

# Cheap Commodities

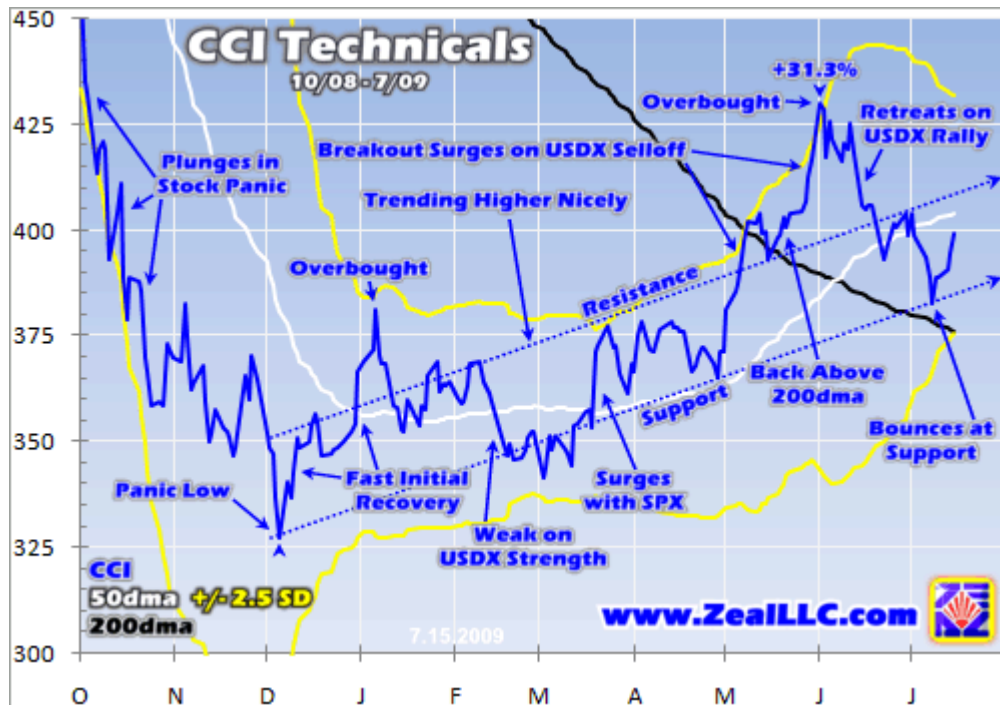
Commodities have had a rough go lately, especially before this week. You couldn't open a financial newspaper or turn on CNBC without seeing endless bearish prognostications for raw materials' prices. Ongoing global economic fears led to the widespread belief that commodities are doomed to grind lower.

And indeed this was an extrapolation of the short-term trend. Between June 1st and July 8th, the flagship Continuous Commodity Index (CCI) plunged 11.0%. This may not seem extreme to stock traders in our wild times, but it really is by CCI standards. This index's unique construction (17 equally-weighted commodities geometrically averaged) means it usually moves with all the sound and fury of a glacier.

Naturally after such fast commodities selling, sentiment in this realm is pretty poor today. Investors are racked with doubts, unwilling to commit more capital and very tempted to liquidate existing commodities-related positions if they haven't already. And I don't blame them if the last 6 weeks is the extent of their perceptions. Commodities have been much weaker than the general stock markets (-6.7%) over this span.

Realize that always in the markets, *price action drives newsflow*. It's not the other way around as most people assume. When prices are weak, we all have a natural selection bias to seek out bearish stories in an attempt to "justify" the decline. The financial media greatly amplifies this tendency, telling its viewers/readers exactly what they want to hear at any time in order to maximize advertising revenues.

So today's bearish commodities sentiment is *the result of* the recent CCI retreat, not the cause of it. But with some perspective beyond the last 6 weeks, it soon becomes apparent the technical case for commodities is actually quite *bullish* now. I'll run you through it in this essay, starting with a multi-month overview and gradually zooming out to a multi-decade one. Commodities are quite cheap, great buys.



Despite the sharp decline of late, commodities' short-term technicals look excellent. Between early December at its panic low and early June at its latest interim high, the CCI rallied 31.3%. Such a strong *yet gradual* move higher has to be considered an upleg, and uplegs are only seen in bull markets. Once a rally extends past the 6-month mark, it has to be taken seriously. More than mere sentiment is driving it.

In contrast, bear-market rallies usually achieve lightning-fast gains over very short periods of time. Most only last 1 to 3 months, as the extreme fear necessary to drive such sharp moves higher quickly dissipates. So to see the CCI climbing so nicely for so long, carving an impressive uptrend, and successfully weathering a couple of previous sizable pullbacks within this uptrend pretty much eliminates the bear-rally thesis. The CCI will not return to its panic lows.

The CCI's latest pullback since early June, driven by the US dollar trying to emerge out of oversold lows, was indeed big and fast. Yet it is provocative that it didn't do any technical damage to the CCI's uptrend. In early June, commodities were overbought and traders were starting to get excited. A pullback was necessary to rebalance sentiment, so one ignited. Yet this pullback ended last week *right at* this uptrend's support. The CCI's upleg is not technically impaired.

If you follow this upleg back in time, the CCI previously bounced off this very support line in late April after a sideways consolidation. Even earlier in March, driven by the strong US dollar which was in turn driven by weak stock markets, the CCI briefly fell under support. Yet in both these cases, support still effectively

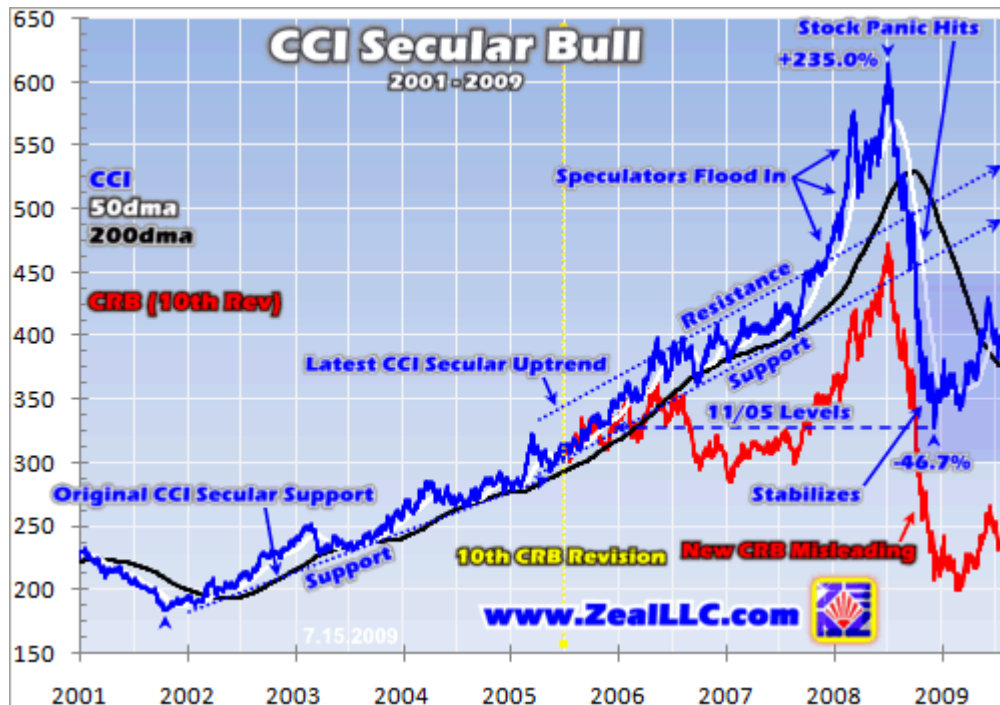
held. The CCI soon powered higher and this upleg persisted. On balance, it continued to achieve higher lows and higher highs.

Even more importantly, in mid-May the CCI shot back above its 200-day moving average for the first time since August 2008. [200dmas](#) are important arbiters in bulls and bears alike. In bulls, periodic corrections usually bounce at 200dmas. In bears, periodic bear-market rallies usually fail at 200dmas. If commodities are in a bear today as mainstream consensus argues, then the CCI should have failed at its 200dma in May.

But instead it blasted through. This is not bear-market behavior. And after crossing back over its 200dma, the CCI has easily remained above it for the couple of months since. Any technician will tell you this is classic bull-market behavior. Between this 200dma crossover, the strong yet gradual uptrend, and the fact that this upleg's support continues to hold in pullbacks, the technicals declare the CCI is in a new [cyclical](#) bull market.

So although the last 6 weeks have spooked traders, a more reasonable perspective over the last 8 months clearly shows there is nothing to fear technically. Commodities are doing great, gradually emerging out of their ridiculously oversold lows driven by the stock panic. And this upleg remains young, commodities look cheap with lots of room to run higher. Their bullish potential is best understood on a longer scale.

This next chart zooms out to the CCI's [secular](#) bull, which started back in October 2001. I also rendered today's CRB index on this chart in red for comparison. Unfortunately the CRB is more popular today due to its long and storied history. But today's "CRB" is a usurper, a [false witness](#) dominated by oil that is nothing like the historical CRB. It is a totally new construct created with [new methodologies](#) in June 2005. Today's CCI is *the* classic equally-weighted CRB of old, and it is what traders ought to follow today.



This long-term chart really drives home how slow to move the equally-weighted geometrically-averaged CCI truly is. Between 2002 and 2005, the CCI gradually meandered higher in the early days of this secular commodities bull. It never once broke below its support or 200dma. These oscillations within trend were so consistent that we used them as [a secondary indicator](#) to successfully trade commodities stocks.

In mid-2005 the CCI's uptrend accelerated into a new higher upslope. This is typical in secular bulls. As a bull advances, more investors get interested in it. They deploy capital, which drives it higher, which attracts in even more capital from an ever-expanding pool of investors. But even with this steeper uptrend, note that the CCI again never broke below support or fell meaningfully below its 200dma. Its bull was rock-solid.

Also in mid-2005, the name "CCI" came into existence. The traditional CRB was "revised" for the tenth time in its long history. But instead of following revision precedent, its new custodians simply threw out the lessons of decades and created an entirely new index from scratch. So what is now known as the CRB (red above) has *no relationship at all* to history before mid-2005. The classic ninth-revision CRB was carried on as the CCI. So the CCI is the true surviving index with decades of historical continuity, not the radically different new "CRB".

Anyway, between 2002 and 2007 the CCI marched higher *gradually*, remaining within its secular uptrends without exception. But then in early 2008, mainstream speculators suddenly discovered commodities. Capital flooded in which drove the CCI up in its biggest and fastest upleg of this entire bull. The CCI peaked in

early July 2008, and as you remember there was far too much greed in commodities then. That was when oil was over \$140 and big Wall Street investment banks called for \$200 within months!

Since sentiment then was so unbalanced to the greed side, a correction was necessary. All bulls witness uplegs where greed gets excessive followed by corrections which wipe out this greed. A bull can't exist without this [upleg-correction cycle](#). And the bigger the preceding upleg, the bigger the necessary correction. These periodic corrections are healthy and necessary. They actually preserve and sustain the secular bull, preventing it from burning itself out too early.

Since that big upleg dragged the CCI's 200dma up sharply in early 2008, I figured it wouldn't hold in the inevitable correction. But the CCI's support probably should have. In late summer 2008, as you can see above, the CCI's support line near 450 was about as far under its 200dma as the preceding upleg's top was above it. From early July to mid-September, the CCI plunged 26.4% in its biggest and meanest correction of this entire bull by far. It dragged this index all the way back to its secular support line.

But right then a peculiar thing happened. The first true stock-panic [in 101 years](#) erupted, an unbelievably disruptive and devastating event. The fear bubble mushrooming in stocks spilled out everywhere, including into commodities. Traders grew so terrified that they wanted to close all their risky positions and hide out in cash. So commodities were aggressively sold, collateral damage, and the CCI continued plunging below support.

When all the dust settled by early December, the CCI had plunged 46.7% since early July! It was a crazy decline, utterly unprecedented. But even though this anomaly was extreme beyond description, it didn't erase the secular commodities bull. After a 235% move higher from late 2001 to mid-2008, commodities nearly getting cut in half in the stock panic merely forced them back to November 2005 levels at worst.

Prices were obliterated in a matter of months, but did underlying global fundamentals change that fast? No way. Finding and producing new commodities was no easier in December 2008 than 6 months earlier. The hard-working citizens of the world's developing countries like China didn't suddenly decide to stop industrializing and striving to increase their families' standards of living. Even in the first world, we kept right on consuming huge amounts of commodities. We simply have to in order to live, no matter what.

While each individual commodity has its own unique global supply-and-demand fundamentals, the one I have studied the most since 2000 is gold. In December I updated my [gold fundamentals](#) research in a new essay. Read it if you question the [fundamental underpinnings](#) of this secular commodities bull. Many of the

general supply/demand trends in gold apply to other commodities as well, and the stock panic didn't materially change them. On a secular scale, global commodities demand continues to grow relentlessly while new supplies are getting harder and harder to find.

This is why commodities prices have been recovering since the panic. The blue-shaded area above corresponds to the entire first chart. The CCI's post-panic move higher, despite looking strong on a short-term scale, has only been modest so far. Investors remain skeptical, wary to redeploy in commodities. But this won't last. Commodities producers' stocks have been one of the best-performing sectors this year and capital chases performance. Soon some of the trillions on the sidelines will start bidding on commodities again.

The CCI, still very cheap today, will power higher. I fully expect it to get back up within its pre-panic secular uptrend within the next year or so. Today that equates to a CCI level around 500, 25% higher than the levels we saw this week. And of course as time marches on, the CCI's uptrend will continue to plow higher. In fact, I believe we need a 500+ CCI for the better part *of a decade* before this commodities bull gives up its ghost. This next chart shows why.

It zooms out once again to a multi-decade perspective, the ultra-long term. And over such great spans of time, the relentlessly declining purchasing power of the US dollar must be considered. So I inflated the historical CCI by Consumer Price Index inflation. Yes, CPI inflation radically *understates* [true monetary inflation](#). But it is very conservative and widely-accepted by mainstreamers. So this real CCI proxy is an exceedingly tame one. The true commodities situation is even more bullish than this chart suggests.



The real CCI (then the classic CRB) peaked at 1085 in today's dollars in February 1974. Of course [real gold](#) and [real oil](#) didn't crest until January 1980 and April 1980 respectively. But realize each of these popular commodities only has a 1/17th weight in the CCI. The balance of the 15 [other commodities](#) that make up 15/17ths of this index's weight peaked much earlier in real terms.

Between February 1974 and October 2001 (commodities' secular bottom), the real CCI fell by 79.5%. This epic secular bear lasted 27.7 years! In other words, for nearly 28 years the real prices of commodities declined on balance. Naturally this wreaked havoc on global supplies. Companies and investors didn't invest in new production capacity because profit incentives were waning. Global production infrastructure rusted while exploration for new deposits dwindled away for decades.

Luckily for the world, all the commodities investment in the 1970s and early 1980s when prices were high created enough capacity to absorb the early expansion of China, India, and the rest of the developing world. For decades we coasted along, depleting existing deposits, to meet gradual yet relentless growth in world commodities demand. In the 1990s, commodities fell even deeper out of favor as capital chased after the tech-stock bubble.

But by late 2001, the secular tipping point was reached. Existing production infrastructure and investment could no longer meet demand. The only solution was rising prices. Higher commodities prices simultaneously retard demand and boost supply. On the demand side, people consume less when prices are higher. Think of your own gasoline demand at \$4 compared to \$2. On the

supply side, higher prices offer higher potential profits which spur exploration and investment in new production infrastructure.

Between that critical 2001 inflection point and mid-2008, commodities enjoyed a 6.7-year secular bull. But again what looked so big on the second chart is really not too impressive at this longer time scale. Can the dampening effects on supply of a 28-year secular bear be completely unwound in a little 7-year secular bull? Probably not even if the developing world, 2/3rds of the world's population, stopped developing. And with the great additional developing-world demand, 7 years isn't anywhere near long enough to close the structural supply gap.

It is not that people in developing nations will consume as much on a per-capita basis as we do in the States. That will never happen, the world just doesn't have enough natural resources. But with around 13x more people in the developing world than in the US, they don't have to consume as much. Small increases in per-capita commodities consumption, inevitable as standards of living improve, translate into *huge* absolute increases in commodities demand when spread across such a vast population.

There is some commodities price level above which the incentive for investors and companies to find and produce new supplies is strong. Looking at this chart above, I'd say 500 on the CCI is as good of guess as any for this new-supplies incentive zone. For *over 13 years* ending in 1985, the real CCI remained above this 500 mark. And indeed supplies were abundant, as evidenced by the declining prices. So many new supplies were brought online that they lasted for nearly two decades after this production boom abated.

You may remember spring 2008's big rush to expand global commodities supplies on the high commodities prices. Investors and companies realized the world would need far more raw materials over the coming decades than the existing production pipelines could produce. So for the first half of 2008 when the CCI was over 500, it looked like big capital was *starting to* take the secular shortfall in global commodities supply/demand seriously.

Then the stock panic happened, and the price incentives to bring new supplies online collapsed. And indeed we have seen an incredibly rapid and drastic curtailing of new investment and plans for new commodities infrastructure worldwide. This is a big problem though. We are not done consuming in the first world, and the developing world is not done growing, just because a fear bubble temporarily screwed up the pricing signals in commodities.

I suspect the CCI needs to *stay* above 500 for the better part of a decade, maybe longer, before enough new supplies are brought online to meet global demand over the next couple decades. And remember this is the first secular commodities bull in history where half the world (Asia) is simultaneously and rapidly industrializing. The sheer quantities of raw materials the world is going to

need are staggering. This particular secular bull will probably be the biggest and longest ever witnessed. It will surely extend for 17 years [like stock bulls](#), and could easily persist even longer.

Commodities are way too cheap today. 28 years of real declines in commodities prices wrought tremendous damage to the future supply pipeline that can't be undone in just 7 years. While these concepts are relatively new to most investors, at Zeal we have been aggressively long this secular commodities bull since [the very beginning](#) in 2001. We and our subscribers have made fortunes investing and speculating in elite high-potential commodities stocks as this bull powered higher.

And the opportunities I've seen since the stock panic utterly dwarf anything witnessed since the early 2000s. Because of the fear anomaly, commodities and commodities-stock prices remain far below where global supply/demand fundamentals suggest they should be. If you want to ride this coming upleg higher in the best stocks, and deepen your understanding of this incredible ongoing bull, [subscribe today](#) to our acclaimed [monthly newsletter](#). Buy now ahead of the crowd instead of later (and higher) with it!

The bottom line is commodities are cheap today. They are cheap relative to this secular bull and even cheaper relative to decades of real price history. Yet world demand will only continue to rise in the coming decades, necessitating massive investment in production infrastructure. The only thing that can drive this is much higher prices. And rest assured they are coming, commodities' secular bull is less than half over.

Sadly, not many investors are capitalizing on these vast opportunities. The stock panic devastated everyone, and most investors remain too shell-shocked to overcome the tyranny of the present on their perspectives. So they are wrongly assuming a multi-week pullback is more important than a multi-year secular bull or the multi-decade secular bear preceding it. Only contrarians are getting deployed today.

Adam Hamilton, CPA

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Questions for Adam? I would be more than happy to address them through my private consulting business. Please visit [www.zeallc.com/adam.htm](http://www.zeallc.com/adam.htm) for more information.

Thoughts, comments, or flames? Fire away at [zelotes@zeallc.com](mailto:zelotes@zeallc.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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