LAWSON KROEKER
INVESTMENT MANAGEMENT

As We See It

"Let China sleep, for when she awakes she will shake the world."
Napoleon

During the last century, there were three extended periods of time when investors were best served by owning natural resources or the stocks of companies that produced those natural resources. The periods when natural resources and the stocks of natural resource producers outperformed the rest of the stock market were the periods leading up to and including World War I and World War II as well as the 1970s.

It is obvious that during periods leading up to and including a worldwide conflict, such as WWI and WWII, the demand for raw materials increases, as preparing for and conducting a war consumes a lot of materials. The rise in demand for natural resources during the 1970s can be associated with the Cold War and the War in Vietnam, but really took hold with the OPEC oil embargo during 1973.

We are now in the fourth period in the last 100 years when the demand for natural resources is so intense that it has lead to record high prices for many commodities. The current rise in demand for natural resources stems largely from consumption by China and, to a lesser extent, India. Both China and India have large populations and rapid economic growth. For the most part, both countries lack the raw materials required by an industrialized economy. Hence, they are buyers of everything from aluminum to zinc—placing upward pressure on commodity prices.

As noted in Kevin Morrison's article in the November 22, 2005, *Financial Times*, "John Nomand, global currency, commodities, and fixed-income strategist for JPMorgan, says China accounts for 8% of oil demand, up from 2.5% in 1990, but well short of the U. S. 25%. In base metals: copper, aluminum, nickel, and zinc, China accounts for 20% of global demand." Since India's economy, at this point, is based more on services than manufacturing, it consumes far less raw materials than China. However, that will change as India industrializes. India's industrialization could have a dramatic impact on selected commodities. For example, according to Citigroup, China relies on imports for about 57% of its nickel while India is totally reliant on imports to meet its nickel needs.

In addition to the base metals, both countries are major purchasers of crude oil. As related in the January 24, 2005, *Fortune* by Ian Bremmer, "Having become a net importer of oil only in 1994, China now imports half its daily consumption." And, according to an article by John Larkin in the May 19, 2005, *The Wall Street Journal*, India's domestic crude-oil production meets ". . .less than one-third of the country's consumption." Thus, it appears that upward pressure on raw material demand and prices will continue unabated unless the economies of China and India falter.

The periods when natural resources and the stocks of their producers outperform the general stock market are relatively rare, but when outperformance does occur, it lasts for an extended period. The three periods during the last century when natural resource producers outperformed lasted from fifteen to twenty years. The reason these periods last so long is because it normally takes a long time before investment in new projects produces sufficient new supply to catch up with demand. For example, nickel producer Inco is studying two potential new mine locations in Canada. They expect, that if they were to proceed with the projects, production would begin around 2015.

The current cycle of outperformance by natural resource companies began in the 2000-2003 timeframe, so it would appear we are in the early stages of the move. Assuming that is the case, natural resource investments should be part of any portfolio for a number of years.

Year End 2005