



**ROGER
JOHNSON**

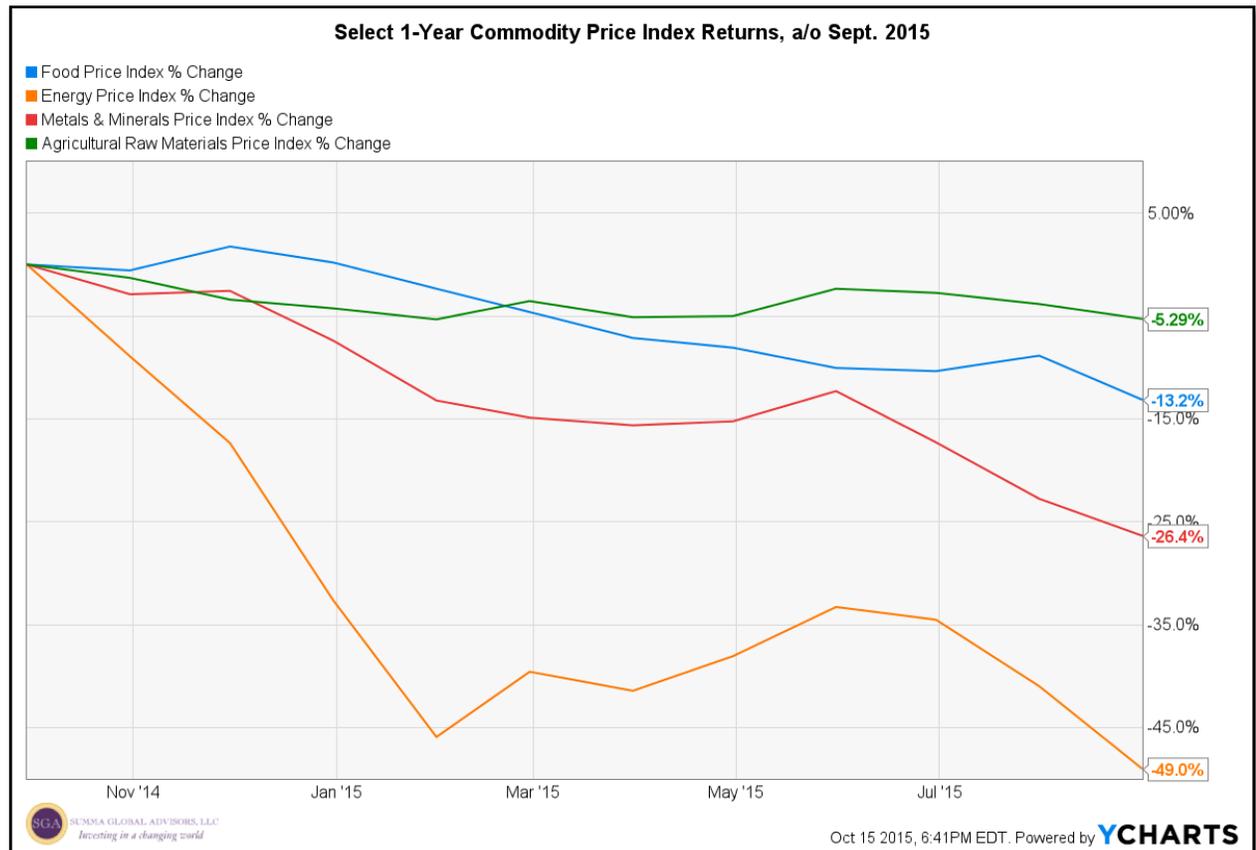
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Beware of Bears: Where the Commodity Market is Headed

Commodities are excellent indicators of global supply and demand. Increased demand for commodities often coincides with a country's GDP growth. The economic boom in China between 1997 and 2013 significantly contributed to the global demand for basic materials, specifically iron ore, copper, and oil. China's GDP has grown from \$46.68 billion in 1962 to \$10.36 trillion in 2014. With a GDP that makes up 17% of the world economy, China is second only to the U.S.¹

As massive infrastructure projects were undertaken, China imported vast amounts of basic materials. In the process, China began to increase inventories of basic materials, anticipating future demand. This excess inventory demand created sudden price appreciation in a number of commodities. When aggregate domestic demand slowed in China, the need for basic materials declined severely, and was exacerbated by excess inventory. This reduced demand from China has been a significant factor in creating the current commodity bear market.

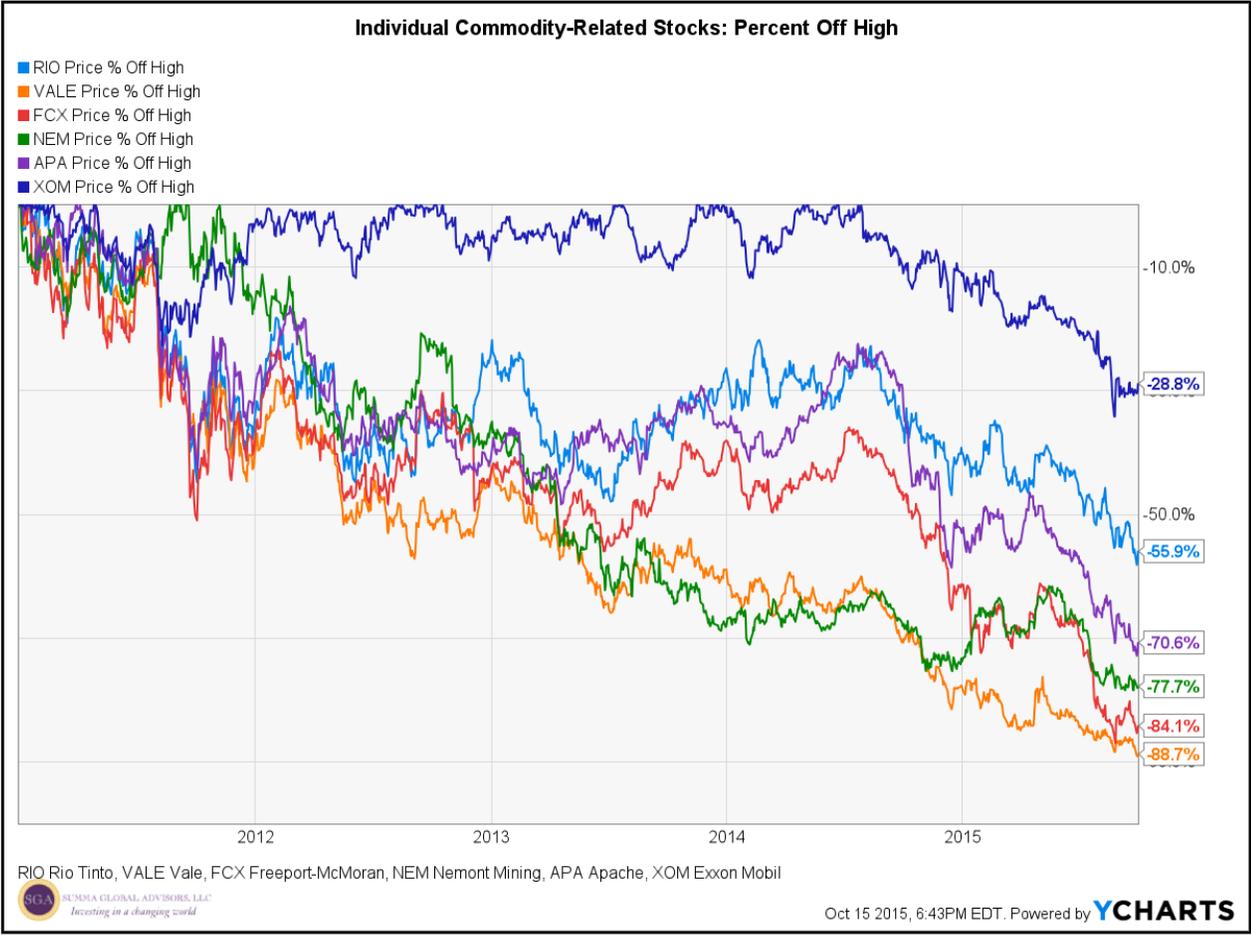
Several commodity indices are down for the past year through the third quarter of 2015 (see chart below).



WHERE THE COMMODITY MARKET IS HEADED

As you can see in the following chart, many individual commodity stocks have declined significantly from their recent highs.

“Are the declines of basic commodities an indicator of future economic activity?”



Are the declines of basic commodities an indicator of future economic activity? Not necessarily. At times, commodities do reflect aggregate demand on a local as well as a global basis. At other times, circumstances such as the over-accumulation of inventories must be worked off, creating short-term price dislocation. Certainly, the current price decline in commodity metals has been vicious and reflects the lack of global demand for these items. Investors in oil and materials stocks have seen significant losses due to dramatic price drops in their stocks. At the current levels, however, there may be excellent investment opportunities in certain companies.

As the dust settles and commodities re-price to a level that reflects the supply-demand equilibrium; rest assured that, in the future, global growth will drive commodity markets forward once again.

Footnotes:
1. <http://www.tradingeconomics.com/china/gdp>