Infomail
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Have All the Sellers Sold?
(Commodities – Too Much Pessimism)

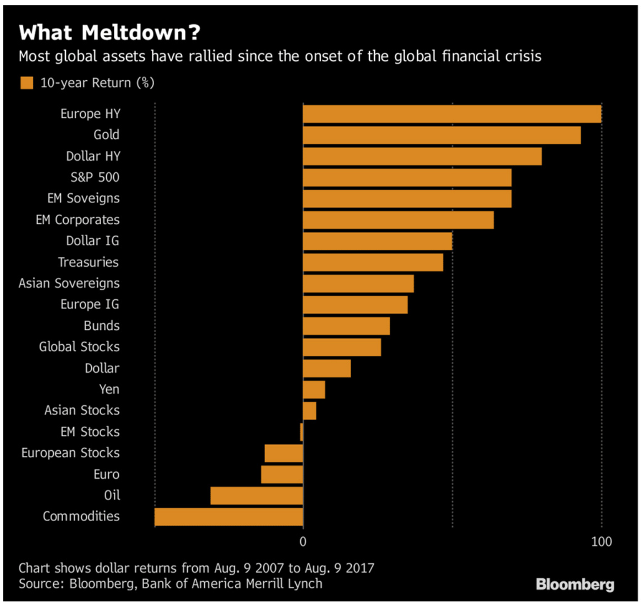
"Be fearful when others are greedy and greedy when others are fearful."

Warren Buffett

Being a contrarian doesn't always pay dividends, but more times than not, I'd say it's not a bad place to start looking for investment ideas.

What's hated the most of any asset class right now? All things resources (i.e. commodities).

Certainly markets have had a decent bounce out of the Great Recession of 2008-09. And while this may be the most un-loved, un-trusted bull market in history, the commodities sectors have seen the least amount of love. Take a look over the past 10 years:



There is no doubt, it has been truly ugly. Have all the sellers sold? Not sure, the sector has given us several head fake starts since it last peaked in 2008. And we've all learned, it's the timing that is the tricky part, and timing is everything.

Going out a little longer (100 years), we get an even better idea on how tough it truly has been for that sector:

Chart 1: 100 Years of Commodity Valuation

(1) Goldman Sachs Commodity Index to 1970. Goehring & Rozencwajg Commodity Index pre-1970.
Source: Bloomberg, Goehring & Rozencwajg Models.

Commodity valuations have not been this cheap since the 1970's, or almost 50 years. Renewed recent pessimism in the oil markets have been a major drag on the sector in 2017. The Bloomberg Energy Sub Index, which makes up nearly one third of the broad Commodity Index, is down about 20% this year.

The devastation of Hurricane Harvey last week, added to the problems, as the city of Houston, the centre of oil refining in the USA, was completely shut down. Throw in resurgent U.S. shale oil output, an expanding global economy, and OPEC cuts, and you have a lot of cross dynamics at work in the energy sector.

In the base metals sector, improving global industrial output should be supportive near term. Copper hit a 2 year high recently, lead hit multi-year highs, as have prices of steel, iron and aluminum. Last week nickel hit its 2017 high on rising stainless and battery demand.

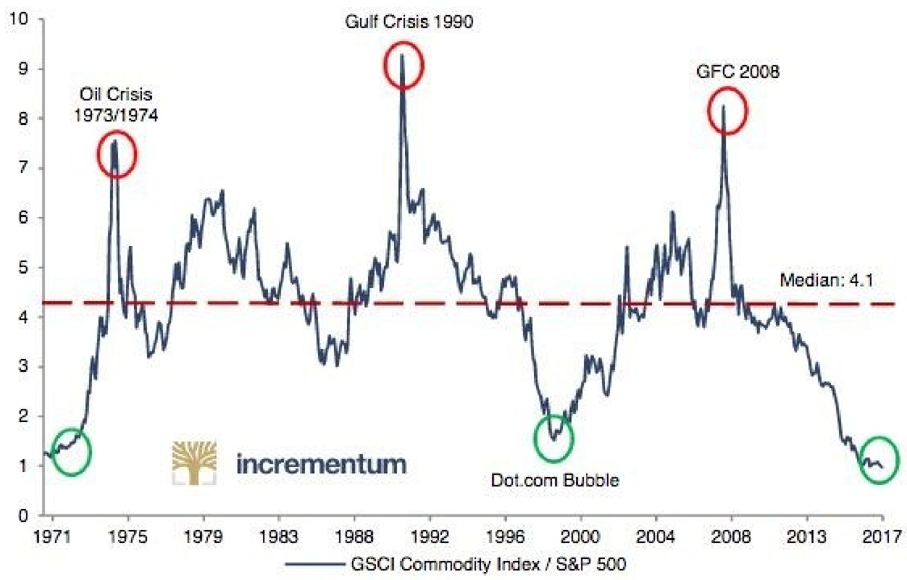
Gold has been one of the best performers so far in 2017, but most of the gold mining shares have yet to reflect that in their prices.

As we enter the last third of the year 2017, there are lots of things to be concerned about: North Korea, U.S. Government policy, the U.S debt ceiling, interest rates rising, uncertain bank monetary policy, valuations, etc…etc…

On valuations, an argument can be made the downturn in 2008-09 was so violent, that instead of a normal 4-5year cycle, that it took a decade to get back to 2007 levels, so we just finished the RECOVERY stage of the economic cycle and have yet to experience the EXPANSION (or growth) stage.

In the context of still low inflation, still low interest rates, and ample liquidity (i.e. cash on the sidelines), market valuations seem "OK". Not cheap, but not crazy expensive. However, as the chart shows below, the valuation of the Commodity Index vs. the S&P 500 has never been cheaper in the last 45+ years:

GSCI/S&P500 ratio: equities expensive, commodities cheap?



Source: Dr. Torsten Dennin, Incrementum AG

While the commodities sector ranks low on most momentum models, if we get the global synchronized growth I've been writing about happens, the cyclicals and commodities should lead the charge.

Remember too, no Canadian Bull Market has taken place without the commodity sector behind it. The recent strength in the Canadian dollar and metal prices may be forecasting what is around the corner.

"The stock market is a device for transferring money from the impatient to the patient."

Legendary investor, Warren Buffett

Stay tuned,

Vito Finucci, B.COMM, CIM, FCSI
Vice President and Director, Investment Advisor
Associate Portfolio Manager