PIVOTAL EVENTS

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Secular Bear For Copper?

Signs Of The Times

"Fed eyes new round of stimulus"

– Globe & Mail, July 14, 2011

"The Federal Reserve remains prepared to respond should economic developments indicate an adjustment of monetary policy would be appropriate."

– Ben Bernanke, July 14, 2011

Quite likely the Chairman of the Federal Reserve System has been saying something similar since it opened the doors in January 1914.

Even though the chairman was not saying it every day, the 96 percent drop in the purchasing power of the dollar suggests that "appropriate" policy has been imposed every day. That amounts to 35,606 days of inappropriate interference with the markets.

"72% favor a free market economy over one managed by the government."

– Rasmussen, July 8, 2011

The report also noted that the number was 75% for those working in the private sector. Over in the government sector, only 53% understand the blessings of a free-market economy.

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Big Picture

The rebound for the stock market out of the slump to mid-June became too enthusiastic – too soon. Our technical research was looking for a rebound out to late July. The first bounce was set back by the discovery that the sovereign debt problem had infected Italy. This distress will continue.

In the meantime there is money to be made in trading.

It seems likely that the US debt ceiling crisis will be resolved by the end of the month. This could provide the surge needed to end the move. The ChartWorks will watch for the opportunity.

Generally, the action in credit spreads, base metal prices and agricultural commodities have been favourable. This was likely to run until the end of the month.

COMMODITIES

Copper has rallied from the low of 3.85 in May to 4.50 on Tuesday. A gain of 17 percent in two months is rather good, but it is worth noting that it jumped from 4.00 to the 4.50 in only 4 weeks. As mentioned, it is in a pattern that can lead to a substantial decline.

Ross is preparing the technical study and this page will look into some of the history. The following updates a piece done a few years ago.

Since the significant lows of 2002, base metal prices have recorded two outstanding rallies. Using the numbers for copper and in real terms the percent gain was the greatest on data back to 1900.

Recent Excesses In Copper

"Analysts have found it difficult to quantify effervescence."

The observation has been an old one, and with the amount of data available these days one can at least place effervescence in perspective. Using copper's price deflated by the Producer Price Index provides a methodical start to reviewing the crowd's age-old ability to boost prices to the moon.

The following tables all of the big bull markets since 1913. The lowest gain was 104% during the "Roaring Twenties". Over all the decades until the most recent one, the biggest bull market accomplished a gain of 172%. Most were between 151% and 172%.

However, in the 2000s the action in copper became, well, hysterical. The rally in the real price topped out at a gain of 427%. That's two and half times the best previous. It took 54 months to accomplish.

The rally that began 26 months ago gained 252% to 483 on the surge into February. This compares to the 2006 high of 501. In technical terms this was an immense test of the high and the failure (on the chart) is obvious.

Technical failure is confirmed by our Momentum Peak Forecaster that signaled the recessions of 1974 and 1980. That was associated with outstanding rallies in commodities and the recession started virtually with the highs.

COPPER

(Deflated By PPI)

LOW	HIGH	GAIN	DURATION
December/2008 134	February/2011 472	252%	26 Months
November/2001 95	November/2005 501	427%	54 Months
October/1984 90.6	December/1988 240.8	166%	39 Months
March/1958 115.9	May/1970 253.4	119%	140 Months
June/1949 91.7	March/1956 249.7	172%	81 Months
December/1932 69.1	March/1937 173.5	151%	63 Months
January/1924 110.5	April/1929 225.1	104%	63 Months
November/1914 154.3	April/1916 335.9	118%	17 Months

Source: www.thechartstore.com

Implication – Secular Bear Market

Copper's real price reached 337 in 1974 and 330 in 1980. Each accomplished a brief spike to the high.

Altogether, it was enough to prompt an enthusiastic expansion of copper production. From the secular high of 337 copper's real price declined to 95 in 2001. With some big swings, the secular bear prevailed for 27 years.

The earlier secular high was 423 in 1916 and the exceptionally high price ran for two years. The secular bear prevailed until 119 in 1946.

This time around, the high was orders of magnitude greater and ran for some 4 years, or twice as long as the best previous. This is prompting a huge and very enthusiastic expansion of copper capacity. Perhaps equivalent to the mid-1800s when the US population growth and migration from rural to city as well as industrial expansion, was equivalent to China's recent history.

Bigger Picture

The above numbers are from www.thechartstore.com and earlier numbers (annual averages against the CPI) were assembled by this writer in the 1970s.

The pattern for copper's real price goes opposite to gold's real price.

With the era of inflation of the early 1800s copper's real price was at a high at 137 in 1806. The low with that Great Depression was 81 in 1839.

On the same move, gold's real price increased from 107 to 174.

The next era of inflation lifted copper to 95.2 in 1864 from where it declined to 66.7 in 1895. That Great Depression ended in 1895.

On the same move, gold increased from 124 set with the end of the 1873 bubble, to 220 in 1895. When gold turned up it also confirmed the end of that Great Depression.

The next era of inflation drove copper's price to 93.1 in 1916 from where it declined to 32 in 1945. That marked the end of that Great Depression.

On the same move, gold's real price increased from 103 in 1921 to 235 in 1935. This reflected the extraordinary intervention by FDR in moving the dollar price from 20.67 to 35.

On the full contraction, gold went from 103 in 1921 to 175 in 1949.

To be consistent all prices are UK, which was the senior economy until the Second World War.

Some Comparisons

Those with an eye for numbers will appreciate the methodical gains in gold and the almost methodical declines in copper on each Depression. Copper prices start in 1806.

Inflation Era	Depression Trough	Increase/Decrease
1700-1720	1743	
Gold 130	220	1.69 Times
1800-1825	1844	
Gold 107	174	1.63 Times
Copper 137	81	-1.69 Times
1860-1873	1895	
Gold 130	220	1.69 Times
Copper 95.2	66.7	-1.43 Times
1910-1929	1946	
Gold 103	175	1.70 Times
Copper 93.1	32	-2.9 Times

Gold's record on each Depression has been a consistent increase of 1.7 times to round off the number. This was clocked no matter what variations in the senior central bank policy about interest rates or foreign exchange pressures. It prevailed whether England was at war or enjoying peace.

With rising gold prices each Depression recorded substantial increases in production. Of interest is that while the price increase was the same, the increase in production varied. On the Depression that ended in the 1890s annual production increased from 136 tonnes in 1874 to 462 tonnes in 1899. An increases of 3.4 Times.

On the next Depression annual production increased from 582 in 1929 to 1122 in 1940 when the War dislocated production. The increase was 1.9 Times.

Numbers in the early 1800s are provided in nine-year spans but the implied annual rate soared from around 10 to around 190 with the gold rushes that typically blossom at the end of a Great Depression.

Annual copper production briefly slumped with each financial disaster and then resumed the long-term uptrend.

Copper Stocks

Copper stocks were the darlings of the 1873 financial bubble and the Mining and Smelting Index soared from 99 in January 1871 (there was the Franco-Prussian War and the world was going to run out of copper) to 447 in late 1872. From a high of 419 in 1873, the mining index declined to 24 (no typo) in 1884. The low with the Depression bottom was 25 in 1897.

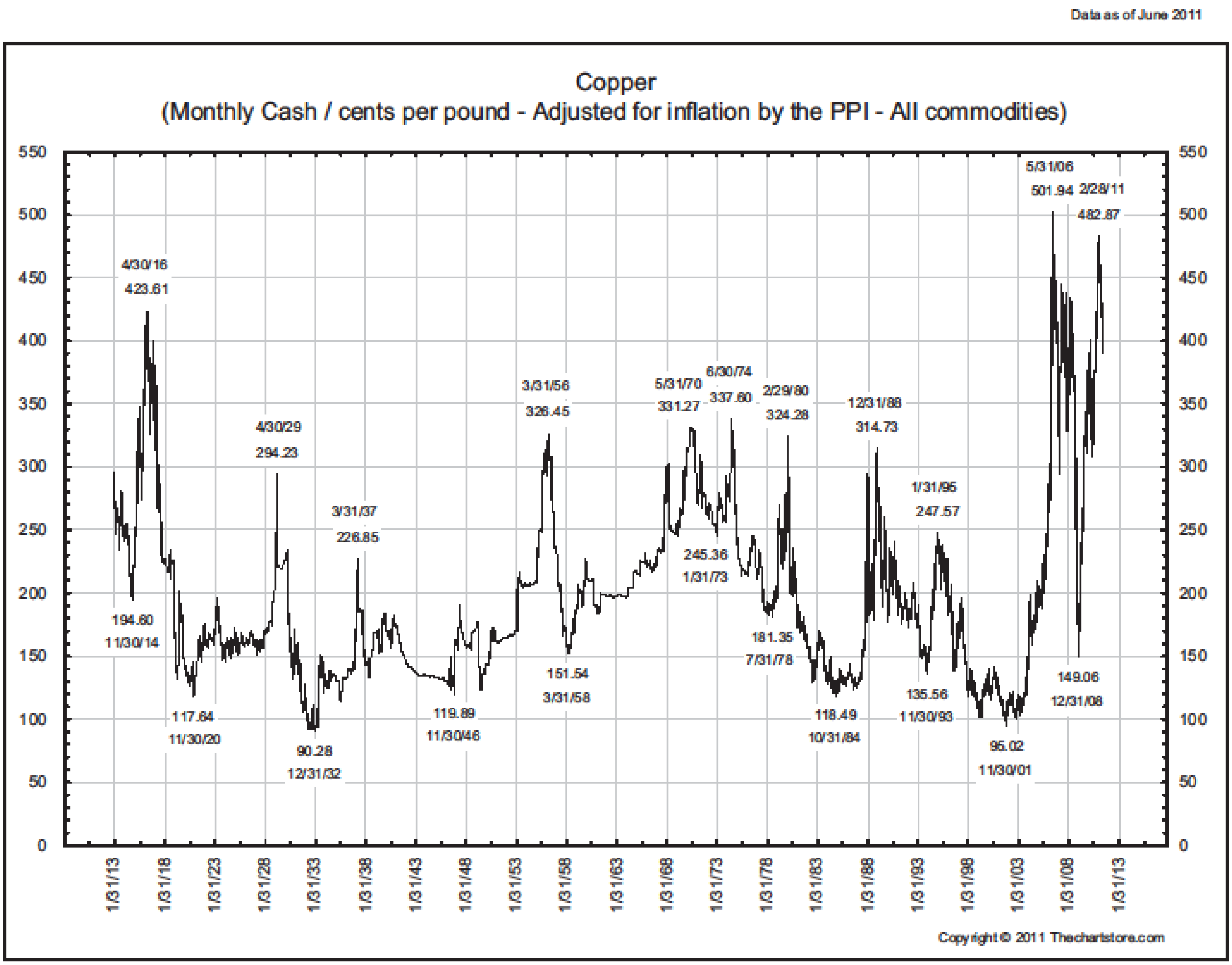
Obviously, mining stocks suffered a secular bear market with the equally long bear market for copper's real price. The general uptrend in annual production provided more distraction than help to beleaguered shareholders.

The behaviour of gold and copper lends itself to historical and technical analysis. Traditional fundamental analysis of supply and demand has been impractical. This seems to be confirmed by a perceptive comment from The Economist on fundamental research in the 1873 mania.

> "***By articles in newspapers, reviews and magazines all sorts and conditions of men were induced to interest themselves in copper. It was shown by figures and arguments, apparently conclusive, and presented with great ability . . . that the world's*** [supply] ***of copper would be so much reduced that famine prices must prevail. The confidence in the future was strong enough to cause a <u>further</u> advance of 25 per cent, which was more than lost in the sequel, furnishing a fresh illustration of the rapid action of high prices in these days in bringing forward supplies from every quarter of the globe***."

These comments could apply to the grave concerns about coal in that inflation era when the leading economist, Stanley Jevons was going on about "Peak Coal" to create a phrase based upon the outbreak of hysterical research with "Peak Oil" that, well, peaked at 147 in 2008.

Quite likely, current high prices will soon be ***"bringing forward supplies from every quarter of the globe"***.



Separately, Ross has updated his model on copper that integrates technical and historical research.

This will provide the path to exit the base metal sector.

Longer-term, the decline in the PPI-deflated price with the last Depression was from 423 to 90. From 337 at the 1974 peak, the price fell to 95 in 2001.

There could be an uptrend in the rising toughs so our guess is that the pending secular bear market could take copper's real price, as deflated by the PPI, down from 501 in 2006 to around 110-140.

Base metal mining stocks would decline proportionately.

CURRENCIES

At the end of June we thought the Canadian dollar could trend up to September. So far, the rise has been from 101.3 to today's 106. Last week we thought it could reach the old high of 105.9.

This was based upon the DX correcting into the summer. Due to sovereign debt turmoil the US dollar has been firmer than expected, but the consolidation could continue into August. That is with the understanding that the severe part of the sovereign debt crisis has yet to be seen.

CREDIT MARKETS

Credit spreads became rather narrow as the street forgot about risk. This flowered in April, just in time for the seasonal reversal to widening in May. If the party has been outstanding going into May, distress will be discovered in the fall.

Early in the year our Forecaster expected the party in hot games to culminate around April. It did.

It also expected the recession to start with the peak in commodities. This seems likely.

COMMODITIES

The CRB plunged from 371 in late April to 333 in mid-May. The rebound made it to 352 in June and the next decline was to 326.

The next rally made it to 350 last week. This seems to be a test of the rebound and commodities are likely to decline in the fall. This would be part of a liquidity problem with a firming dollar.

PRECIOUS METALS SECTOR

Ross has been providing frequent and reliable comments on the sector.

The very long term has been covered above and it is worth adding that gold's real price had been expected to turn up in advance of the hot games blowing out in April.

This time around and using our Gold/Commodities Index, the low was 303 in February and the uptrend was set at 338 in mid-April.

This continued to 388 on June 22nd. The slight decline since has been associated with the rebound in the favourite games, which could run out of steam in a few weeks.

The next rise in gold's real price could take it well towards the 518 reached with the panic that ended in March 2009.

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