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ARE WE IN A COMMODITIES BOOM OR BUST?

By Arin Ruttenberg, Financial Advisor at Brenthurst Wealth Sandton

THE VOLATILITY IN COMMODITIES CAN PRESENT BOTH DANGER AND OPPORTUNITY, DEPENDING ON WHERE WE ARE IN THE CYCLE.

The oil price hit fresh new highs on Monday, 7 March, touching \$139 per barrel before pulling back to \$128 per barrel later in the day. On the same day palladium briefly hit \$3 440.76 per ounce, an all-time high, and the gold price tested \$2 000 per ounce.

This is largely driven by the ongoing Russia-Ukraine tension, which has now made commodity price moves headline news. But will it last? And what does it mean in terms of investment returns?

The graph below shows the Bloomberg Commodities Index since inception, now up a total of 24% since 1991. That is an annual return of about 0.8%.

That is well below the approximate annual 2.5% inflation rate in the US over the same time, and a lower return than investors earned in USD cash. Three-month US Treasury Bills have returned 2.3% per annum since 1991.

There are many ways to dissect commodities over this time, such as taking individual weightings of specific groups or even 100% of one commodity, but to make things easier I selected this index as it is a popular broad-based commodities index comprising of 23 exchange-traded contracts on physical commodities (see groups below).

BLOOMBERG COMMODITIES INDEX SINCE INCEPTION, NOW UP A TOTAL OF 24% SINCE 1991



THE VOLATILITY IN COMMODITIES CAN PRESENT BOTH DANGER AND OPPORTUNITY, DEPENDING ON WHERE WE ARE IN THE CYCLE.

Group	Commodity
Energy	WTI Crude Oil Natural Gas Brent Crude Oil Low Sulphur Has Oil RBOB Gasoline ULS Diesel
Grains	Corn Soybeans Soybean Meal Wheat Soybean Oil HRH Wheat
Industrial Metals	Copper Aluminium Zinc Nickel
Precious Metals	Gold Silver
Softs	Sugar Coffee Cotton
Livestock	Live Cattle Lean Hogs

This basket of commodities has delivered roughly the same returns as cash, but with much higher volatility.

Volatility is neither good nor bad, but depends on how investors apply and react to that volatility. Portfolios can be built to withstand volatility by using diversification via strategic or tactical asset allocation.



THIS IS THE BOOM/BUST NATURE OF THIS ASSET CLASS:

SOMETIMES THESE CYCLES ARE SHORT. OTHER TIMES THEY CAN LAST FOR AN EXTENDED PERIOD.

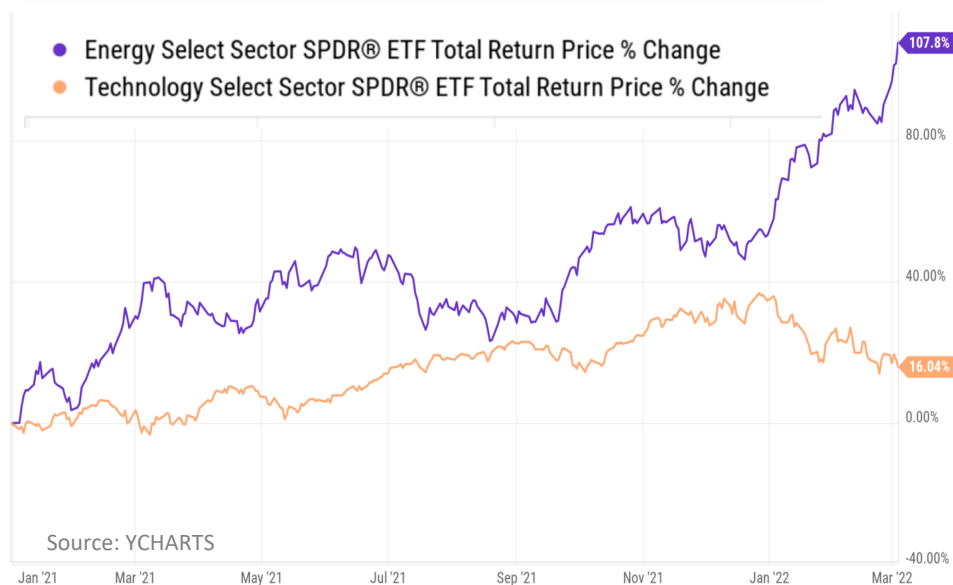
Time Frame	Total Returns
1991-1996	68.6%
1997-1998	-29.5%
1999-2000	63.9%
2001	-19.5%
2002-2007	145.2%
2008-2020	-54.3%
2021-2022	46.9%
Bloomberg Commodities Total Return Index (thru Feb 2022)	

IT IS CERTAINLY POSSIBLE THAT WE ARE HEADING TOWARDS ANOTHER COMMODITIES BOOM OR SUPERCYCLE AND THE TRANSITION TO RENEWABLE FORMS OF ENERGY IS NOT GOING TO BE A SMOOTH PROCESS.

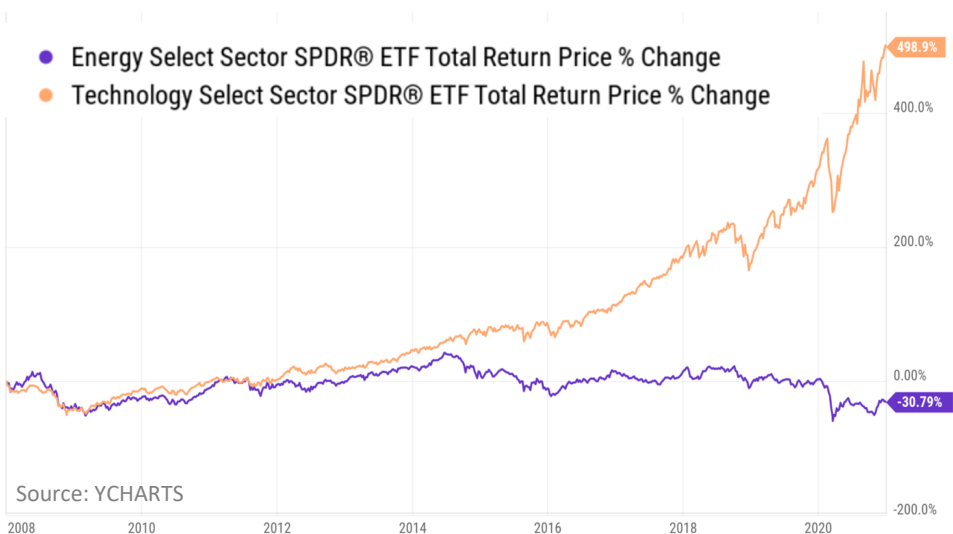
WE ARE DEALING WITH SUPPLY CHAIN ISSUES, THE PANDEMIC AND A WAR INVOLVING ONE OF THE BIGGEST ENERGY SUPPLIERS IN THE WORLD.

Whilst technology is assumed to be deflationary, despite the current headwinds, things do not work in a straight line.

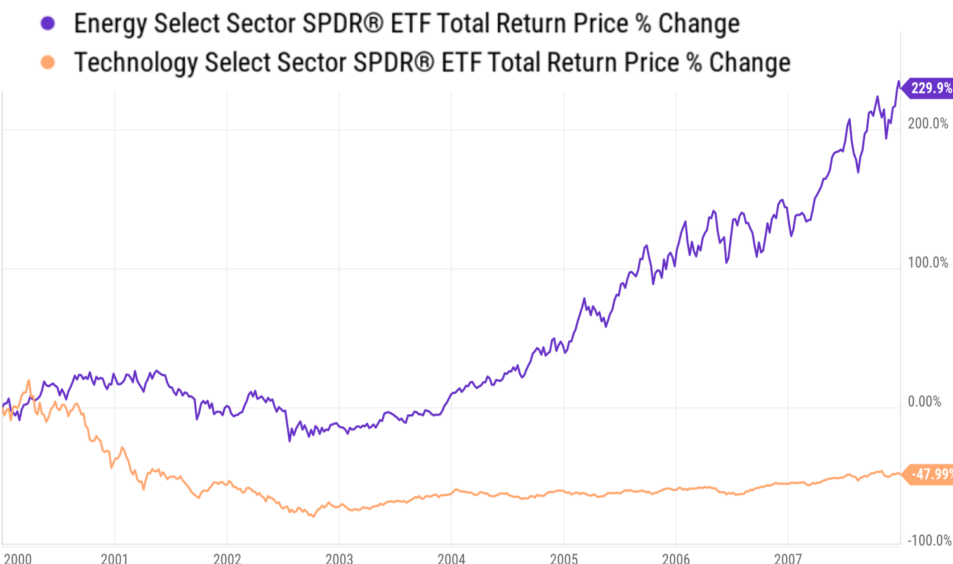
THIS TUG-OF-WAR ACTUALLY MAKES FOR INTERESTING BOOM-BUST CYCLES IN TECHNOLOGY, AS WELL AS IN ENERGY STOCKS. LET US TAKE A LOOK AT SOME HISTORY BETWEEN THE TWO.



Following the bursting of the DOT-COM BUBBLE at the beginning of the 2000s, commodities went into a bull market that saw energy stocks trump tech stocks.



The aftermath of the 2008 FINANCIAL CRISIS saw a reversal of this trend in a big way, as tech stocks have since performed remarkably, while energy stocks got hammered.



The recent reporting of the highest INFLATION RATES in four decades in the US and a strong comeback in oil prices has seen energy stocks take the lead again since the start of 2021.

This year alone the energy sector is up almost 36%, while tech stocks have fallen nearly 14%.

Despite the current run-up in prices of energy stocks, the long-drawn-out bear market in energy stocks caused major damage to the sector. In 2008 energy stocks made up 17% of the S&P 500. By 2020 it was down to 2.7% of the index. Even after gaining more than 100% since 2021, energy stocks still make up less than 4% of the S&P.

Investors who are bullish about energy stocks will likely say that there is still a lot of room to run, after getting hammered for more than a decade.

Investors who are bearish about energy stocks could argue that these things are always cyclical, and that nothing lasts forever.

Just like commodities, it is impossible to know if the energy sector outperformance will last. The hard part about cycles is that their lengths and magnitudes are impossible to predict.

The problem for many long-term investors is how they react to the boom-bust nature of commodities.

After the boom of energy and commodities from the early to mid-2000s, investors rushed to add or increase their holdings of commodities to their asset allocation strategy. Many chased those highs just before commodities were about to go into hibernation again, starting in 2008. However, after years of pain, volatility and losses, investors who added commodities to their portfolios at the end of the first decade of this century finally gave in and sold them.

The worst thing you can do when it comes to cyclical investments, is to invest in them after the gains have been made and sell them after already having suffered the losses during a bust or bear cycle.

The resurgence in energy stocks and commodities, combined with a slowdown in tech stocks, also provides a vital reminder to investors that nothing lasts forever in markets. Whether it be higher interest rates driving tech valuations down, high inflation or geopolitics driving up the prices of commodities, it remains the same free lunch in investing, as always, to remain diversified in a manner that overexposure to any sector should be avoided, unless you have the experience to make such tactical allocations.

The average investor does not have that experience and it is, therefore, advisable to consult a qualified and experienced advisor or portfolio manager that understands your unique needs, time frame and risk profile and can, most importantly, prevent you from making emotional decisions.

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