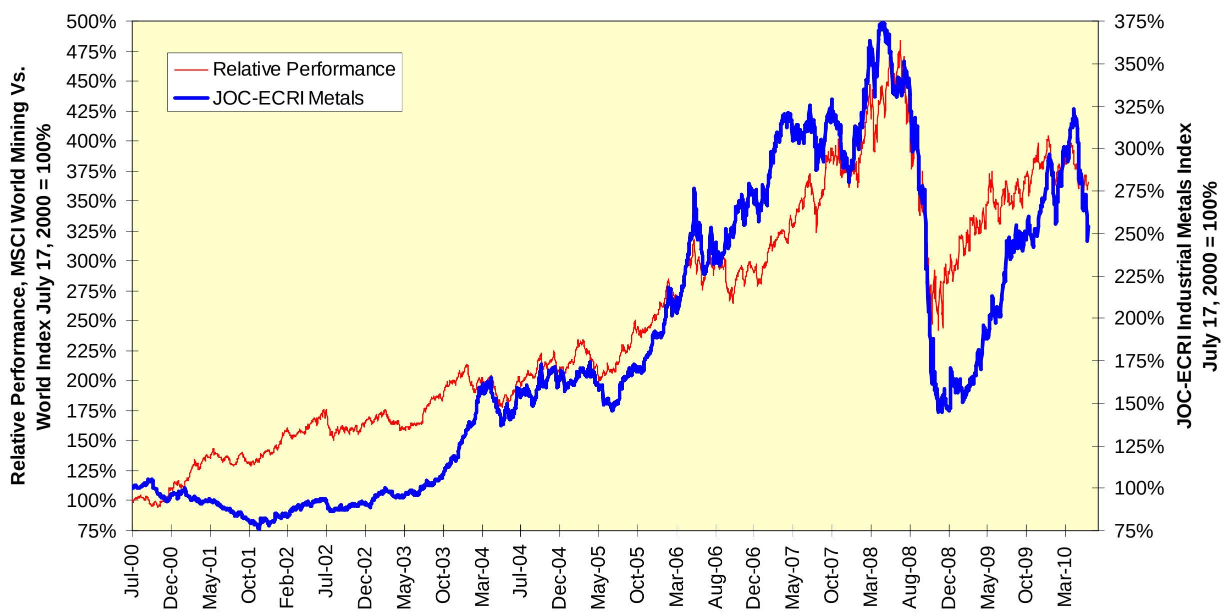
Flying High In A Lead Balloon

A little learning can be a dangerous thing, which may explain the parlous state of both the global economy and many of our leading financial markets. As anyone capable of looking at two lines on a chart can attest, many of the base metals have been rising and falling in close lockstep with equities and other risky markets of late. Twenty years ago, a time when common sense was more common, analysts sensed metals prices rose and fell as a coincident function of economic growth and as a lagging function of investment in mining capacity and let it go at that. Who knew one day there would be tick-for-tick trading in our dash-for-cash flash-crash world?

But it is what it is, and by the reflexive property of equality it isn't what it isn't. The sheer weight of money can force a commonality of behavior into markets over the short-term, and not many of us have the firepower to resist it. As a result, we see a distinct and accelerating convergence between the Journal of Commerce-Economic Cycle Research Institute's base metals index and the relative performance of the MSCI Metals & Mining index to the MSCI World index.

Miners' Relative Performance Tracking Metals Index

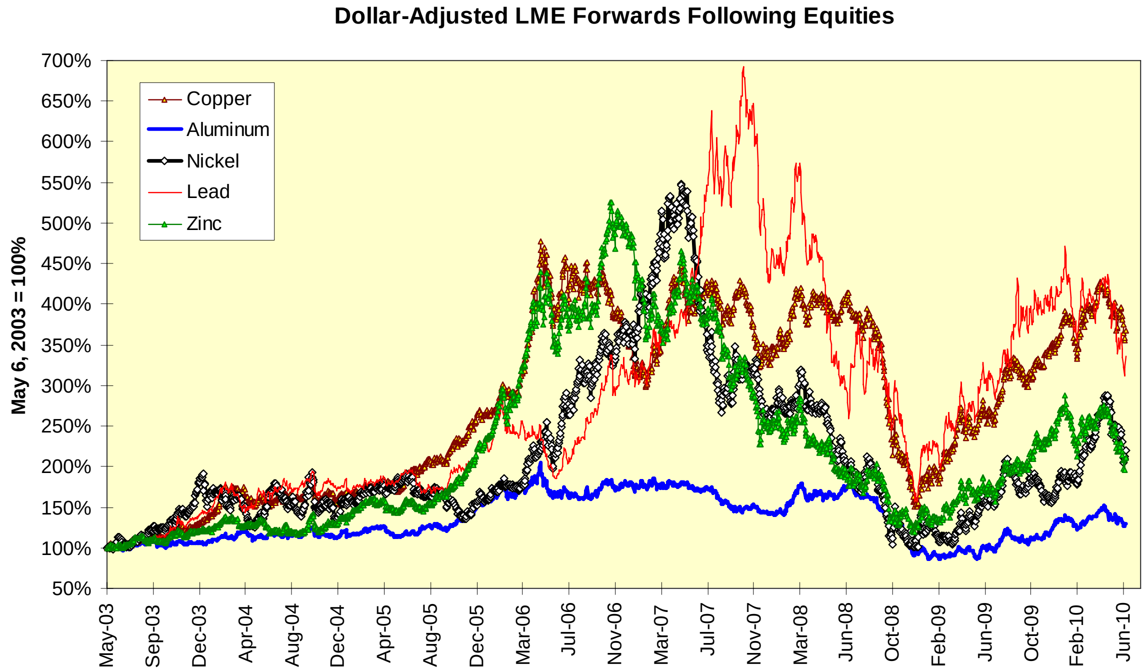


Neither market leads the other in either direction, which tells us causation is absent. But what is interesting is how abruptly the JOC-ECRI metals index declines; it has headed for the exits earlier and with greater enthusiasm than have the mining equities, which indicates these metals were being held not as final inventories at the user level but rather as speculative playthings. This is a revelation for those, such as myself, who used to regard prosaic metals such as lead and zinc as being more or less devoid of speculative content. It seems when the going starts to get tough, the tough start shedding exposure to the base metals as fast as or faster than they shed exposure to mining equities.

As an aside, the flight from lead, zinc and other base metals stands as rebuttal to the notion the rally in gold is part of a 1970s-style flight into tangible assets. Those who fear the end of the world might take a flyer on gold out of the mistaken notion they will be the wealthiest survivor in a post-apocalyptic nightmare, but they will not belly up to the bar with tin.

Not Really A Lockstep

If we back away from the index approach and look at some of the metals individually, we see they rose and fell at different points during the 2005-2007 period. Aluminum never joined the party to the upside; copper peaked in May 2006, followed by zinc, nickel and lead, which waited all the way until mid-October 2007 and the global high in equities before crashing to the ground. This time around, lead peaked in January, while all of the other base metals waited for the equity peak in late April to start heading lower.



It is, to turn a phrase, a market of metals and not a metals market.

Should you head for the exit in risky assets because metals prices are declining? No; at best it is one indicator amongst many and as these prices do not lead financial markets they provide no warning. However, you should consider yourself warned and be on the lookout for confirming information. After all, these markets would not be breaking like this if global demand was screaming higher, would they?