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Is "Dr. Copper" a Quack?

Last issue, I asked rhetorically which market(s) are "lying." How was it that stocks (here in the U.S. of A., anyhow) have been making new highs even as the bond market seemed to be signaling danger, with yields creeping lower? With what seemed to be very disparate fundamentals arguing for the opposite, how is it that the euro was about to break out *higher* versus the U.S. dollar?

A related question is posed by the above headline. I'm sure that many of you have, in the past, heard of the red metal being referred to as *Dr. Copper*. Historically, copper has been proven to be one of the best barometers of the general health of the global economy. This key industrial metal is used in more areas of technology, infrastructure building, energy and others than pretty much any other substance. A strong copper price over the years has usually meant a healthy economy, *and vice versa*.

As this is written, the copper price has logged a close below the key $3.00 per pound mark for the first time in about 3 1/2 years. What is worrisome about Dr. Copper's "diagnosis" right now is that it comes *not* as the markets are throwing a conniption fit over the *belief* that global growth would be threatened by some event (you'll remember, perhaps, that last year's plunge in the copper price to near the $3.00 mark came after former Fed Chairman Ben Bernanke made public the central bank's plans to cut back on its money printing at some point.) Instead, it comes as economies are not only slowing, but doing so at a greater pace despite all the past money printing. Copper thus seems to be more accurately reflecting *a present reality*.

It is largely the economic slowdown -- and what could be the beginning of a credit market bust -- in China that has the copper trade on the back foot. Despite that country's insistence that it will somehow still manage to log GDP growth in the 7.5% range, competing figures have been released more frequently of late showing *an actual contraction* in economic activity. We just learned as well that Japan's GDP for the last quarter of 2013 was revised downward to a rate of 0.7% from a previous 1.0%; notably, in spite of its dramatically ramped-up money printing of the last year or so. In Europe, *economies* are crawling forward at best, even as capital flows into the euro and peripheral European debt have improved things -- for now -- for the continent's *markets*. Here in the U.S., things are less robust than was expected at 2013's close.

And it isn't just copper flashing a warning sign for global growth. At the beginning of this week, iron ore delivered into China plunged in price to $104.70 per metric ton, an 8.3% daily drop that is the second largest one-day decline *ever*. Other key industrial metals such as aluminum and (to a lesser extent, reportedly due to a looming supply shortage) zinc have also been weak for months. And over the last several days even the crude oil price has come off the boil, and is back below the $100 per barrel mark, as fears of weakening demand trump geopolitical ones.

Adding to the basic issue of weakening demand leading to weaker prices for copper and these other key commodities, we also have more acute worries of an implosion of debts in China. Indeed, to a very real--and rather scary--extent, the slow-motion train wreck of an overextended Chinese credit structure is seeming to feed the decline in many of these key base metals...and vice versa. Staple metals such as iron ore and copper are regularly used as collateral for loans, especially in the Wild West-type of environment that is China's shadow banking system. Much as happens when margin calls exaggerate the decline that might otherwise happen in an overvalued stock market, many are suggesting that some of these latest plunges in metal prices has been brought about by shaky debts in China. Here is how *Zero Hedge* (www.zerohedge.com) reported on this back on February 21, in part:

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> "As we warned last week, stockpiles of iron-ore have reached record levels in China as end-demand slumps but, as *Bloomberg* notes, this is potentially creating massive dislocations in other markets. Record imports of iron ore and copper, driven by traders who use them as loan collateral, risk repeating the vicious cycle of repayment difficulties and falling prices already seen in the steel-trading market. A **stunning 40 percent of the iron ore at China’s ports are part of finance deals** (having replaced copper after China's last shadow-banking crackdown) and with the glut, prices drop (driving down the value of collateral on loans) and '**borrowers, forced by their bankers to repay loans or to top up collateral, will have to sell the metals, sinking market prices even further and begetting a vicious cycle**.'"

. . . .

Early this week, a *Reuters* story explained that part of the reason for copper's latest, accelerating swoon was that a key Chinese buyer had failed to honor a contract to buy scrap copper. Together with the issue of the recent weakening of the yuan that I spoke of several days ago, the discussion regarding plunging metal prices is appropriately morphing from, simply, one of a country that is no longer the driver of growth that it was in the past decade, but into a story of *an entire country* that might turn into the "Lehman Brothers" of the next major monkey wrench to be thrown into global markets.

So far, last week's default of Shanghai Chaori Science and Technology has not brought global markets to their knees. But China's *seeming* decision to try and reintroduce such outmoded concepts as actual credit worthiness into the decision-making process of investors is not without risk. Policymakers in America thought they were doing the right thing *morally* when they let Lehman go belly up in 2008 also, *and look what happened*. It's a bit late in the game for China as well to try to force debt markets to take on a little more discipline and responsibility for their own actions and to price risk as it should be priced. It will be neither easy nor painless to back out of a regimen where investors can do darn near anything based on their belief that the People's Bank of China, or the central government itself, will make any bad decisions good. We know neither if nor when the right kind of "weak link" will be revealed in China that breaks the chain. But the markets seemingly now are paying a bit more attention to the possibility.

FINANCIAL AND MARKET POTPOURRI

ITEM: BHP's Mackenzie says commodity "supercycle" ended a few years ago

In an interview with CNBC's Sharon Epperson from a trade show in Houston, Texas last week, Andrew Mackenzie, the C.E.O. of global mining giant **BHP Billiton** (a former successful pick of ours) opined that the former "supercycle" in the commodity markets (from roughly 2001-2008) is over with. It ended "quite a few years ago," he said.

Mackenzie, of course, credited China's breakneck growth with having fueled the boom of the last decade. In textbook fashion, a powerful commodity cycle was born from what had been a roughly two decade bear market for most commodities. The slight amount of exploration activity, production that had been ramped down due to low prices and all the rest did a "180" as, in dramatic fashion, the explosion in demand reinvigorated metals markets in particular. We all enjoyed that run!

But with China making an attempt to "transition" from an economic model tilted toward infrastructure development in favor of one led by domestic consumption (and without having its banking system implode in the process) there is no longer such a growth driver for most industrial commodities, says Mackenzie. Thus, his company has already started to stress investments in energy and fertilizers (where have you heard that before, folks?) ...

(The above is an excerpt pulled from the first regular issue of *The National Investor* for March, 2014.)

Our predictions -- and warnings -- of the nature of the commodities trade as we enter 2014 have thus far panned out. As BHP's Mackenzie has also intimated, we will plainly not be seeing the kind of broad move in commodities that was driven chiefly by China from 2001-2008. This will be a selective one.

As we have said, investors will want to focus on precious metals (gold, the PGM's and silver, *in that order*), agricultural-related commodities and -- carefully -- reasonably-priced plays in energy.

We continue to incrementally add opportunities in these areas for our Members...do learn and take advantage of them, we invite you to join us! Simply visit us at www.thenationalinvestor.com and click on the link Subscribe/Renew; there, you'll see a unique discounted offer, and several FREE gifts that will be yours!
