MARKET COMMENTARY

***e*Research Corporation** is pleased to provide an investment newsletter, courtesy of **Rick Mills** of **AHEADOFTHEHERD.COM.** (Referred to as AOTH)

Rick Mills publishes pertinent investment articles on his website on a regular basis. He also publishes a regular investment newsletter.

Richard Mills is owner and host of **AHEADOFTHEHERD.COM**. His articles have been published on over 400 websites.

Ahead of the Herd Newsletter - 2019 Issue Four

Saturday January 19th

BW: Rick's latest Newsletter, while highly informative, is very extensive. For this reason, we are separating the newsletter into six reports for publication over the ensuing days on the *e*Research website. If you want to read it in its entirety all at once, just <Ctrl-Click> on the link provided below. The general theme is Commodities and why Rick believes that NOW is the right time to take or add to positions in commodities: Our six AOTH reports are as follows: (1) Why and Which Commodities?; (2) Copper; (3) Lithium; (4) Rare Earths; (5) Gold; and (6) Uranium.

Link to the entire January AOTH Newsletter is **HERE**.

NOTE: If you want to sign up to Rick's website/blog, and subscription is FREE, you can do so here: www.Aheadoftheherd.com.

Commodities are the right story for 2019

As a general rule, the most successful man in life is the man who has the best information

The markets are up and down like a bride's nightgown, as my dad used to say, bitcoin is in the toilet, and tech stocks, once as steady as the banks, are as unreliable as an old Apple computer. If you are reluctant to dip your toe back into the stock market, you are not alone.

'The Hunt for Red October' was a great movie but nobody thought 'Red October' would actually happen. In October it did. Anyone that was invested saw their equities turn as red as a Russian submarine commander. The S&P 500 churned. When the calendar mercifully turned to November, the benchmark US stock index had fallen 8.5%, the worst month since February 2009 and the ugliest October since the collapse of Lehman Brothers in 2008. The Dow and the Nasdaq were equally pummeled.

And then it kept going. December was the worst month since the Great Depression. The financial talking heads could not decide what was going on. The trade war with China, speculation that the Federal Reserve would raise interest rates in December (it did) and slowing global growth, were all trotted out as culprits. Algorithmic trading and end-of-the-year tax selling also played a role, as did good old profit-taking by retail investors, who figured it was as good a time as any to exit a nine-year bull market.

A recent post-mortem pointed the finger at retail bearish sentiment, the partial US government shutdown, and a weakening Chinese economy. Despite improvement so far in 2019, some equity strategists are tempering expectations, thinking that companies' soon-to-be-reported fourth-quarter-earnings and 2019 outlooks will be anemic.

So where is a smart investor, cash account flush after having sold all their 2018 under-performers, to park their capital in 2019? In a word: **commodities**. Forget about trendy cryptocurrencies, blockchain, and marijuana. We like investing in *tangible things* that create real jobs, real money and real wealth.

The question is: which commodities?

Well an irrefutable truth right now is the global shift towards the electrification of the transportation system (cars, trucks, buses, trains) as governments and businesses realize that saving the planet from certain environmental destruction involves moving from an oil-based economy to one grounded on electric vehicles and sources of energy that emit fewer to no greenhouse gas emissions.

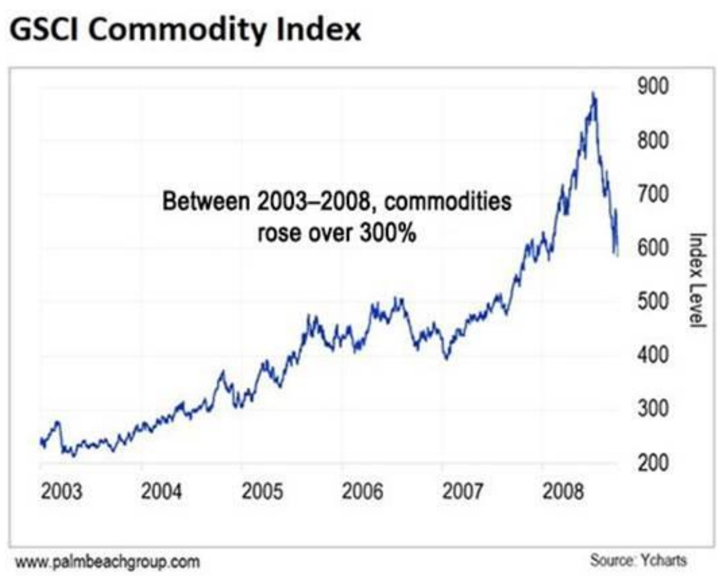
At Ahead of the Herd, we are invested in commodities that ride this electrification trend. Among the metals we are most bullish on, are copper, lithium, rare earths, and gold. The first three are crucial to this global transportation shift. We continue to believe in gold because: (a) it is smart to have gold as a portion of your portfolio (most managers say 10% at minimum); and (b) now is an excellent time to own physical gold or gold stocks. All of this will be explained. But, first, why commodities, and why now?

We offer three reasons: (1) timing; (2) a lower U.S. dollar; and (3) a global infrastructure build-out.

1. Timing

Commodity prices rise and fall with economic conditions. Conventional wisdom has it that commodities tend to do well during late expansions and early recessions. As the economy slows, interest rates are cut to stimulate the economy (remember QE?), the U.S. dollar falls, and demand for commodities, which are priced in USD, goes up, along with commodity prices. Stocks and bonds on the other hand do not perform well during recessions.

A commodities "supercycle" can happen in the late stages of an economic expansion, where growth is running so hot that companies cannot produce enough commodities to keep up with demand. The last commodities supercycle was between 2004 and 2008. From the bottom in 2003 to the peak in 2008, commodities rose over 300%.



So where are we now? The popular narrative is that the great "commodity supercycle" of the 2000s collapsed in the Great Recession of 2008, then resumed from 2009 to 2011. The supercycle ended in the bear market of 2011-2015, and we have only seen commodities recover since 2016, or so it goes.

The problem with this argument is it assumes a complete reset of commodity prices. In fact this has not happened. The prices of copper and other base metals, gold, and some agricultural commodities have indeed fallen from 2011 heights, but not to below 200220-03 levels.

Some, like Seeking Alpha contributor Geoffrey Caveney, believe that the commodity supercycle is far from over; rather, it has been "put on pause" and is about to take off again.

In a June 2018 commentary he writes:

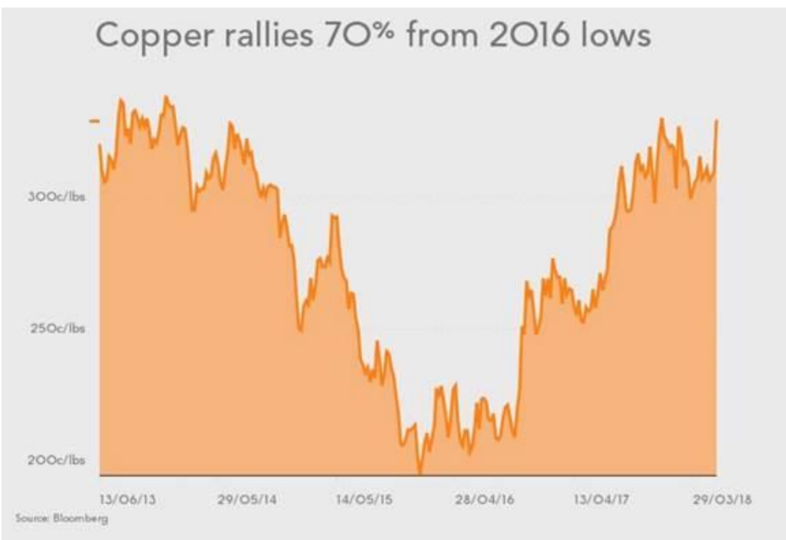
I argue that the "Commodity Supercycle" has a lot more to do with industrial and base metals in particular, since the trend was driven predominantly by China's massive consumption of industrial raw materials in its construction and infrastructure building boom of the 2000s.

The bottom line is this: Copper, other base metals, and iron ore are the true heart at the core of the Commodity Supercycle boom.

The boom was driven predominantly by China's voracious consumption of industrial raw materials in its construction and infrastructure building boom of the 2000s. Above all, this required massive amounts of copper, steel, iron ore, zinc, lead, and nickel.

Most people in the market think the Commodity Supercycle ended with the bear market of 2011-2015. I disagree. I think the supercycle merely got put on pause for a few years. And I think it "unpaused" in 2016: the copper and base metal rally we have seen in the past couple years, is the first step in the resumption of the Commodity Supercycle.

Where is the evidence? Caveney points to the record amount of copper that China imported in spring of 2018 - more than at the height of the supercycle - driven by the country's 'Belt and Road Initiative' aimed at creating a huge infrastructure supply chain from over a hundred countries, all feeding into new Chinese bridges, roads, ports, dams, etc. And we have not even begun to supply the amount of copper needed for electric vehicles which promise to demand as much or more of the red metal currently used in construction, transportation and communications.

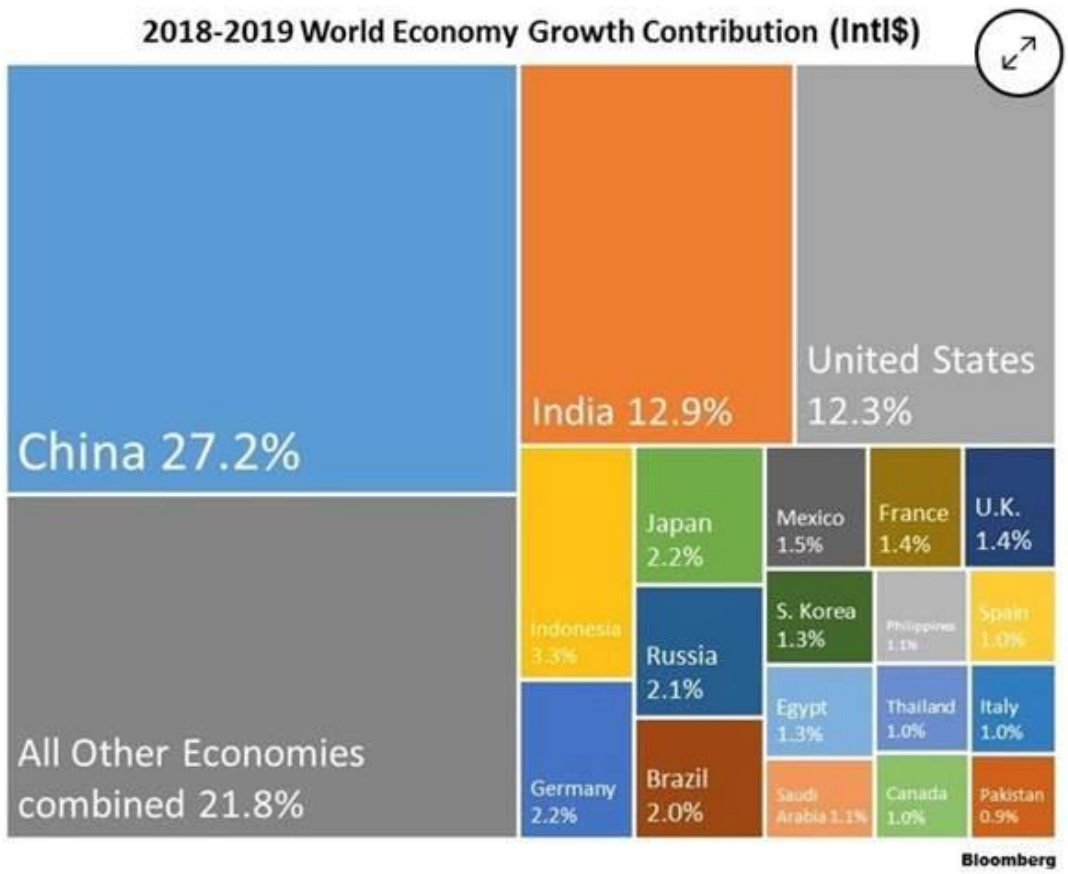


Casey Research has a bit different take on the timing of commodities. Looking back at what happened in 2004-2008, author Nick Rokke believes that [the three tailwinds necessary for a commodities bull market] - strong global growth, rising inflation, and the expansion of credit in the United States - are back again.

First: global growth. While in 2004 all but one of the 35 countries in the OECD showed accelerating GDP growth, currently all 35 countries do. Bloomberg graphed what global growth will look like in 2018-2019, and 2022-2023. See the two charts, below and on the next page.

Of interest is what happens to China, India, and the USA. While China contributes the most to global growth in both charts, it begins to pull even farther away from the USA in the 2022-2023 chart (on the next page).

In 2018-2019, the USA and India are pretty close but, in the early 2020s, India contributes nearly twice to global growth as the United States.



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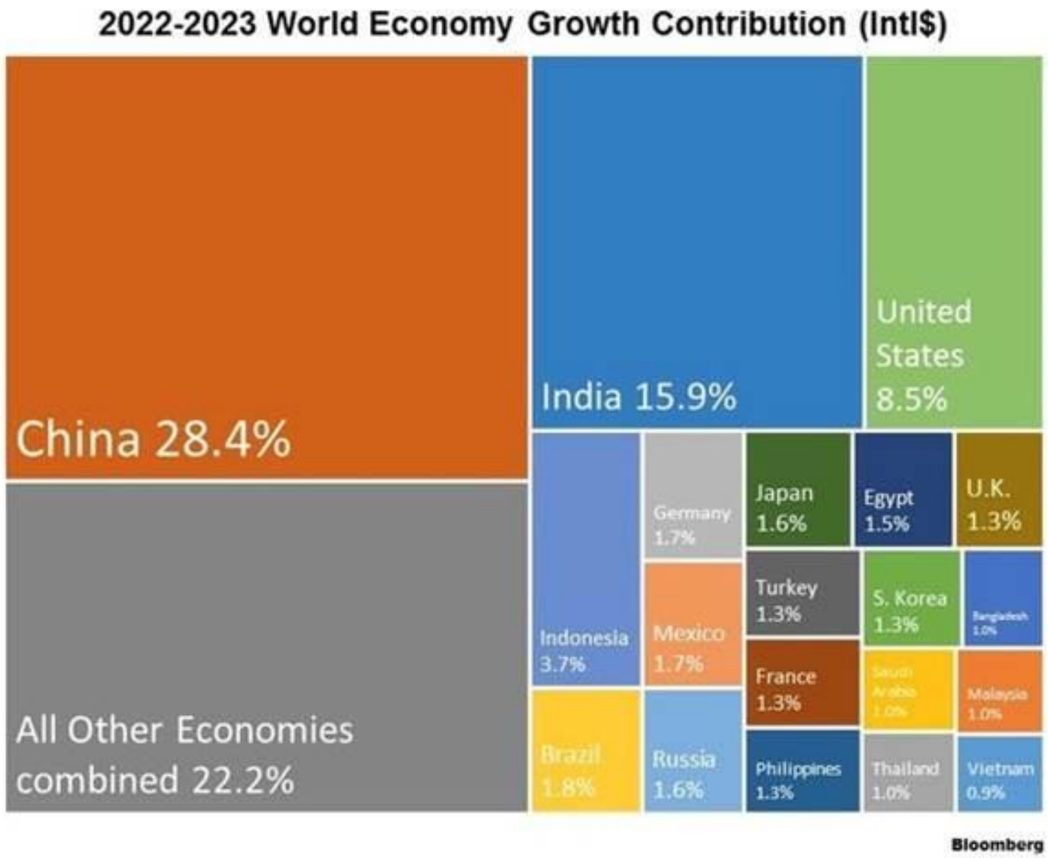


Second: rising inflation. Inflation is on the rise again. While the current US inflation rate of around 2% is within the range of the Federal Reserve, there was no inflation in 2015. Inflation is bad for bonds, but good for commodities, since price rises tend to float all boats, including commodities.

Third: expanding credit. An expanding economy requires credit. When the U.S. economy is expanding, as it is now, people and businesses borrow more money, which is used to buy products. Those products are made from commodities, meaning demand for them increases, as do their prices. Critics might argue that, in 2004, total U.S. credit grew by 10% versus the current measly 3.5%, with the difference accounted for by the early 2000's housing boom, but as Rokke maintains, "any time credit expands, it is good for the overall economy.

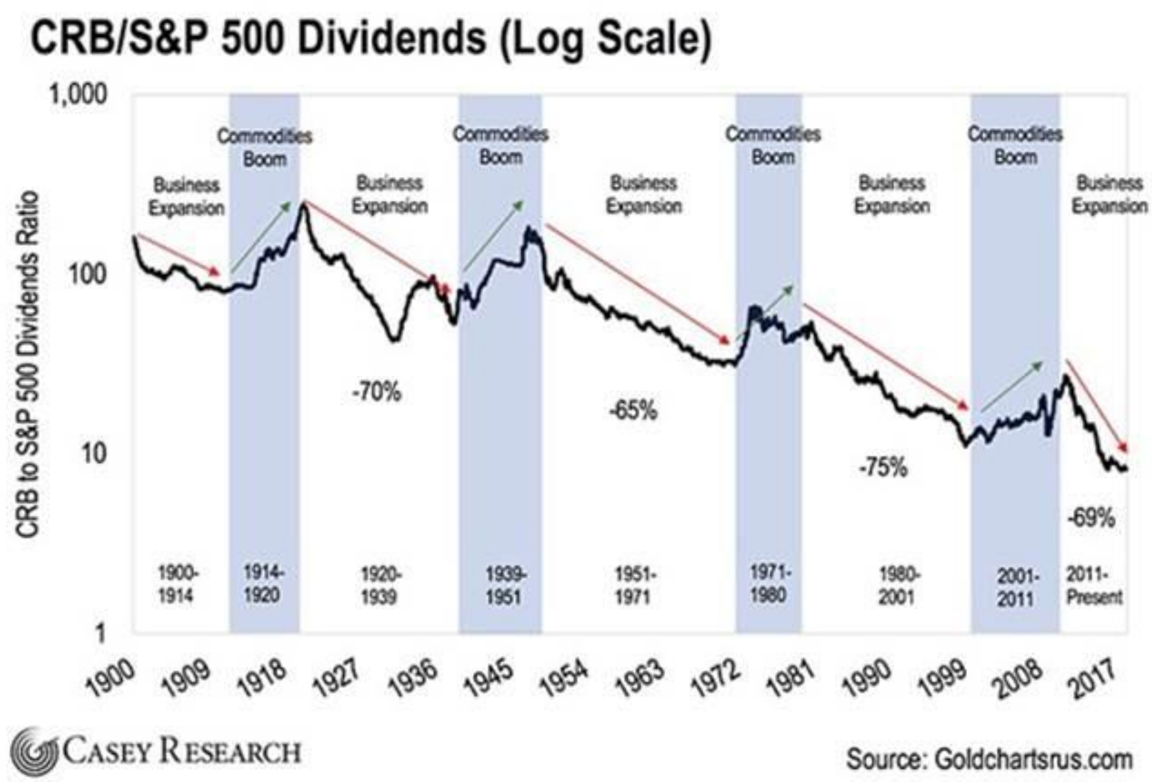
"These three conditions generally line up near the end of an economic cycle. Also, we are in the "melt-up" phase—or late stages—of the current bull market. The conditions are now ripe for another supercycle in commodities."

Dave Forest, also of Casey Research, writes that a coming "Business Inversion" will be great for commodities. What does this mean? It means that when the business cycle expands, making companies profitable and growing their dividends, commodities tend to suffer.

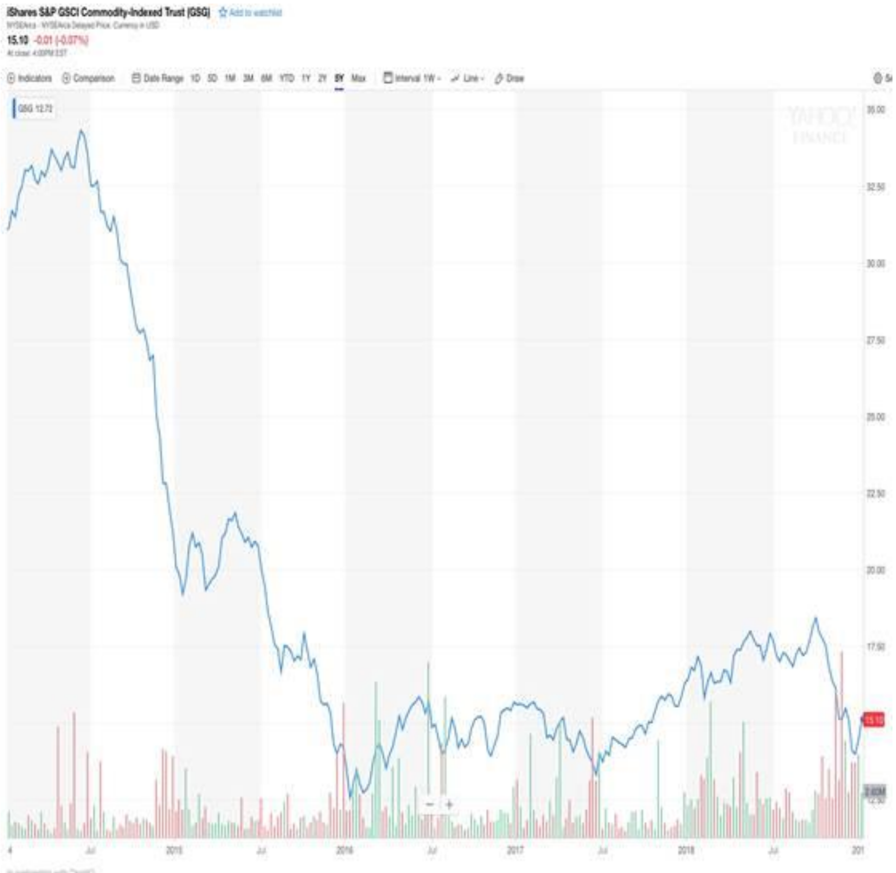
The chart below compares historical dividends paid by the stocks making up the S&P 500 index, to the value of commodities measured by the CRB index. During periods of business expansion, the ratio declined.

Forest writes:

> During each of the last four business expansion cycles, the ratio of commodities to dividends dropped – showing that as dividends were rising, commodities were also falling.
>
> But… once the business cycle ends and stocks start to suffer, commodities take off – you can see how rising commodities lifted my ratio during each of the commodities booms (blue bars) that followed periods of business expansion.
>
> I call this point the "business inversion." And it may be the most profitable pivot you can make in your portfolio this decade.
>
> If you're not yet invested in commodities, now's the time. A resurgence is underway… and it's shaping up to be the biggest bull market I've seen in my career.



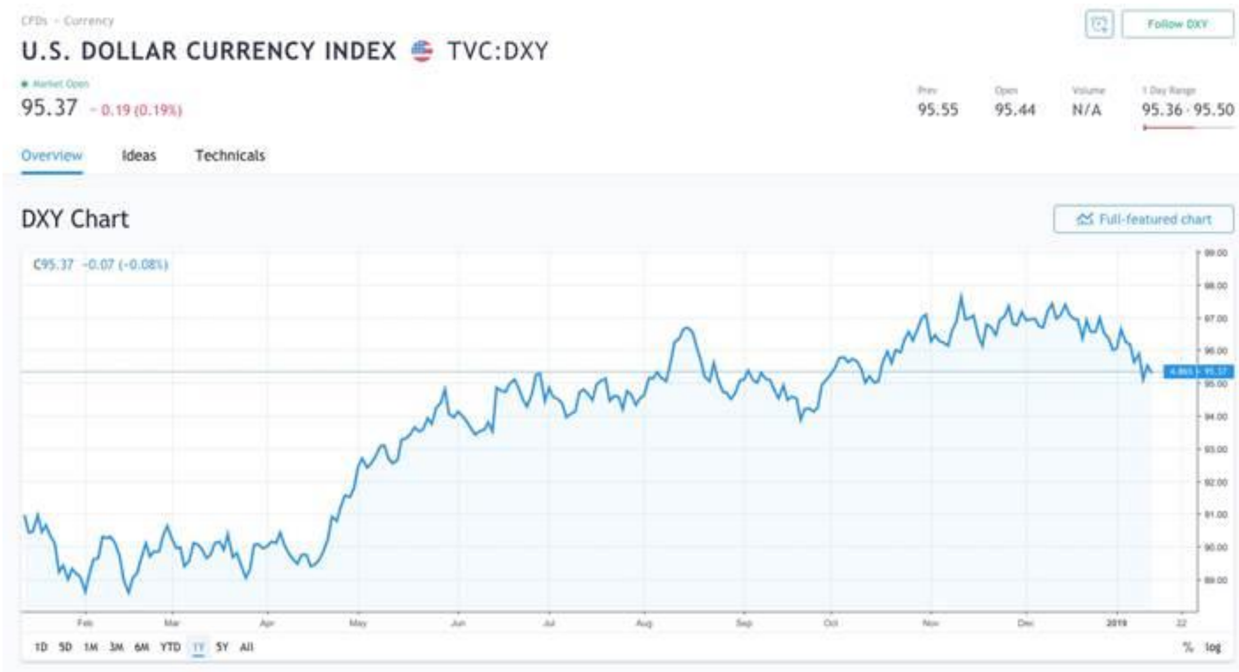
It appears that Forest is onto something here, when we look at the two main commodity indices, the S&P GSCI (GSG) and the Thompson Reuters/Core Commodity Index (CRB). While it is early days, both show an uptick starting in the New Year.



2. Lower Dollar/Fed Loosening

A weak dollar usually means stronger commodities prices. Because the USD is the reserve currency and commodities are traded in dollars, the value of the dollar is of crucial importance in determining the value of the commodity in question. Take the case of a low dollar. When the dollar drops it takes less of another currency to buy dollars needed to purchase the commodity, so the demand for that commodity will increase. The inverse happens when the dollar strengthens.

As the dollar barreled along during the mining bear market of 2012 to 2016, commodity prices slumped. For most of the past year, however, the greenback gained strength against a basket of other currencies, with the U.S. dollar index (DXY) rising from April until mid-December, as the chart below shows.



This is the opposite of U.S. President Trump's plan to keep the dollar low, in order to make exports cheaper. Trump wants to bring jobs back to the USA after many were exported abroad to take advantage of lower labor costs and, therefore, rebuild the U.S. manufacturing sector.

What happened to keep the dollar high? It was mostly the purchase of U.S. Treasuries, a safe haven. Foreign investors purchased some $26 billion of T-bills in May, for example, driven by fear of a trade war. Institutional and retail investors were also drawn to T-bills due to their higher yields which competed with the average S&P dividend yield.

The situation with the USD now, however, has changed. Since mid-December the greenback has fallen, due to doubts about the Federal Reserve's ability to raise interest rates any further. While the Fed originally planned to raise rates four more times in 2019, after last year's stock market rout, it is being pressured to hold the rate hikes to two, or possibly even none, as the economy recovers.

If the dollar continues to fall, and the Federal Reserve follows a looser monetary policy (ie. keeping rates low), it will be good for commodities.

There are other factors that could affect commodities to the upside. A resolution to the US-China trade war would accelerate the ongoing USD downleg, notes FXStreet, adding:

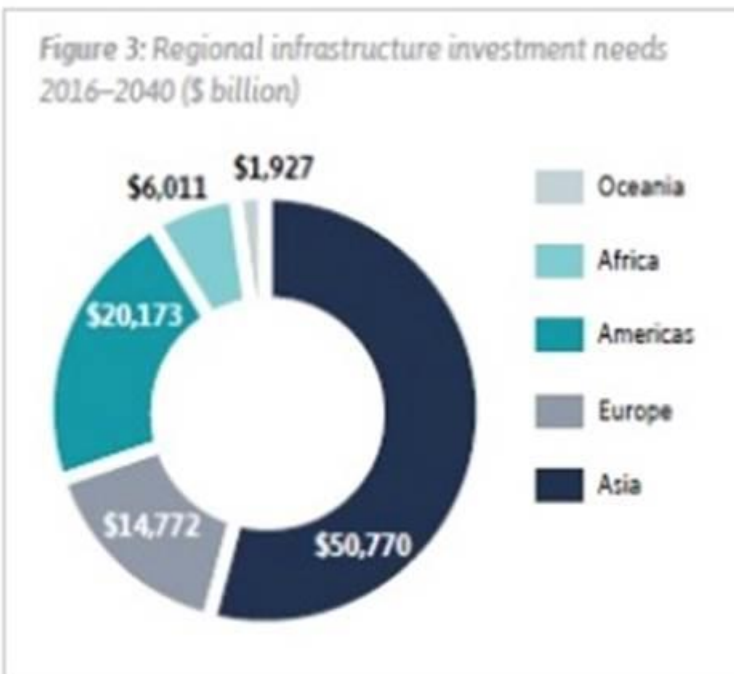
> *In addition, the rising dichotomy between the U.S. solid fundamentals (favouring further tightening) and markets' belief that some slowdown would be in the offing, in turn prompting the Fed to refrain from acting on rates this year, keeps fresh USD-buyers at bay and undermines any serious attempt of recovery in the Dollar.*

3. Global Infrastructure Spend

Commodities are the building blocks of the infrastructure we all rely on for daily life. This includes roads, bridges, ports, railways, commercial buildings, fibre-optic installations, sewers, water lines, etc. Iron ore and coking coal are the chief ingredients in steel, copper is used in construction, telecommunications and transportation, and nickel is used to make stainless steel. Agricultural commodities feed the world and satisfy our modern-day tastes. Without staples like wheat, rice and corn, billions of people would die. Coffee, sugar and tobacco are not life or death, but doing without them would be a hardship for many. These are just a few examples.

According to a 2017 report, an expected 2 billion rise in population (46% in cities) will necessitate $94 trillion in global infrastructure spending by 2040. That works out to $3.7 trillion a year - an amount equal to the annual economic output of Germany.

Three of the top five countries most in need of new infrastructure are in Asia: China, India, and Japan. China, being the world's largest commodities consumer, will need almost a third of the total, $28 trillion. The United States will have the largest gap in infrastructure spending - $3.8 trillion - despite Trump's campaign pledge to fix America's crumbling cities.



Much of the Chinese demand will come from its 'Belt and Road Initiative' (BRI). The 'Belt' refers to a network of overland road and rail routes and oil and natural gas pipelines planned to run along the major Eurasian land bridges. The 'Road' is a network of ports and other coastal infrastructure projects, from Southeast Asia to East Africa and the Mediterranean Sea.

Taking copper as an example, BRI is expected to generate an extra 2.2 million tonnes of copper demand, between now and 2030. That's about 10% of the total amount of copper mined throughout the world in 2017, 20 million tonnes (International Copper Study Group).

More spending on infrastructure means more mined commodities. More copper, iron ore, nickel, zinc, manganese, vanadium, lithium, graphite, rare earths, etc.

So, if we accept the reasoning that now is a good time to be getting into commodities, the next question is, which commodities?

Electrification

The most prevalent trend related to mined commodities is the shift, driven by climate change, away from the use of fossil fuels, towards the electrification of the global transportation system. Future Agenda, a non-profit think tank, identifies three reasons for the inevitable move away from the internal combustion engine (ICE) vehicle, to the electric vehicle (EV): total cost of ownership, brand commitment, and political will.

Battery-powered electric vehicles versus hybrids or ICEs are already the cheapest option in the U.K., with a subsidy, according to Future Agenda. This is because, while the up-front cost of buying an EV is more than a gas vehicle, owning an EV costs considerably less, over time, in terms of electricity use versus gasoline, plus the relative lack of maintenance in an EV engine.

Electric vehicles have far fewer moving parts than gasoline-powered cars - they don't have mufflers, gas tanks, catalytic converters or ignition systems. There is also never an oil change or tune-up to worry about. But the clean and green does not end there. Electric drives are more efficient then the drives on ICE-powered cars. They are able to convert more of the available energy to propel the car therefore using less energy to go the same distance.

Auto manufacturers are increasingly investing in EV models. Just about all car makers are incorporating EVs into their production mix, and they are calling for public charging infrastructure to accommodate them. Volvo has banned the ICE, stating that this year, all models will be electrics or hybrids. Nissan, JLR, Daimler, BMW, Geely and BYD have made public commitments to EVs.

The last piece is the hardest to accomplish: political will. In North America, a very small percentage of the auto market is electric, but elsewhere governments have made deeper commitments. Future Agenda states:

> With a focus on more CO2 and NOx legislation in cities, Stuttgart, Paris, Mexico City, Athens, Madrid, Paris all banning diesel by 2030. Moreover, countries such as Norway, The Netherlands, France, Germany, UK, China and India have indicated they will ban cars running on fossil fuels.

At Ahead of the Herd we are invested in commodities that support the electrification of the transportation system. These include copper, lithium, and rare earths, all of which are critical components of electric vehicles.

By 2047, there are expected to be upwards of 1 billion electric cars on the road. All these EVs will need lithium-ion batteries containing lithium, graphite, nickel and cobalt, plus other mined metals that go into EVs, like copper.

BW: We will publish tomorrow the next installment of the January 19 Newsletter from AheadOfTheHerd.com. It will focus on COPPER.

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