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Inflation – what inflation?

Since the Great Financial Crisis in 2008/09 (and since 1990 in Japan), the words *deflation* and *stagflation* have been the buzzwords in economic research and at the forefront of central bank policy across the developed world. In recent weeks and months however, these words have faded away and instead have been replaced by their phoenetically similar cousin *inflation*. It seems as though everybody (except Jay "Transitory" Powell) sees significant inflationary pressures coming down the track.

"It ain't what you know that gets you into trouble.
It's what you know for sure that just ain't so"
Mark Twain, attrib.

Evidence for this new re-emergent inflation typically includes the price of oil which on a flat price basis has more than tripled from lows of just under $20/bbl to a current $70/bbl in just over 12 months. The strength of copper on a flat price basis has been similarly impressive, with the price more than doubling from just under $2/lb to around $4.25/lb. Gold is only up around 20% (on a flat price basis) from around $1500/toz to around $1800/toz, but you get the picture. This sort of price action tends to get many market commentators giddy with excitement and that trusty old chestnut, the commodity "supercycle" has been headlined in recent despatches;

"Commodity boom or supercycle?"
Investors Chronicle, 31st March 2021

"Are we about to enter a commodity supercycle?"
Forbes, 13th April 2021

"Markets weigh prospect of new commodities supercycle"
The FT, 12th May 2021

"Is this the start of a commodities supercycle?"
Refinitiv, 24th May 2021

"Is a commodities supercycle under way?"
The Economist, 2nd June 2021

Perhaps it will come as no surprise to learn that all of these publications were fairly non-committal when it came to answering their own questions. The general consensus was that, despite their vaguely alarmist headlines, the markets are likely in a short-term boom and not in fact at the start of a commodity supercycle – and that current speculative levels will likely tail off over time as current demand/supply issues unwind and the global COVID situation settles.

Figure 1. below shows the level of the SPGSCITR[1] from January 1990 to end of June 2021 – and clearly highlights the difference between booms and supercycles.

[1] The S&P Goldman Sachs Commodity Index – Total Return. The Total Return Index is a more accurate reflection of price performance since it incorporates underlying contangos and backwardations, i.e. the true cost/benefit of holding positions over time.

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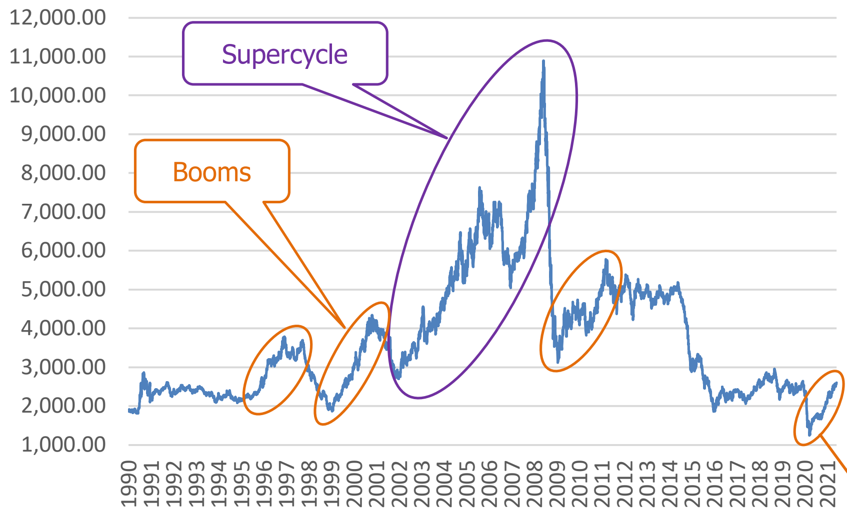

Figure.1 – SPGSCITR January 1990 to June 2021

Clearly the difference between booms and supercycles is simply the magnitude and duration of rising prices, and therefore one can only truly classify whether price action is boom or supercycle after the event. However, in our humble opinion, the price action seen over the last 12 months feels more boom than supercycle, and in this we would concur with those research reports mentioned on page 1.

In any case, the more eagle-eyed readers among you will have noted the words "flat price basis" in the second paragraph above. The reality is that long positions in commodity markets incur funding and insurance costs, which the market prices constantly (as contango or backwardation) and in more usual contango markets these costs can be substantial. Thankfully the SPGSCITR incorporates these factors for us (TR being Total Return) and thus gives a much more accurate picture of true commodity price performance. Figure 2. above shows that notwithstanding all the hyperbolic "supercycle" chatter, in fact prices are only back to where they were in early 2020, i.e. pre-COVID.

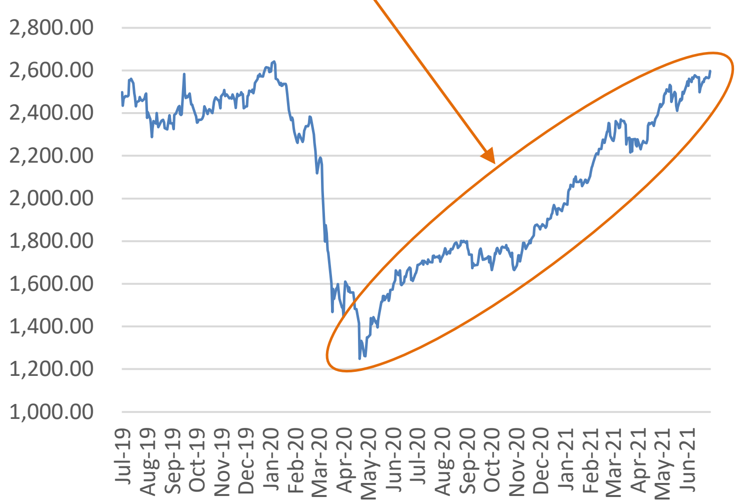

Figure.2 – SPGSCITR July 2019 to June 2021 (24mths)

On that note, you can see that the SPGSCITR has traded broadly within the 2000-3000 area – see Figure.1 above – since late October 2015 (apart from the COVID inspired slump last Spring) and that the current level of 2500 is precisely mid-range. This reinforces our belief that we are not in the early stages of a supercycle.

Finally, Figure.1 above also shows that the trillions of dollars thrown at the economy from late 2008 onwards saw commodity prices double (SPGSCITR ran from around 3000 to 6000) but that then prices began to tread water before falling back sharply. Since early 2020, the trillions of dollars thrown at the economy has seen commodity prices double (SPGSCITR ran from around 1250 to the current 2500). Enough said.

"I always like to look on the optimistic side of life, but I am realistic enough to know that life is a complex matter"

Walt Disney

We would be pleased to talk to you in more detail about our strategy.
Kind regards
Jaguar Investments