

Commodity Perspectives

Resources are the investment focus of the Gravitas Short-Duration Flow-Through 2017, so we expect questions about commodity markets from advisors and their clients. Many feel cautious.

We believe this perspective requires a counter-point. David Fickling discusses the missing volatility in commodity markets of late, plus we provide a graph that can be shared with clients -- it shows that commodities are now trading at their lowest level in 50 years.

Here at Gravitas Investments, what we are seeing are numerous attractive opportunities for investment, plus management willing to negotiate favourable terms for their flow-through shares. All this works very well for our investors.

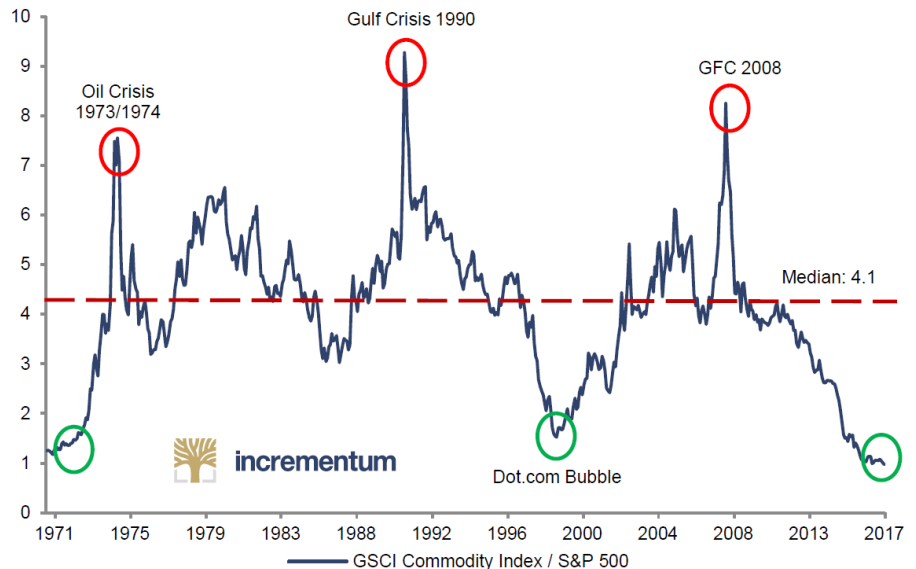
With thanks and acknowledgement to David Fickling of Bloomberg News and Dr. Torsten Dennin of Incrementum AG, we are pleased to present the following perspectives on commodities.

The following chart sets out to answer the question “is now a good time to invest in commodities”.

It illustrates the historic relative valuation of commodities, using the S&P GSCI Commodity Index as a proxy, and the S&P500, the generally accepted proxy for stocks. It looks back 47 years.

Red circles indicate peak periods when commodities were expensive relative to stocks. Green circles show peak periods when commodities were extremely cheap.

In relation to the S&P500, the GSCI commodity index is currently trading at the lowest level in 50 years



In a historical context, the relative valuation of commodities to equities seems extremely low.

Also, the ratio sits significantly below the long-term median of 4.1. Following the notion of mean reversion, we should be seeing attractive investment opportunities.

(Chart and conclusions: Dr. Torsten Dennin, Incrementum AG, “Ingoldwetrust” June 1, 2017)



A general view of a crude oil importing port in Qingdao, Shandong province, in this Nov. 9, 2008 file photo. (China Stringer Network/Reuters)

The commodities lull will pass. It's the swing of things

David Fickling

SYDNEY — Bloomberg News

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Remember when commodities markets were fun?

Just before Christmas 2008, WTI crude futures soared almost 18 per cent in a day. As recently as last November, the contract was able to climb 9.3 per cent on the back of OPEC announcing production cuts. Back in June 2014, soybeans fell 19 per cent in one session; three months later, sugar prices jumped 14 percent.

Those times, at least for the moment, are past. The 90day volatility of the Bloomberg Commodity Index touched its lowest level since November 2014 this month, driven by declines in energy, crops and precious metals. Volatility in spot gold has been running at levels almost unseen so far this century.

Various reasons could account for this. The sheer volume of information that's out there about supply and demand and the range of instruments available for those who want to act on it means there are fewer surprises these days. Before he founded the trading giant now known as Glencore Plc, one of Marc Rich's greatest successes came from working out how the market in mercury functioned at a time when few other people knew or cared.

Nowadays, a day trader can check the weather forecast in Mato Grosso and use it to invest or divest in a soybean ETF from the comfort of her mobile phone and other investors can study such funds flows to divine the direction of the market.

"Everything is transparent, everybody knows everything and has access to information," Daniel Jaeggi, the president of oil trader Mercuria Energy Group Ltd., lamented to a panel in Singapore earlier this month.

Fundamental factors may also be playing a part. The most dramatic instance of volatility this century came in the runup in prices before the 2008 financial crisis, when China's voracious commodity demand crashed into markets that were short of supply, sending prices soaring. The opposite happened in 2015, with Chinese consumption dropping just as producers were running supply hard to pay off debt they'd taken on to increase output.

Right now, we're closer to a Goldilocks economy. There's abundant supply in both agricultural and energy markets these days, and the development of U.S. shale oil in particular has meant the market is able to respond quickly to supply shocks, causing prices to even out.

That's great news for consumers of commodities, who generally don't like to see materials costs go all over the place. It's a dreadful bind, however, for traders, who depend on the gaps between high and low prices to make their money.

That helps explain why oil traders like Vitol SA and Trafigura Beheer BV are looking to invest in upstream and downstream operations where money can be made even in becalmed markets like the current one. Volatility is around an alltime low, Christopher Bake, a member of Vitol's executive committee, told an event in London earlier this month.

It also explains why grains trader Bunge Ltd. was the subject of a takeover approach last week, and why the bidder was Glencore a trader that's already a long way down the road of transforming itself into an integrated commodity producer.

Such times are unpleasant for traders, but there's a silver lining. Commodities markets have been becalmed many times before but furious squalls have always shown up in the end.

David Fickling is a Bloomberg Gadfly columnist covering commodities, as well as industrial and consumer companies. He has been a reporter for Bloomberg News, Dow Jones, the Wall Street Journal, the Financial Times and the Guardian.