

BASE METAL PRICES 2000-2005

UPDATE 1Q2002

Synopsis:

Using copper as a proxy, base metal prices have increased to an important high with the dramatic conclusion of each new financial era, from which a very long bear market followed.

We identified the top for what it was in 1Q2000 and summed it up in our May 23, 2000 special study. Then, when our index was 696, our initial target was 375. As this adequately described the most likely course of events, the original is attached.

Near Term:

For last year, base metal prices were expected to recover with the stock market and narrowing credit spreads until April-May. The high was 546 on May 21 - the high for the Nasdaq was on May 22.

After this, prices would continue their decline with the trend accelerating with mounting financial pressures beginning in September/2001.

Long Term:

Eventually, a reliable post-boom feature has been a chronically strong reserve currency. That's against most currencies and most commodities most of the time. The original study concluded that the consumption growth curve would flatten to around zero (0%) as the global economy contracted. The following table indicates the duration of the deflation consequent to a New Era.

Rise	New Era End	Initial Decline	Duration Decline	Ultimate Low	Duration
1 year	1825	to 1830	5 years	1840	15 years
2 years	1873	to 1879	6 years	1894	21 years
3 years	1929	to 1934	5 years	1944	15 years
1 year	2000	to 2005	????	????	????

The last liquidity crisis was expected to clear around November and some favourable developments were expected to run until around March, 2002. This would include recovering base metal prices (✓), narrowing credit spreads (✓), and a flattening treasury curve as short rates increased (✓).

In reviewing this in mid/February, the 9/11 atrocity accelerated the expected crisis and the rapid rebound in the stock markets and base metal prices seems to have preempted much of the gains expected to late February-March.

Base metal prices hit our target of 375 on November 2 and recovered to highs of 475 on January 16 and February 5. Favourable seasonal influences usually expected from March to May could be curbed or violated by the financial and economic contraction scheduled to resume around mid/year.

BASE METAL PRICES

MAY 23, 2000

The probability of an important decline in base metal prices seems to be increasing. First of all, we have had an outstanding rally of somewhat more than a year's length, which has been typical of the recoveries for the last 30 years. Indicative of this, the Coppock on The Economist Commodity Index gave a huge cyclical "buy" in December, 1998.

Other and somewhat independent timing also seems in place. Often stock markets have completed speculative bull markets some 18 months after interest rates began their rise. This was the case for most tech sectors in March.

Boom Indicators:

Beyond being something to forecast or even consume, base metal prices are a key item in our Boom Indicators, which collectively turned positive in early 1999. These reached a very positive reading at the first of the year and quickly turned negative in February. In turning negative in March 1998, these anticipated the financial distress that began that July with the subsequent shock of the LTCM calamity.

These indicators continue to deteriorate, with adverse developments in credit spreads and the U.S. yield curve the most concerning. From a cyclical high reading of 12 (14 is max) on January 3, the decline to 6 in February we took as a warning on most aspects of the global financial mania. Of interest, during the stock market rebound from April 14, the indicators did not improve but declined with the latest changes from May 11 to 22, bringing the reading to 0. The warning is now severe.

More specifically, within our indicators, the U.S. yield curve, as determined by the yield ratio between 30-year AAA bonds and 180-day commercial paper, has been very reliable. Over the past 140 years, whenever the curve inverted a recession was inevitable. In some cases, only reaching 90% of inversion anticipated a recession. The ratio reached .883 on May 18. The last high (.89) on July 6/98 nicely anticipated the subsequent harsh deflation in most commodity prices.

Consumption Growth Trends:

Should the indicators continue to deteriorate, the implications are awesome and the outcome bears hypothetical discussion. The speculation in financial assets (including incredible misadventures in spread markets) has been equivalent to the action in precious and base metals in 1980. That marked the end of the long phase of dynamic economic expansion. From 1949 to the late 1970s, the trend of non-ferrous metal consumption averaged 5.7% growth annually.

One of the features of new eras has been adequate industrial capacity, disinflationary pricing pressures, and a shift to financial speculation. As in previous examples, the growth trend in metal demand has declined, and since the bull market began in 1982 it has averaged 3.0% - a noticeable change.

On the big picture, base metal prices in real terms have had their highest prices during the global boom in tangible assets, but record only a secondary recovery during the final phase of a mania in financial assets. A long period of financial and economic contraction has followed each such bubble. These conditions have taken down base metal prices in real or nominal terms for a number of years. Should financial pressures become more acute, consumption figures could trend near zero for around 5 years.

Attached is our study of Fabulous Cars and Fabulous Bull Markets. According to reports in May, the fashion for extravagant SUVs seems to be diminishing, and should it continue to do so, it will have a noticeable effect on metal consumption per car. [This is now in our website, which also includes a review of our Economic Research.]

Going the other way, once each bubble was over, the consequent contraction in the normal instruments of credit sharply increased the investment demand for gold. To meet this, real or deflated prices in every case increased for at least 3 years within a much longer trend.

Our advice to producers has been to sell base metals forward into a rising market through May. Now our advice is to be very aggressive in selling forward. Similar aggression could be applied to covering forward sales in gold.

Wrap:

For readers new to our work, the advice in March/97 was that "another rally could set up the market [base metals] for a magnificent failure". Our base metals index increased to 624 in late April and the May/97 edition projected the decline in two years to 350. The low was 358 in January, 1999.

Currently, supported by unusual circumstances for nickel, our index is at 696. However, another phase of credit contraction could take the index down to around 375. The index, minus nickel, has accomplished a 50% retracement of the decline to mid-April which was associated with the first phase of liquidation in the Nasdaq, which is now setting new lows. Most base metals and mining shares are vulnerable to another period of deflation.

Original Study - May 23, 2000

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