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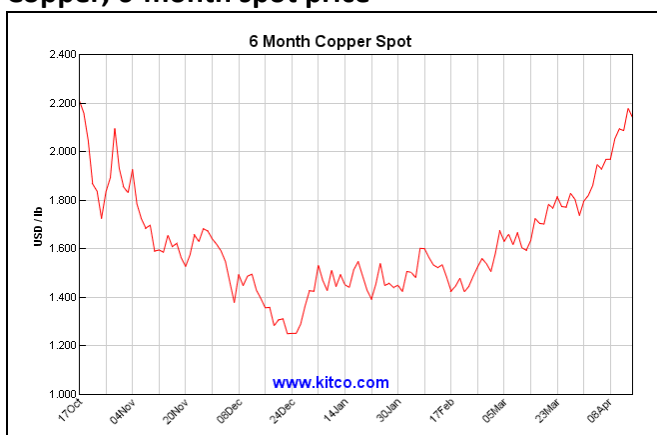
INVESTMENT COUNSELLORS-PORTFOLIO MANAGERS

Consulting Dr. Copper

Are commodity-related indexes signalling a turn?

April 17, 2009 – A quick glance at the charts for spot copper prices and the Baltic Dry Index shows that both have been in an uptrend since the beginning of the year. This is an interesting correlation, and is cause for at least a little bit of optimism that the fiercest global recession in over 70 years is beginning to ease.

Copper, 6-month spot price



Courtesy Kitco.com

Baltic Dry Index, 6-month



Courtesy Bloomberg LLP

Copper is often used as an indicator of economic activity because of its wide usage in construction and manufacturing, particularly electronics and cars. Any rise in activity in these areas translates directly into demand for copper. Although warehouse inventory levels have expanded dramatically over the past six months, global copper production

dwindled last year as mining operations were cut back or shut down. And with the absence of credit, new exploration and development has been virtually at a standstill for a year. Now, with very early signs of economic recovery in the wind, spot copper prices are starting to rise in anticipation of a drawdown in inventories colliding with a near-term supply crunch.

And there are, in fact, early signs of recovery, though you'd never know it from the daily menu of appalling news lighting up the business news sites. Still, we look at indicators like new home construction, a metric that often gets cast into the shadow of things like house prices and sales volume, both of which have declined dramatically over the past year, in both Canada and the US. But Canadian new home construction climbed 13.7% overall in March. In the US, new single family home construction rose 1.1%, but construction in new multi-family dwellings rose 82%. Monthly real estate construction numbers are notoriously volatile, and industry observers point out that the new construction will only add to the existing glut of unsold inventory, depressing the market even further for the next year. In the meantime, the new construction is adding to the demand for copper.

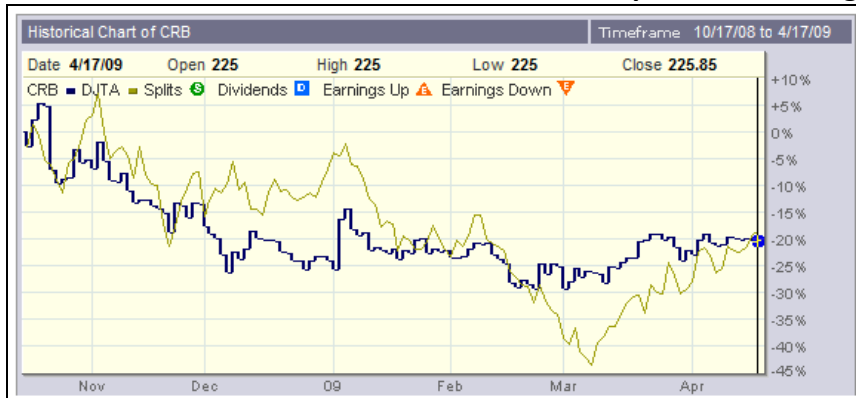
China, which is a huge consumer of raw materials, particularly base metals like copper, reported that first-quarter gross domestic product grew at an annualized 6.1%. These days, that would be a sign of red-hot growth anywhere else. But in China, which saw extended periods of double-digit growth over the past few years, and where a growth rate of 8% is considered the minimum acceptable level for sustainability, a rate of 6.1% is close to disaster. But the government's two-year stimulus package equivalent to about 13.3% of GDP is beginning to pay off. Fixed-asset investment rose an annual 28.8% in the first quarter, and retail sales surged 15.9%. Most importantly, industrial output rose 8.3% month-over-month in March, while the purchasing managers index climbed above the 50 growth/no growth threshold for the first time since last July. Again, this is bullish news for copper, and contributes to copper's price surge over the past six months.

The Baltic Dry Index is often used as a gauge of the direction of commodity prices. It measures changes in the cost to ship raw materials such as metals and ore, grains, and oil. Because it measures shipments of raw materials, which are considered much less speculative than futures, the BDI can be used as a leading indicator of economic activity. By the same token, however, it can be quite volatile, as seen in the graph above. Recently, demand has been very high for ships that carry bulk shipments like iron ore and coal.

Interestingly, Canadian National Railways Co. said last month that it is seeing increasing volumes of shipments of grain and coal from the US Midwest, another encouraging signal that raw materials are beginning to move again after a year of declines.

We can see the correlation between transportation and commodity prices even more clearly since the March low in the chart below, which compares the performance of the Reuters/Jeffries CRB Index and the Dow Jones Transportation Average.

Reuters/Jeffries CRB Index vs. Dow Jones Transportation Average, 6-months



Courtesy BigCharts.com

It's details like these, when combined with other telling metrics, like falling inventory levels, that have some analysts daring to hope that the global economic slump may be coming to an end, setting the stage for recovery and a return to growth in the fourth quarter of this year.

The S&P/TSX Composite Index advanced 1.7% on the week, for its sixth consecutive weekly advance. The benchmark S&P/TSX is now up 5% for the year to date, outpacing its larger US cousins, both of which are still in the red for the year to date.

However, both the Dow Jones Industrial Average and the S&P 500 Composite Index recorded gains on the week, mostly as a result of positive news from the financials. The DJIA gained 0.6% on the week, while the S&P 500 advanced 1.5% from the previous Friday's close.

Goldman Sachs Group Inc. and JPMorgan Chase & Co. both reported better than expected first-quarter earnings, and both have made provision to repay the billions in government loans from the Troubled Asset Relief Program (TARP). Citigroup reported its smallest quarterly loss since 2007. And two weeks ago, Wells Fargo said it expects record net income this quarter. General Electric Co. reported a 36% slide in first-quarter earnings, which fell to US\$0.26 per share, but still beat Wall Street estimates.

The generally more optimistic news from the major financials eclipsed imminent bankruptcy protection for both Chrysler and General Motors. Both companies have long been discounted by the market in any case, as prime Jurassic candidates for the Darwin List.

And speaking of the Darwin List, Canadian newsprint maker AbitibiBowater Inc., the world's largest, sank into its own unused pulp tank and sought bankruptcy protection last week. Newsprint demand has been in decline for decades, but as old-style metropolitan newspapers fall like nine-pins to the depredations of Twitter and other always-on electronic news sources, that decline has turned into a collapse with no hope of recovery. Weaker companies like Abitibi can no longer compete against rising rival newsprint-producing powerhouses in India and China.

The writing has been on the wall for Abitibi for some time in any case. And it's writ large, in six letters that spell out the word "Google." Last week, the company reported first-quarter net revenue of \$4.07 billion for better-than-expected earnings of \$5.16 per share.

At some point in the very near future, all the current fun will come to an end in a bout profit taking. But this time, a correction is likely to be a near-term hitch before the next leg up, rather than the next leg down. ■

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