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Copper still a reliable economic benchmark

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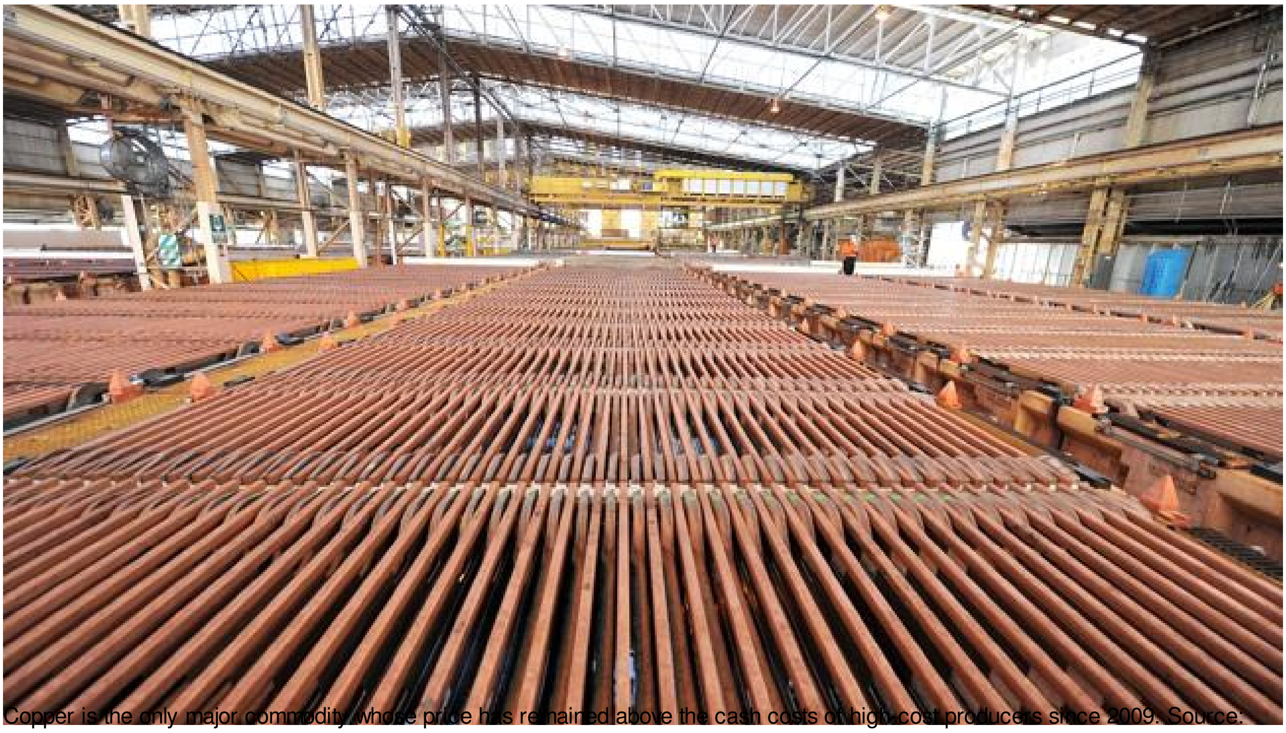

Copper is the only major commodity whose price has remained above the cash costs of high-cost producers since 2009. Source: News Corp Australia

This story is not about speculating or even investing in a particular commodity but rather about finding a smart weathervane, which would allow us to objectively assess which directions the Chinese, European, US and global winds are blowing.

Finding such would mean we would not need to rely upon stockmarket or volatility benchmarks, which all agree are currently distorted by the machinations of unconventional monetary policies and, in particular, quantitative easing (QE).

Fortunately, such a weathervane can be found in the industrial metal of copper. Having fallen out of favour with speculators as a synthetic exposure to the rising "Chinese Phoenix'' investment play, copper nevertheless remains a particularly important primary element, both practically and symbolically, for markets, economies and investors.

Even Warren Buffett last week acknowledged at the Berkshire Hathaway 50th annual general meeting, when referring to US quantitative easing, that "so far, I have been wrong on interest rates. It's so hard for me to see how, if you toss money from helicopters, that eventually you don't have inflation, but we haven't."

Therefore, one thing global economists, politicians, market participants, investors and even the rightfully recognised "oracles" such as Buffett unanimously agree upon is that QE — particularly that which was prosecuted in the US — has worked per se but, in so doing, caused new distortions in markets not previously seen.

Hence, the job of assessing where we are in both the real economy and markets has become almost impossible at this point in time.

Two hundred years of collective economic and financial acumen, experience and anecdotes don't help us in such circumstances.

This truly is new territory.

Fortunately, the silver lining surrounding this paradox could well be found in the symbolic industrial component of copper.

This is because, unlike other real economy indicators, copper remains a very useful anemometer for determining where the present and future winds may be taking us.

This is not to say that copper's spot pricing is not error-free, far from it, but at an aggregated global level, its metrics remain acute to what is happening in real economies in relatively real time.

Given the above circumstances, this could be considered far more helpful to us at present, when juxtaposed against other lionised indicators.

These include the S&P 500 Volatility or "VIX" index, the 12 US Federal Reserve member bank National Activity Indicators or any number of global Purchasing Managers' Index (PMI) barometers.

The metal and its alloys' global applications remain significant, despite a wobbling Chinese manufacturing sector, a continually subdued European construction industry and the worrisome perennial underinvestment in core US infrastructure assets.

Broadly speaking, 60 per cent of industrial copper is still employed for electrical wiring and power generation around the world, another 20 per cent for roofing and plumbing and the bulk of the remainder, for industrial machinery plus consumer discretionaries, such as mobile phones and computers.

Contrary to some popularised misconceptions, copper is used rarely, if at all, in coinage in the 21st century.

There is a lot to unpack in the pricing of this industrial staple, however, fortunately, even at prima facie, the ways its spot price ebbs and flows provides invaluable insight into world economic growth or lack thereof.

The latest London Metals Exchange (LME), Shanghai Futures Exchange (SHFE) and CME Commodity Exchange (COMEX) positioning and open interest data suggest that net speculative copper positioning moved substantially lower during late 2014 and early 2015, alongside weakening Chinese macroeconomic data, copper cost deflation which was driven by falling oil prices in unison with a strengthening US dollar and broader concerns surrounding global demand and deflation.

All being considered, though, copper is likely to prove one of the better performing commodities over the next decade.

Copper prices have held up more resiliently than those of other commodities in recent years —

despite current underperformance — and will be supported by the depletion of reserves at existing mines, the scarcity of new large-scale and low-cost projects and continued Chinese import demand, as their real economy shifts into a new and more exciting gear.

It is important to note that copper has been the only major industrial commodity whose price has remained above the cash costs of the highest-cost producers since 2009 — a reality which many Australian and Brazilian iron ore producers watch enviously.

Remembering that the point of this story is not to predicate the future speculative benefits in understanding copper market price movements but rather that this market provides us some crucially important indications about the economic plights of global economies, that Australian ultra high net worth investors will continue to rely upon.

For broader Australian investment communities, as luck would have it, two of the world's most significant copper participants are our very own BHP Billiton and Rio Tinto. This is fortuitous for all Australian investors as both of these two listed entities, who judiciously abide by the ASX's prescriptive and clearly mandated continuous disclosure rules, regularly keep Australian investment communities up to date with copper market news, supply and demand expectations and the broader "Realpolitik" of global commodity marketplaces.

Remaining wary of copper market-related scandals such as the "Decheng Mining" and "Qingdao effect" — where several Chinese companies allegedly feigned pledged copper stockpile quantities to receive inflated letters of credit in lieu of collateralised chattel — the Australian global investor remains very well positioned to look to this particular commodity as a source of perspective about the true nature of our global economy.

For all the reasons mentioned above, copper has always galvanised a lot of my interest and, as a dowsing rod, helped Larkin Group with its sense of direction.

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