Platinum During The Gold Rush

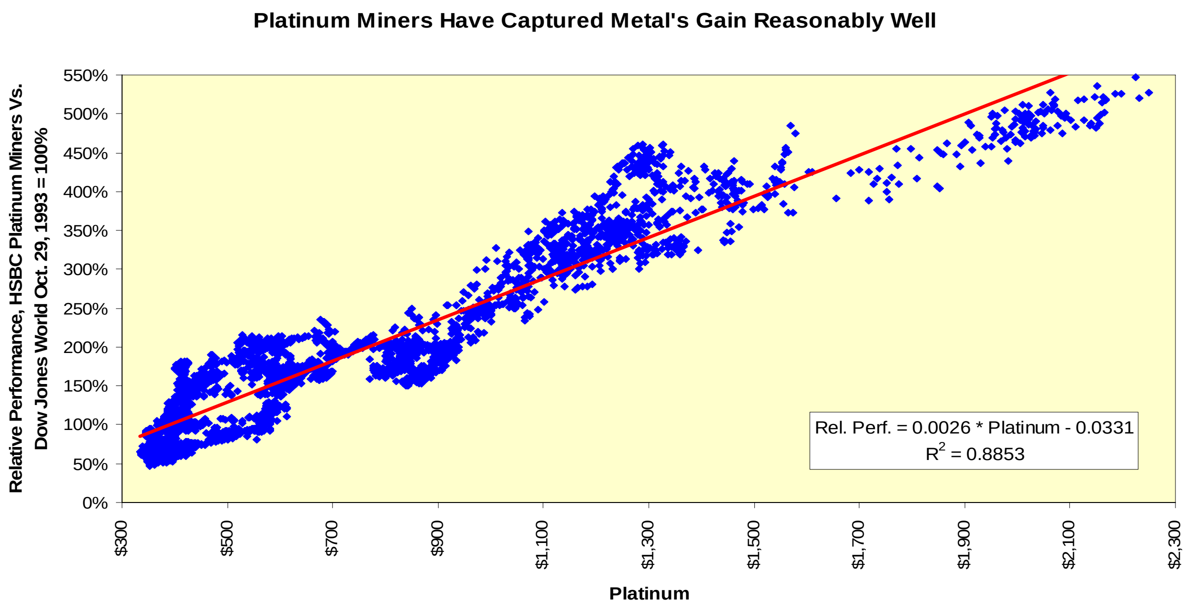
One of the toughest lots in life for any woman is, I suppose, being the less-glamorous younger sister. No matter what you do or what you accomplish, you are being compared constantly to a standard who can do no wrong.

If we can anthropomorphize a metal, platinum must feel this way about gold. Gold's actual uses in electronics, dental work and other applications pale in comparison to its real role in life: Sitting in a vault and looking shiny. If gold had the industrial applications of platinum, and it has been estimated one out of five industrial products have a platinum catalyst somewhere in their manufacture, it might not have its more glamorous monetary role. Or, conversely, if gold was not yellow but rather platinum's silvery-white (the word derives from the Latin term, "little silver") would it be so coveted for jewelry and artwork?

Platinum Miners

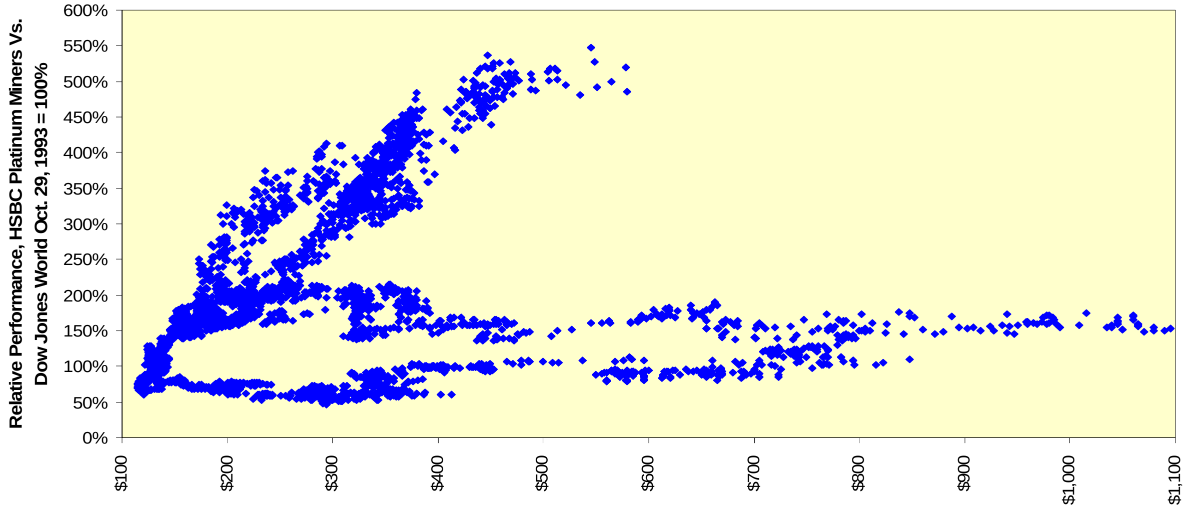
A common point made in this space is commodity producers' stocks are not a substitute for the underlying commodity. I made this point in reference to the base metals miners just one month ago. The normal pattern is for the miners to outperform the broad market during the early phases of a bull market in the underlying commodities and to gradually start underperforming the broad market as production costs rise.

This has not been the case for the global platinum miners tracked in the HSBC Global Mining Platinum index. Its performance relative to the Dow Jones World index since the end of October 1993 has been fairly linear. Normally the relative performance curve starts to flatten as if a short call option on the underlying metal were embedded. The daily beta of the relationship, .0026, comes out to a sub-unitary .677 per year, but this is a very high number for such an analysis.



As a quick test case, let's switch the underlying metal from platinum to its less-glamorous younger sister, palladium. While the two metals are often produced from the same zones, a significant percentage of the world's palladium output is associated with nickel mining and thus should be unrelated to platinum at the production end. Here we can see just how unrelated the platinum mining index' relative performance is to palladium.

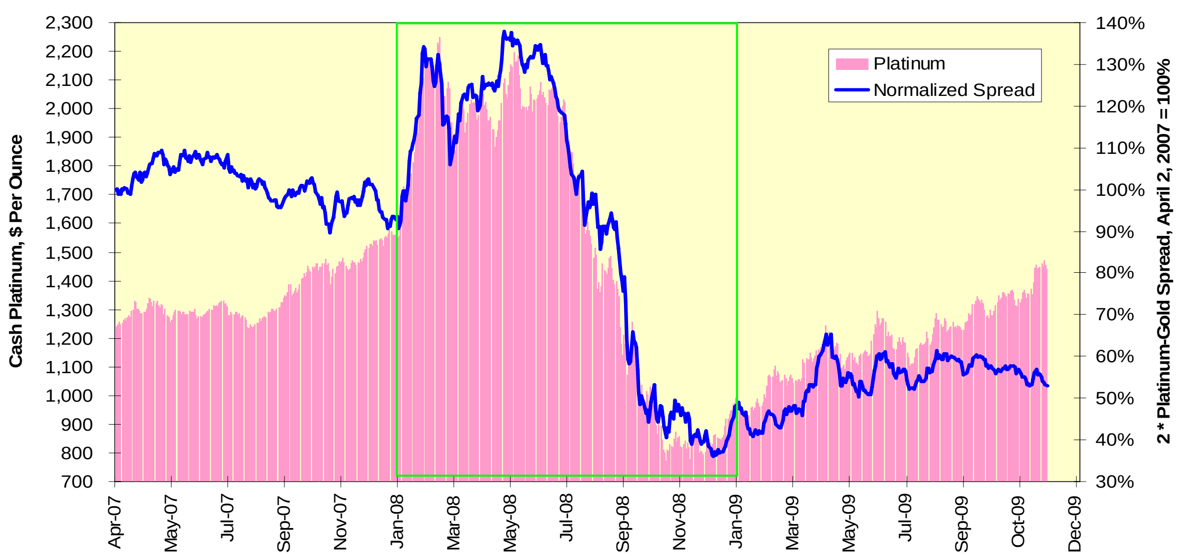
Platinum Miners Not A Play On Palladium



We can extend the entire theme of fashions and sororal jealousy to the spread between platinum and gold. This spread has been recognized by the futures trading industry going back to the days when platinum traded on the NYMEX and gold on the COMEX when both exchanges shared trading pits on the same floor in the World Trade Center. The COMEX is part of the NYMEX, which in turn is part of the CME Group. The spread of 2 platinum contracts against 1 gold contract receives a 50% margin offset from the CME.

While the two metals are produced in different zones and have wildly different uses except in jewelry, their spread often converges quite tightly as risk is either added or shed during a financial crisis. Take a look at the spread during 2008; you might think gold and platinum are direct substitutes for each other.

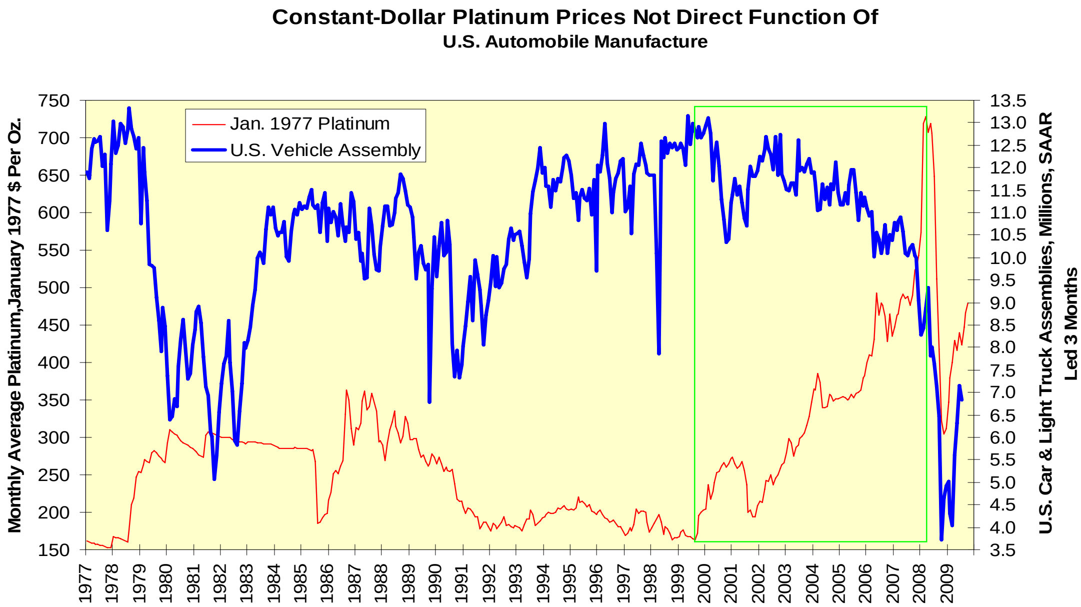
Platinum-Gold Spread Became Highly Directional In Financial Crisis



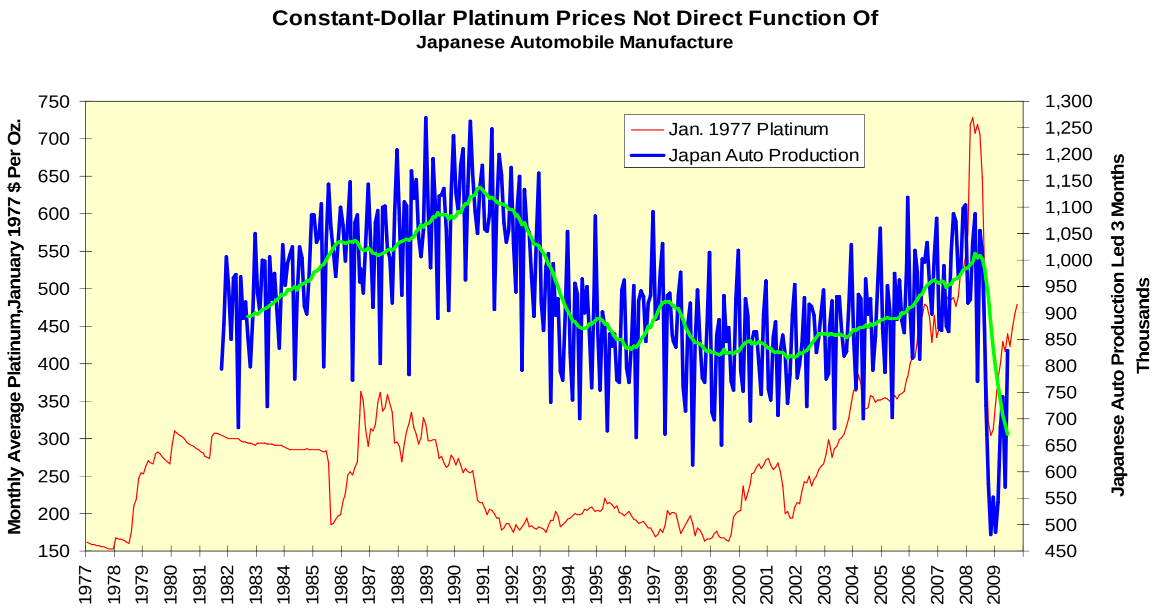
Automobile Manufacture

While the refining and petrochemical industries are major users of platinum-based catalysts, the big variations in demand come from catalytic converters for automobiles. Yes, much of the metal used is recycled out of junkyards, but the overall trend in demand has to rise as the world's auto fleet grows.

Interestingly, the relationship between the constant-dollar price of platinum and U.S. vehicle assembly is not only hard to discern, but actually was inverted between 2000 and 2008, highlighted with a green rectangle in the chart below. Real platinum prices surged while U.S. vehicle assembly fell during this period.



If we employ the same analysis for Japan, however, a more direct relationship comes into view. Still, the monthly automobile production data, either raw or smoothed with a 12-month average, looks to be only a minor contributor to platinum prices.



We are left, as is so often the case with various physical commodities these days with investment demand as an explanation. However, platinum is not part of either the Dow Jones-UBS or S&P-GSCI commodity indices. There are exchange-traded notes such as the iPath Dow Jones-UBS Platinum Sub-Index and the E-TRACS UBS Long and Short Platinum notes, but these do not take physical metal off the market the way ETFs such as the SPDR Gold Trust or iShares Silver Trust do. Much of the metal is "invested in" the old-fashioned way, by someone hoarding it in a vault. This passes for progress in a world where paper can be printed faster than metal can be mined. Speaking of old-fashioned, should the relatively strong link between platinum miners and the metal noted above make you look at individual firms such as Stillwater Mining? Its total return over the past year has been a cool 223%, but that can be deceptive: Over the past five years, its average annual total return has been -6.08%. For comparison, the average annual total return on the Russell 3000 index has been 0.59%. A stock such as this with a five-year beta to platinum of 1.20 may makes sense only if you believe the money pump will remain turned on and the world will not plunge into recession. Both outcomes appear likely in the short-term, and this may be the most direct and applicable play on platinum for a U.S.-domiciled investor.