Platinum Could Flatten 'Em

Shortly after the SPDR Gold Trust became successful and inspired a host of imitators such as the iShares Silver Trust (Does Wall Street ever do anything once? Does Wall Street ever do anything once?) I remarked they had better not try a similar physical-repository ETF for platinum lest its price go to infinity or even higher.

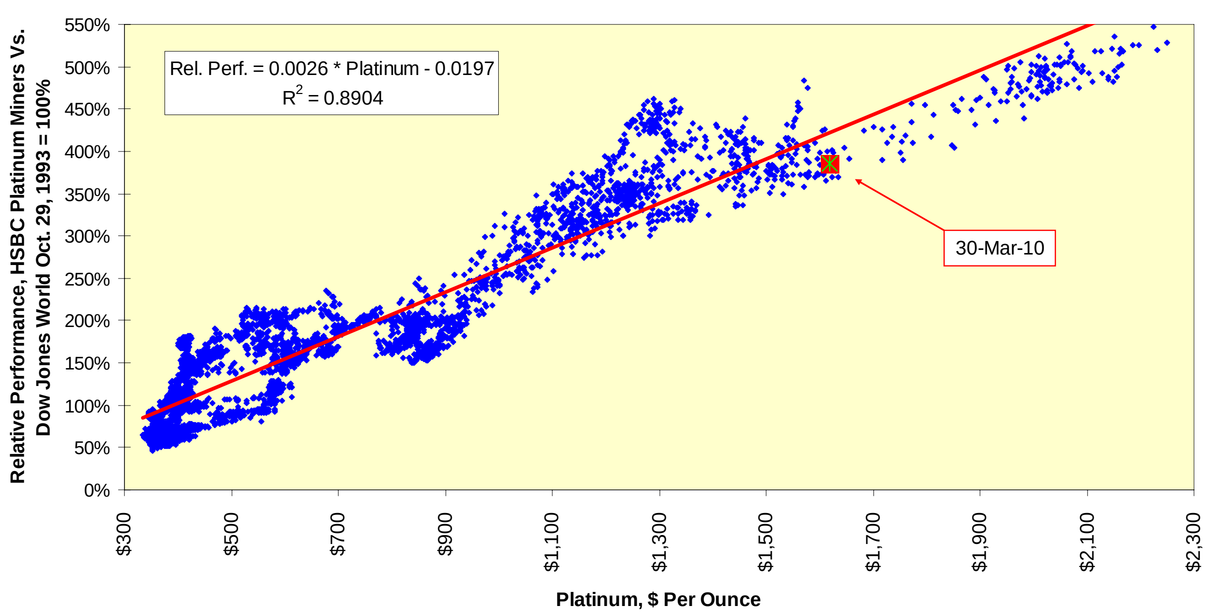
The reason is strikingly simple: While gold is mined only to be reburied in vaults, the platinum group metals (PGMs) are so useful you have to appreciate the Divine wit involved. While palladium is reasonably abundant, rhodium, ruthenium and iridium are so rare it was the telltale presence of iridium, more common in meteorites than in terrestrial rocks, in a layer of clay between Cretaceous and Tertiary (or Paleogene, if you prefer) rocks that led to the theory the dinosaurs were clobbered by an asteroid. Divine wit, indeed.

The mere prospect of platinum and palladium being removed from the market by ETFs such as the ETFS Platinum and Palladium Trusts was sufficient to duplicate the experience seen with silver and cause preemptive buying of the metals. If we add rising industrial demand to the mix from recovering automobile manufacture, the refiners and petrochemical plants that used PGM-based catalysts would be faced with spiraling costs.

Even worse, the demand for PGM catalysts is extremely inelastic. A refinery is not going to close over higher catalyst costs; it could close, however, if the physical metal becomes unavailable. All it would take to end the ETF game would be to have one refiner close one operating unit and watch gasoline prices jump. An activist CFTC not predisposed to liking commodity traders – I would go find something else to do if that is how I woke up in the morning – would hit these things with both feet.

If you really want exposure to platinum prices, you are much better off either trading a financial claim such as the NYMEX futures or trading the equities of platinum miners. In an interesting exception to my general maxim not to trade commodity-linked equities as substitutes for the underlying commodity, the incremental performance of an HSBC platinum miners' index to the Dow Jones World index since late 1993 has been a near-linear function of platinum prices themselves. Restated, this means owning the stocks of platinum miners instead of a global stock index will get you that exposure you think you crave.

Platinum Miners Have Captured Metal's Gain Reasonably Well



The argument reverts back to trade-the-commodity-instead-of-the-stock for palladium. Here the incremental performance of the platinum miners failed to capture the huge price spike in palladium in 2000-2001 resulting from a disruption in Russian exports. In addition, if we separate the history since December 24, 2009, the start of the ETF-induced upside breakout in palladium, (why do these moves always start during holidays?) highlighted in red markers, we see the miners are failing to respond directly to higher prices. Palladium needs to be traded as palladium; I recommend the NYMEX futures.

Finally, the general move higher in the PGMs is to be welcomed as an unmistakable sign of revived manufacturing growth worldwide. It is not a perfect indicator, but when PGM prices are rising and indicators such as the platinum-gold spread are moving in platinum's favor, things are going right in the world.