Zinc A Link For Traders Who Think

With apologies to U2...

I have bought the highest tech stock / I have run through my funds
Only to lose a few / Only to lose a few

I have bought, I have held / All the stocks that have smelled
That have smelled / Only to lose a few

But I still haven't found / What I'm trading for
But I still haven't found / What I'm trading for

For those who love all things metal, this has been the best of times and the worst of times. It will be many years before another former Alcoa chairman romps through Africa with Bono *and* gets sacked as Treasury Secretary in the same year. Keep this episode in mind for Trivial Pursuit games with your grandchildren. And remember: That Larry Lindsey trading card could be worth something someday.

On the other hand, various representatives of the global steel industry, the greatest group of corporate panhandlers since airlines were invented, have opened exploratory talks with the London Metals Exchange about starting steel futures. I'll write the headline on this one: "Steel industry brass emerges from Stone Age."

Besides, the likely marker grade to be traded will be hot rolled coil (HRC), and won't that have some possibilities as a conversation starter in London watering holes?

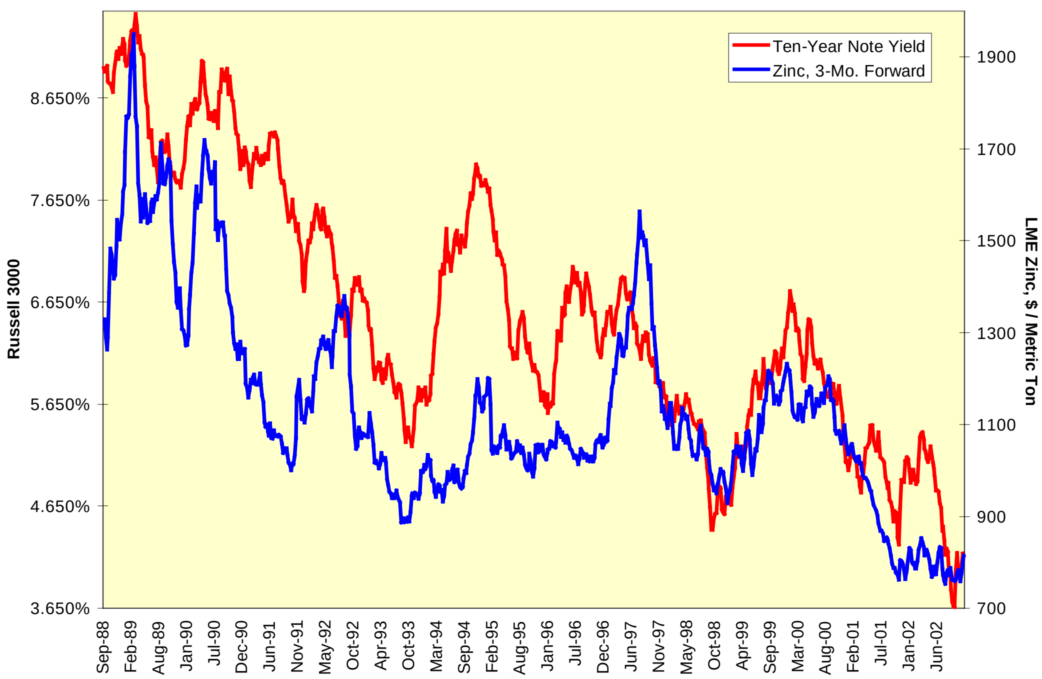
Market Analysts Cheer

One of the many social benefits (seriously) of futures markets is their ability to moderate price cycles both by facilitating a market for storage and by providing price signals for market participants on future supply/demand imbalances. Steel has a couple of minor problems for actual physical storage: It has myriad grades and alloy mixtures, and it has an annoying tendency to rust. The NYMEX' unleaded gasoline futures contract has, to some extent, overcome similar grade and deterioration problems.

The forward curve and price trends of steel futures will provide valuable economic information for market analysts, a group society simply does not thank often enough. Metals buyers are an unimaginative bunch unlikely to risk either running out of necessary supplies or to take a speculative fling on an ingot or two. Industrial base metals are bought shortly ahead of when they will be needed, and their price turns a remarkably sensitive short-term economic barometer.

Let's take zinc, a metal used in brass alloys and for galvanizing steel. It is about as pedestrian as you can get, but its ability to lead ten-year note yields is formidable. Since 1988, it has only gotten it wrong once, and that was during early 1997, just prior to the Asian crisis that defined so much of our recent financial history. The principle is disarmingly simple: Higher zinc demand means stronger industrial activity. Stronger credit demands and higher interest rates ensue. No razzle-dazzle, and that's just fine with me, and I suspect you as well.

Notes Galvanized Into Action

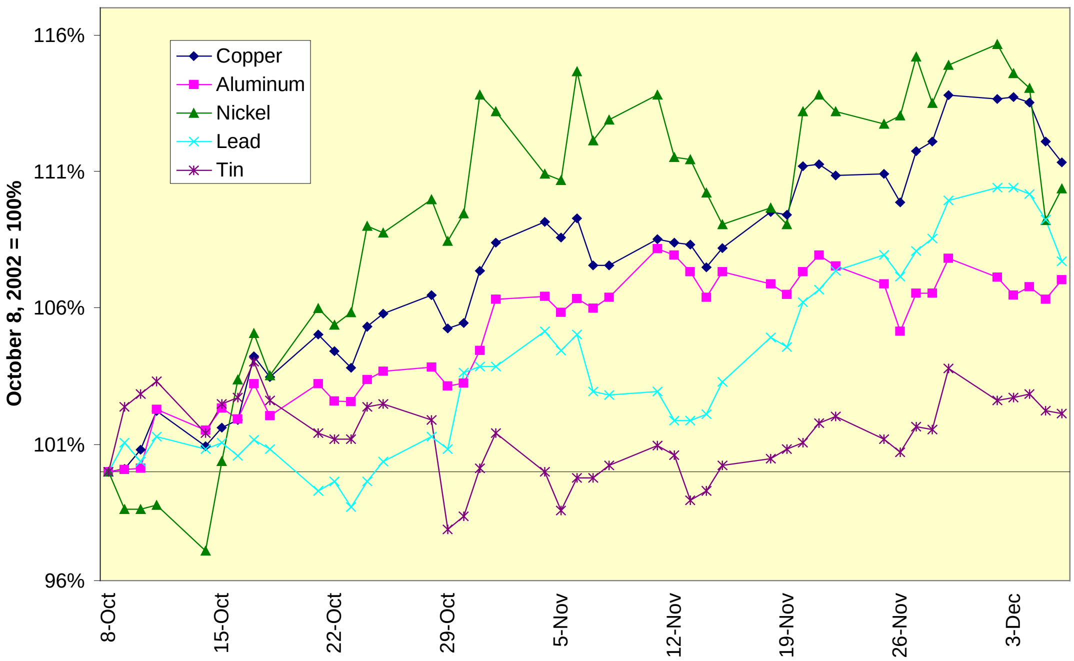


At present, zinc prices have stopped falling, which is damning by faint praise. Do any of the other base metals have anything to say about where economic activity is headed?

Metals Not Out Of The Woods

Nothing is more infuriating than a non-answer from a non-person, and yet that is what the metals markets are providing us with right now. Just like stocks, they rallied from low points in early October and hit resistance in early December. The pattern is the same from generally quiet lead and tin to the always-volatile nickel to industrial workhorses copper and aluminum. None of these metals appear in any danger of turning sharply lower, but none of them have been able to sustain any sort of rally, either.

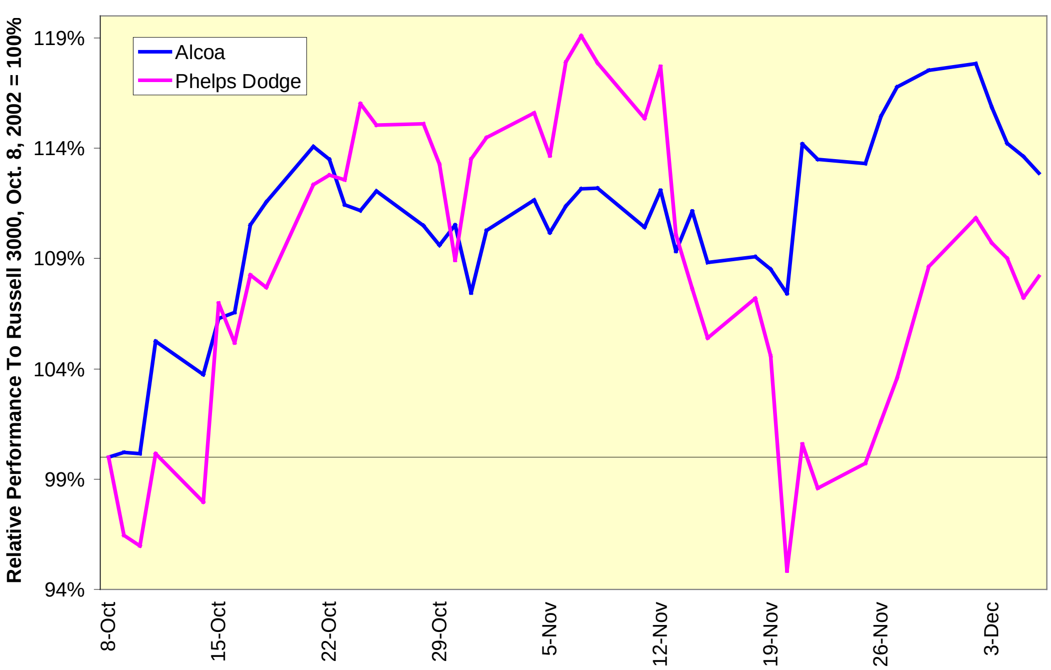
Not Moving Higher



Metal Stocks No Help, Either

If metals prices themselves won't cooperate with our forecasting needs, will the stocks of metal producers be any more cooperative? Let's take a look at two of them, the aforementioned Alcoa and copper producer Phelps Dodge, to see whether they have been able to outperform the broad market recently.

No Hints From Metals Stocks



We're back to the same half-empty / half-full conundrum. Both of these stocks have outperformed the broad Russell 3000 since the October low, but not by much. Worse, they have backed off from the October-December rally more quickly than has the market as a whole.

No Easy Answers

Alice Roosevelt Longworth once said "If you can't say anything nice, come sit next to me." Card-carrying Fed bashers can say something nice about the Fed: It's better than either the European Central Bank or the Bank of Japan. Now that the ECB - the hot dogs from Frankfurt - have thrown up their hands and cut rates by 50 basis points just to be sociable, will this stimulate European industrial metals demand? Probably not, given the experiences elsewhere: Refinancing home mortgages does not chew up a lot of aluminum, does it?

What will increase metals demand and prices? An old-fashioned industrial recovery, obviously, but that just does not appear imminent. A protracted war in the Middle East will certainly consume a lot of metal in a most inelegant fashion, and may go a long way to relieving global deflationary pressures. Cry, don't laugh: Both World Wars followed periods of deflationary pressure.

Whoever the replacements for Messrs. O'Neill and Lindsey will be certainly will have some forecasting challenges ahead. They can read the tea leaves. Or, they can read the steel futures.