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## MV Capital Management Weekly Market Flash

### A Tale of Four Commodities

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We normally think of commodities as a single asset class: an alternative investment exposure alongside equities and fixed income. An examination of commodities trends in 2014 to date should disabuse anyone of the idea that there is much in the way of close correlation between the major commodities sub-classes. Global macroeconomic trends, geopolitics, Mother Nature and quirky human behavioral economics all have an impact on commodities prices. In this piece we look at four representative exposures to the main commodities groupings of energy, industrial materials, precious metals and agriculture.

#### Crude Oil: The Economics of Geopolitics

“Geopolitics” is the term we use to describe socio-political flashpoints around the world, but more often than not the term could be substituted with “whatever is happening in the Middle East this week”. Unsurprisingly, the major action in crude oil trends so far this year has taken place in the last couple weeks, as violent civil unrest once again threatens the sustainability of a single government in Iraq. Prices for Brent crude, a key benchmark, shot up 8.5% from mid-April to mid-June (they have subsided somewhat since then). With the summer driving season in full swing we should not be surprised to see continued upward pressure on crude – and its downstream refined products – in the weeks ahead.

#### Copper: As Goes China...

Copper is widely used as a proxy for industrial metals, the fortunes of which very much track trends in the world’s major manufacturing centers. Today that means China more than anywhere else, and copper’s rather volatile trajectory in 2014 reflects investor perceptions of how well China is managing its dual objectives of economic growth and rebalancing its GDP mix to a more stable allocation between consumption and investment. At the beginning of the year those perceptions were negative, and a “China hard landing” turned into one of the driving motifs of the first twelve weeks or so of the year. Copper prices plunged 12.3% through mid-March, at which point data coming out of China were conflicting enough to indicate that a major negative event was not imminent. Prices have regained strength since then, and have recently regained position above key technical support levels, though still down year to date.

#### Corn: The Climate Change Commodity

Two years ago a scorching drought hit the Midwest, America’s breadbasket, and agricultural prices soared. Since then, extreme weather events have become a familiar part of the daily news refrain. 2014 started with one of the coldest, nastiest winters on record, and investors appeared to believe this signaled another rough year for crop harvests. Corn futures prices, one of the benchmark agricultural commodities, soared 20% from January to early May. Then, a bevy of crop reports indicated that this year’s harvests are actually likely to be some of the best in recent years. That has resulted in a dramatic plunge over the past six weeks, to where corn futures prices are now just below where they started the year. Climate change is a reality, but it would seem that betting against Mother Nature remains a fool’s errand.

## Gold: The Risk-Off Mindset Continues

Precious metals occupy a strange place in the popular mindset. The storied role of gold throughout human economic history gives it a luster as something special: an asset towards which to run when things start to look grim. In 2011 gold prices soared as the Eurozone seemed on the edge of collapse and political dysfunction drove the U.S. to the brink of a debt default. But what the gold bugs never seem to comprehend is that gold is just another commodity, the price of which rises and falls like any other. Currently prices are about 30% below those highs reached in 2011. Gold is up about 7.2% in 2014; recently it has followed crude oil up as a hard-asset play amid uncertainty in the Middle East. But there's no magic here. There is no floor to gold prices, there are no contractual obligations to repay principal to investors (as there are with fixed income instruments), and so it is hard to make a compelling case for gold being a safe haven.

So there we are: two key commodities sectors up (crude oil and gold) and two down (copper and corn) as the second half gets underway. As the tone of this paper should indicate, we tend to be skeptical of the value in predicting near-term commodities price trends. But we do pay attention to correlation relationships between commodities, equities and fixed income. These have been much higher in recent years than historical norms, but we see some evidence of potential mean reversion. That may afford an opportunity to bring commodities back into our asset allocation mix.

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