LAWSON KROEKER
INVESTMENT MANAGEMENT

As We See It

> "It's like a Ferris wheel—what's at the top will go to the bottom; what's at the bottom will come back up."
>
> —Unknown

A study of history reveals that stocks and commodities go through alternating cycles of out performance. For example, from 1906 to the early 1920s, stocks did little while commodities boomed. During the 1920s, stocks soared while commodity prices declined. Everything was a disaster during the 1930s, but commodity prices fell far less than stock prices and actually rose with the approach of World War II. However, the rise in commodity prices was contained by price controls during the War. Then, stocks resumed their out performance until the late 1960s.

The last bull market in commodities started in the late 1960s and lasted through the 1970s. There were a number of notable events with regard to commodities during this period. For example, the United States went off the gold standard, and the price of gold—which had been fixed at $35 per ounce—was allowed to float. This was also the period when the Hunt brothers tried to corner the market for silver. And, of course, there were two oil embargos during the 1970s. There was a tremendous rise in raw material prices during this period, despite economic stagnation. Stocks spent this entire period in a trading range and, as measured by the DJIA, they made no progress between their peak in 1966 and 1981.

As we all know, the last bull market in commodities was followed by the biggest bull market in stocks this country has ever experienced. That bull market in stocks has come to an end, and it would appear that we have entered another period in which commodities are the superior performer.

Why do these bull markets in raw materials occur every 20–30 years? Simply put, it is a case of supply and demand. During the boom phase, there is extensive investment in raw material production capacity. As is characteristic of a capitalistic system, eventually too much capacity is created resulting in a collapse in prices. During a period of low prices, little money is invested in productive capacity for natural resources. In fact, high cost capacity is often taken out of production. Eventually, demand again exceeds supply, and we repeat the process.

At the margin, there always seems to be a source for extra demand at the beginning of a bullish phase for commodities. Often that incremental demand source is a war. While we have war this time around, an even greater source for incremental demand is China. China is importing huge quantities of everything from cotton to zinc. In fact, China, the 7th or 8th largest economy in the world, recently surpassed the United States in production of stainless steel. A lot of stainless steel is needed to build the manufacturing infrastructure of a new economy. Two-thirds of the nickel mined in the world goes into the making of stainless steel, and China has minimal supply. Hence, the price of nickel has exploded.

To a great extent, the stocks which performed the best during the 1970s were the stocks of companies that produced commodities or those that benefited either from the increased production of a commodity or the expansion of the production capacity of a commodity. It would appear that we are in store for something of a similar nature for the next few years. We expect this bullish trend to receive increasing attention from both the financial and media communities. This heightened attention will have an important influence on investor psychology and may even result in commodity-related assets becoming financial market leaders, much as speculative and technology equities were in the 1995–2000 era.

Year End 2003

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