeal. We've been intensely researching, and actively investing and speculating in, this sector [since 2001](#). We have unparalleled experience in trading commodities stocks in this secular bull. And we share our world-renowned work and resulting high-potential stock picks with our subscribers in the form of acclaimed [subscription newsletters](#).

[Subscribe today](#) to deepen your market knowledge and wisdom and to capitalize on handpicked commodities-stock opportunities going forward! You too can profit from the fruits of our labors and build a better financial future for your family.

The bottom line is commodities stocks probably have the most bullish fundamentals of any stock-market sector. They produce the physical building

blocks of all the world's necessities. They have a guaranteed and endlessly growing global market for their products. And the underlying commodities fundamentals virtually ensure higher commodities prices and hence higher profits for production in the years ahead.

In early 2008, many investors feared this unprecedented bull market (Asia has never universally industrialized before) had left them behind. But the once-in-a-lifetime stock panic temporarily slashed commodities and commodities-stock prices so severely that buying now is almost as attractive as getting in on the ground floor back in the early 2000s. This sector is still due to outperform for many years to come.

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April 24, 2009

So how can you profit from this information? We publish an acclaimed monthly newsletter, [Zeal Intelligence](#), that details exactly what we are doing in terms of actual stock and options trading based on all the lessons we have learned in our market research. Please consider joining us each month for tactical trading details and more in our premium Zeal Intelligence service at ... www.zealllc.com/subscribe.htm

Questions for Adam? I would be more than happy to address them through my private consulting business. Please visit www.zealllc.com/adam.htm for more information.

Thoughts, comments, or flames? Fire away at zelotes@zealllc.com. Due to my staggering and perpetually increasing e-mail load, I regret that I am not able to respond to comments personally. I will read all messages though and really appreciate your feedback!

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