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Weekly Note

CANACCORD Genuity
Wealth Management

To us there are no foreign markets.™

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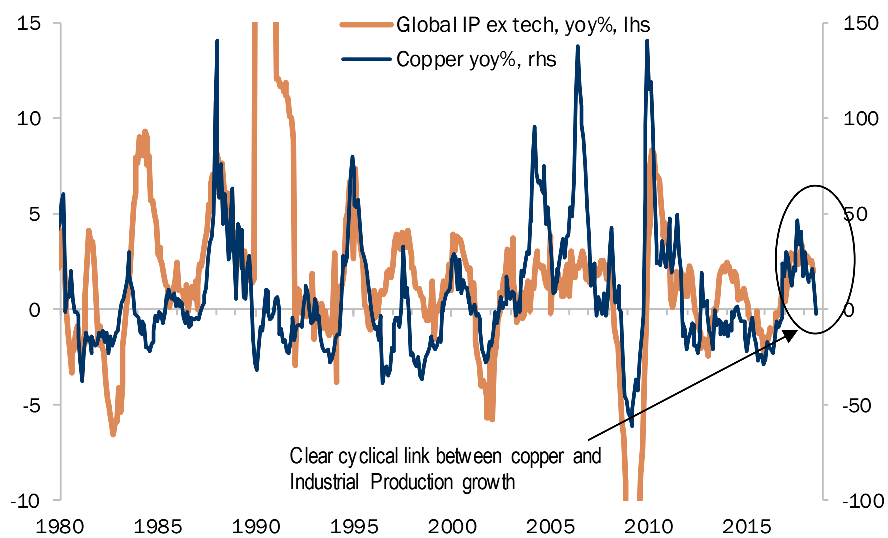
Not the Doctor

Copper price inflation turned negative again this month for the first time this year, but not for the first time this cycle. Unlike the last cycle where the copper price was bid up on the back of an infrastructure building boom, this cycle has been characterised by oversupply and an over-estimated recovery in demand. The Chinese domestic fiscal pump prime through 2009 and 2010 pushed the copper price briefly above $10k on the London Metal Exchange, but that proved to be the high point of this cycle with prices now hovering around just $6k. After the slump in copper prices over the past few weeks in line with rising trade war rhetoric, we wonder if we should we be worrying about global growth prospects in line with the “Doctor Copper” moniker? We suggest that the global industrial production is encountering another late-cycle soft patch, but we are not yet at the start of the next recession. Copper is not the doctor, it has a stronger link with industrial production than GDP, but market volatility will likely rise if this weakness persists.

Figure 1 shows the relationship between copper price inflation and global industrial production growth. The relationship is far from perfect, but copper price deflation is usually associated with a contraction for global industrial production growth. Given the strong link between construction and copper, that should not be too surprising, but remember that copper has a far better relationship with industrial production than it does with services and hence the wider relationship with GDP growth (Figure 2).

Figure 1: Copper Price Inflation versus Industrial Production Growth

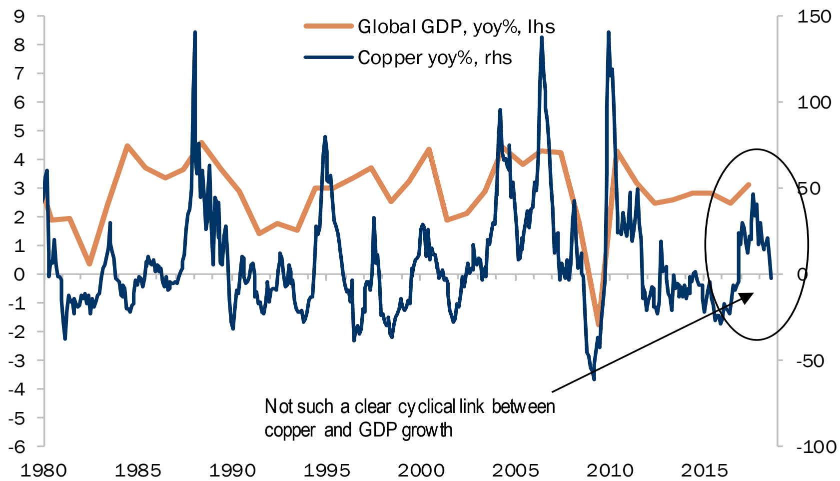


Source: Canaccord Genuity Wealth Management

All that said, copper is not the only metal to have softened in recent weeks, gold and silver have also fallen in value (Figure 3), as has the broader commodity complex, all of which are down year to date. A small part of the dynamic there is the stronger US dollar, but the wider picture is likely to be the rising uncertainty from escalating trade tensions and the proximity to the end of this cycle. In classical economics, rising trade tariffs are consistent with a shift in the supply curve which would initially force prices up and output down. While this is indeed the direction of travel, the quantum remains small, but the real-world effects will first become visible through industrial sentiment indicators and commodities sensitive to output such as copper.

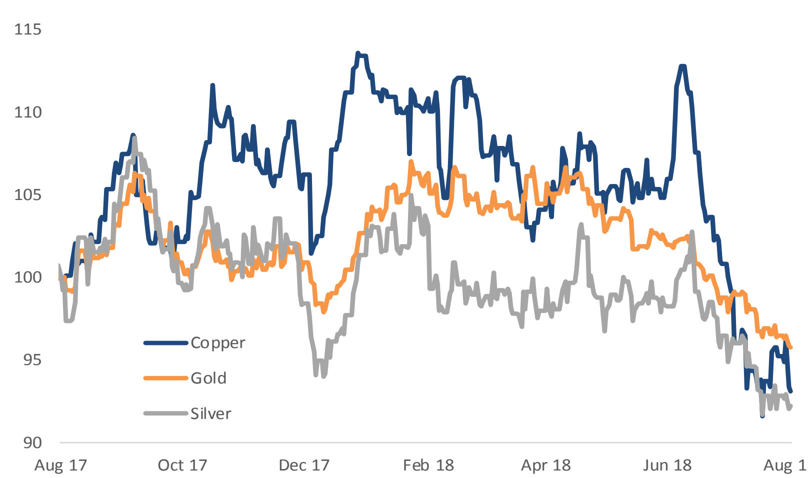
Copper is not the doctor, and we do not want to overstate the importance of its recent fall in value. That said, the risks continue to rise, and a stronger US dollar would be the natural consequence of deteriorating global trade relations amidst a potentially dangerous BREXIT shock all to be navigated towards the end of the economic cycle. We recommend investors stay risk aware with well diversified portfolios and overweight the US dollar.

Figure 2: Copper Price Inflation versus GDP Growth



Source: Canaccord Genuity Wealth Management

Figure 3: Moderation in metal prices



Source: Canaccord Genuity Wealth Management