LAWSON KROEKER
INVESTMENT MANAGEMENT

As We See It

> "Long economic cycles have been traced throughout history. From the Bible, we know of 50-year jubilees during which old debts were forgiven. Every 54 years, the Mayans in Central America held a festival to fend off calamities; and a 54-year cycle in wheat prices can be traced back to the 13th Century."

Marc Faber, ***Tomorrow's Gold***
Asia's age of discovery

Russian economist Nikolai Kondratiev argued in the 1920s that commodities move in 50- to 60-year cycles. Rising commodity prices typically occur after years of underinvestment in new productive capacity—whether in exploration for new oil or metal deposits, construction of new smelters and refineries, or the planting of new orange trees or coffee plants.

Kondratiev observed three upswings in commodity prices: 1789 to 1814, spanning the French Revolution and Napoleonic Wars; 1849 to 1873, an era of European industrialization; and 1896 to 1920, when the United States emerged as the world's largest economy. Each of these periods of rising prices was followed by a decline in commodities prices of between 23 and 35 years. The average decline lasted 29 years, and the average upswing was 24 years.

Using Kondratiev's analysis to project forward, a 29-year slump was due from 1920 to 1949. That declining period was cut short by demand for commodities created by World War II. It is interesting to note, however, that if we use 1949 as the starting point, a full 53-year up-and-down cycle followed, making another upswing due in 2002, almost exactly when the current up cycle began.

Over the years, commodity prices have tended to rise during periods when stock and bond markets have been lackluster. For instance, commodities did poorly during the stock market booms of the 1920s and the early 1980s to 2000. Conversely, commodities outpaced stocks during the Great Depression and the inflation-ridden 1970s. A study by capital-goods analyst Barry Bannister—while at Legg Mason and now with Stifel Nicolaus—found that over the past 130 years commodities and stocks have alternated performance leadership in regular cycles, with the periods of commodity outperformance lasting about 18 years. His work suggests the current cycle of commodity outperformance started in 2001 or 2002.

Marc Faber and Jim Rogers, two investors for whom we have the utmost respect, are also positive on commodities. Marc Faber is a Hong Kong-based money manager and author of several books including his 2001 *Tomorrow's Gold*. Jim Rogers, a fabled hedge fund manager in the 1970s, has also written several books including *Hot Commodities*, published in 2004.

In *Tomorrow's Gold*, Faber devoted a chapter to Kondratiev and other long-wave theorists, writing that once the cycle turns higher, ". . . it will change the entire rules of investing, because in a rising wave, commodity prices will rise, inflation will accelerate, and interest rates will increase." Mr. Rogers is also bullish on commodities stating in a 2006 *Barron's* interview, ". . . commodities will rule over stocks and bonds for the next decade or more."

When we put it all together, we come to the conclusion that commodities—and in our portfolios, the producers of commodities rather than direct commodity investment—are in a long-term up cycle. The Kondratiev cycle, Barry Bannister's work, and the well-thought-out views of two investment professionals—for whom we have high regard—all point in the direction of a long, upward commodity cycle. There will, of course, be setbacks. While the corrections have to be monitored with an open mind, we suspect our portfolios will maintain exposure to commodities for some time to come.

April 2008