Ned Davis Research Group

U.S. SECTOR STRATEGY

COMMODITY CORNER FOCUS

PUBLISHED MONTHLY • AUGUST 14, 2015

John LaForge Commodity Strategist
Warren Pies, ERP Senior Commodity Analyst
E-mail Us

Oil & The Super-Cycle Overhang

The dying commodity super-cycle remains the most important influence throughout the commodity complex. It is the factor that trumps all others, still in 2015. This has been the case for the last four years, and we suspect it stays that way for a while, knowing that the average bear lasts about 20 years (chart).

A bear super-cycle is essentially a black hole, sucking-in most commodity-related matter. Avoiding it is nearly impossible. Fighting it is futile. Commodity prices and investors alike eventually succumb. From the moment we began studying commodity super-cycles, we were struck by the repeatedly sharp moves during the transition from bull to bear. Each parabolic rise was met with a thundering crash, obliterating all parabolic gains and then some. No exceptions. The early bear years are consistently the hardest on commodity prices, as this is the time that the black hole churns at max strength. And with no yield to buffer the fall, commodity prices lose ground fast, and persistently. **Welcome to how commodity super-cycles die.**

With that cheery long-term context in mind, our main focus for this pub will be oil's short-term action (less than 18 months), and what may happen next. As you'll read in a bit, $42-43/barrel may not be the ultimate low this cycle.

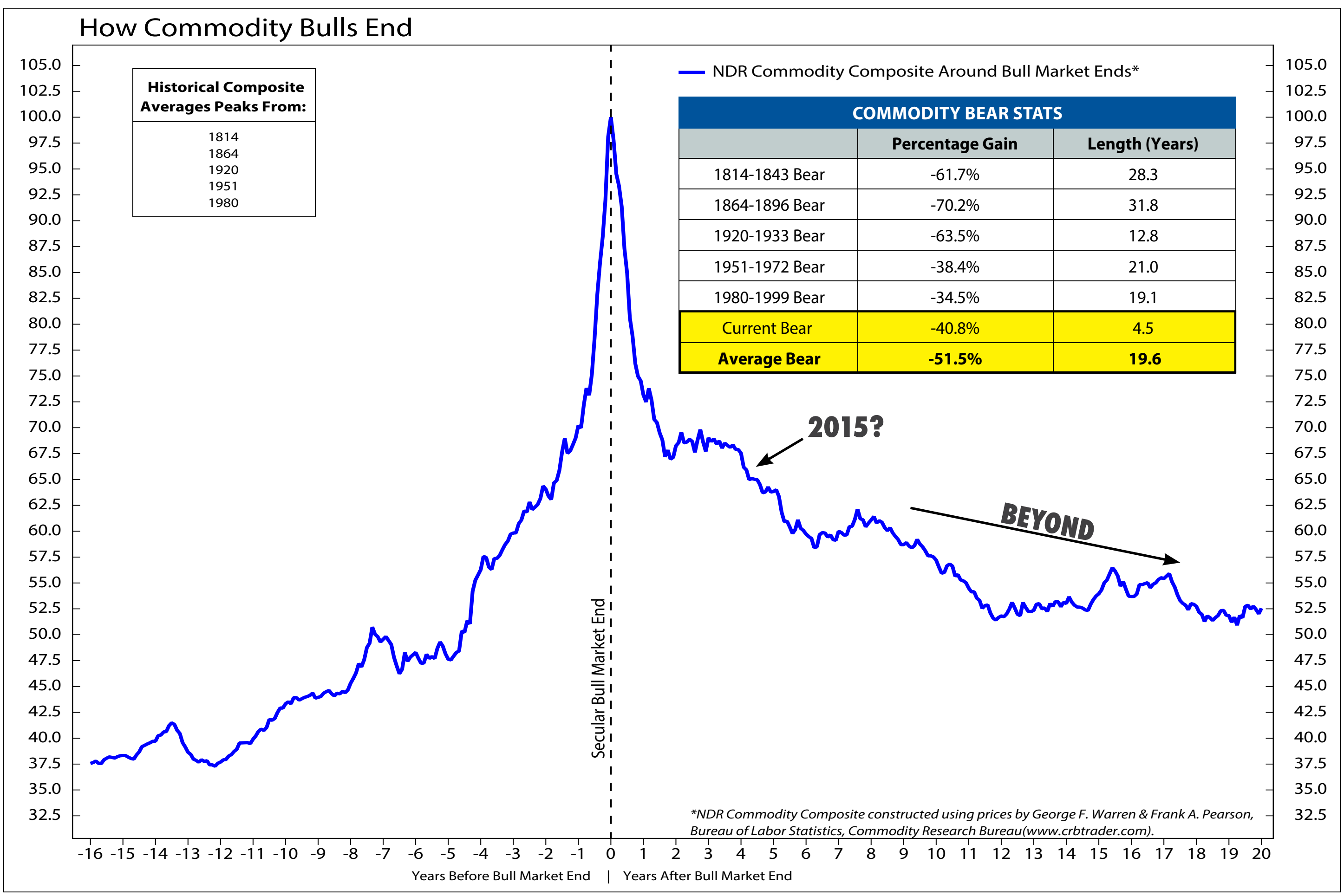
BOTTOM LINE

- Dying super-cycle hanging on oil.
- A run into the $30s to balance global supply/demand may be needed.

KEY COMMODITY PRICES

- **Gold** . . . . $1115/oz.
- **Copper** . . . . $2.35/lb.
- **Oil** $49.14/barrel
- **Natural Gas** $2.91/MMbtu

REFERENCED CHART LINKS



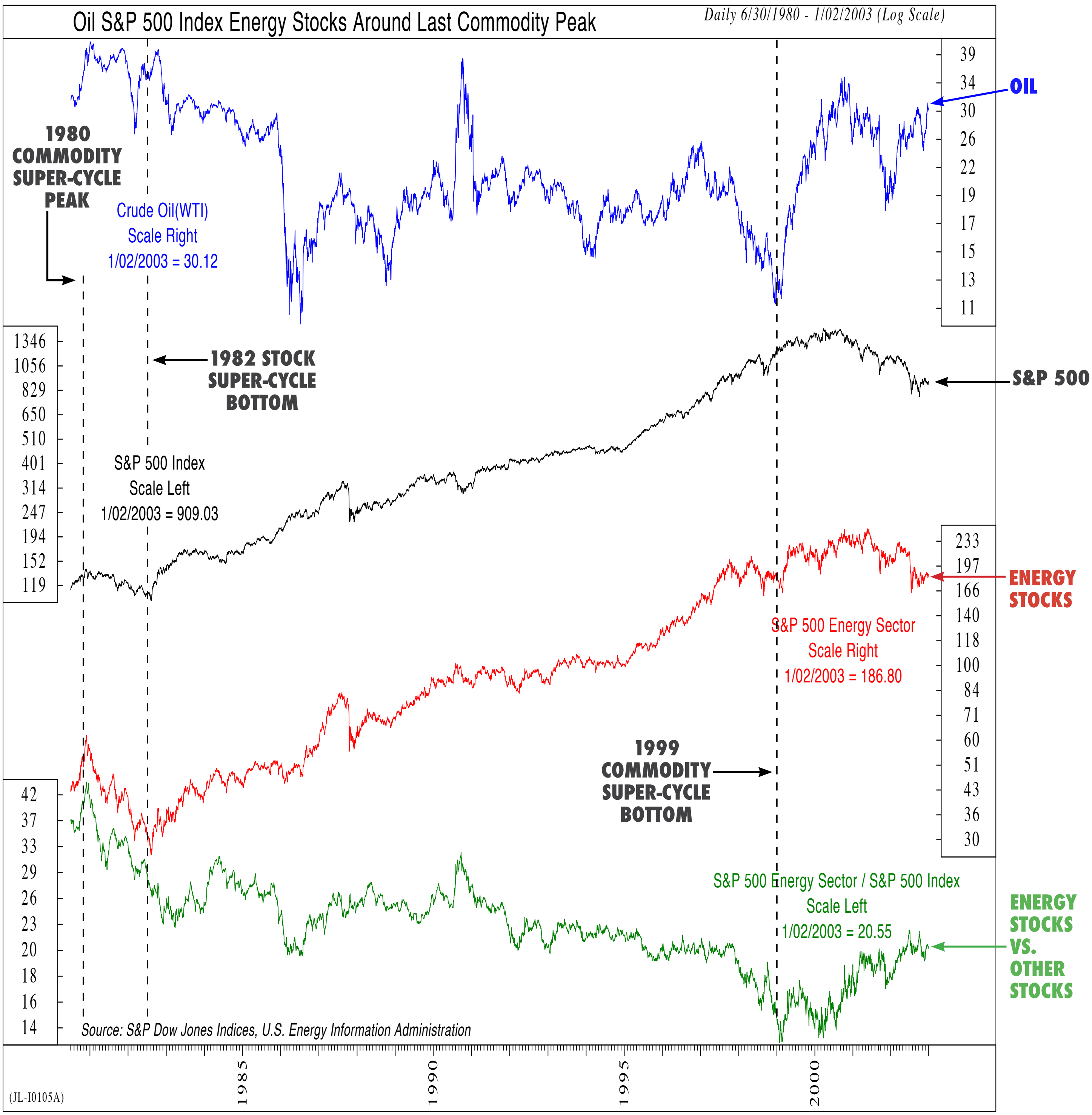
COMMODITY BEAR STATS

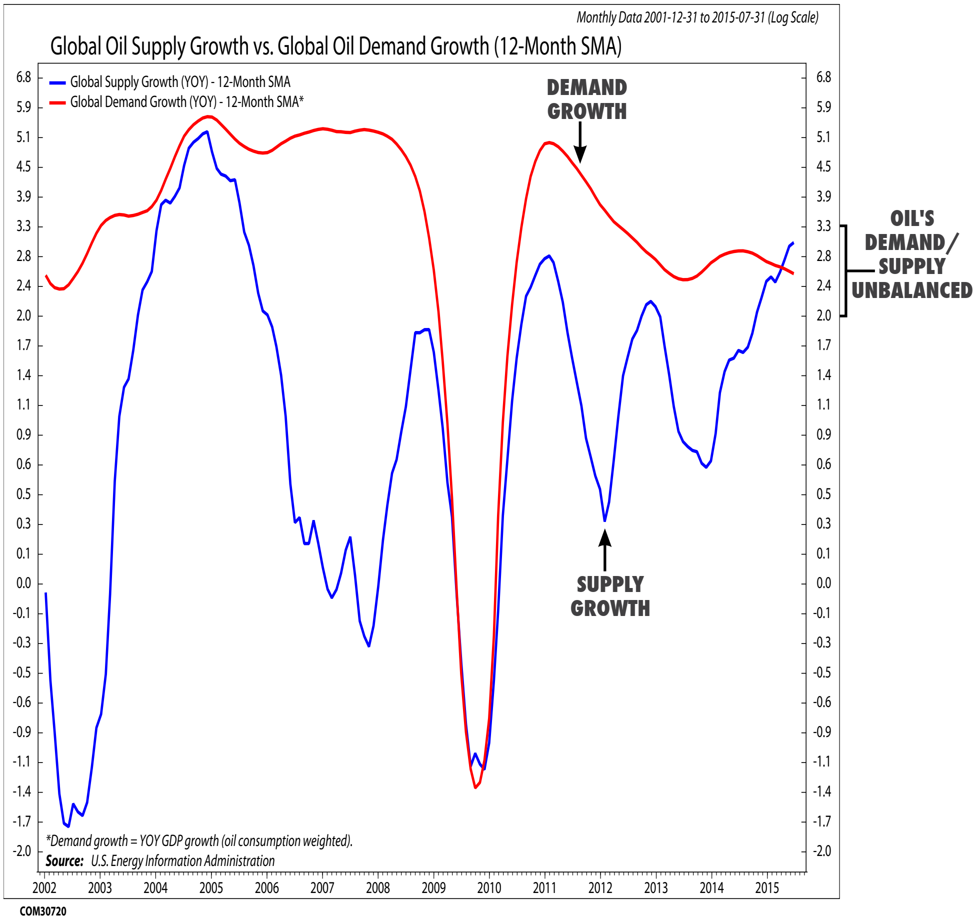
	Percentage Gain	Length (Years)
1814-1843 Bear	-61.7%	28.3
1864-1896 Bear	-70.2%	31.8
1920-1933 Bear	-63.5%	12.8
1951-1972 Bear	-38.4%	21.0
1980-1999 Bear	-34.5%	19.1
Current Bear	-40.8%	4.5
Average Bear	**-51.5%**	**19.6**

COM13

If it isn't clear from Page 1, I remain super bearish on the complex long-term. It is important to understand this context as I talk oil or gold, or some other commodity. Oil may very well find a major bottom near here, but that doesn't change my view on the long-term. Oil seems destined to repeat the action from 1986-1999; a major bottom forms, oversold bounces occur, but oil stays in a lower tight range for many, many years (chart). Remember, 2015 is only year four of the commodity super-cycle bear.

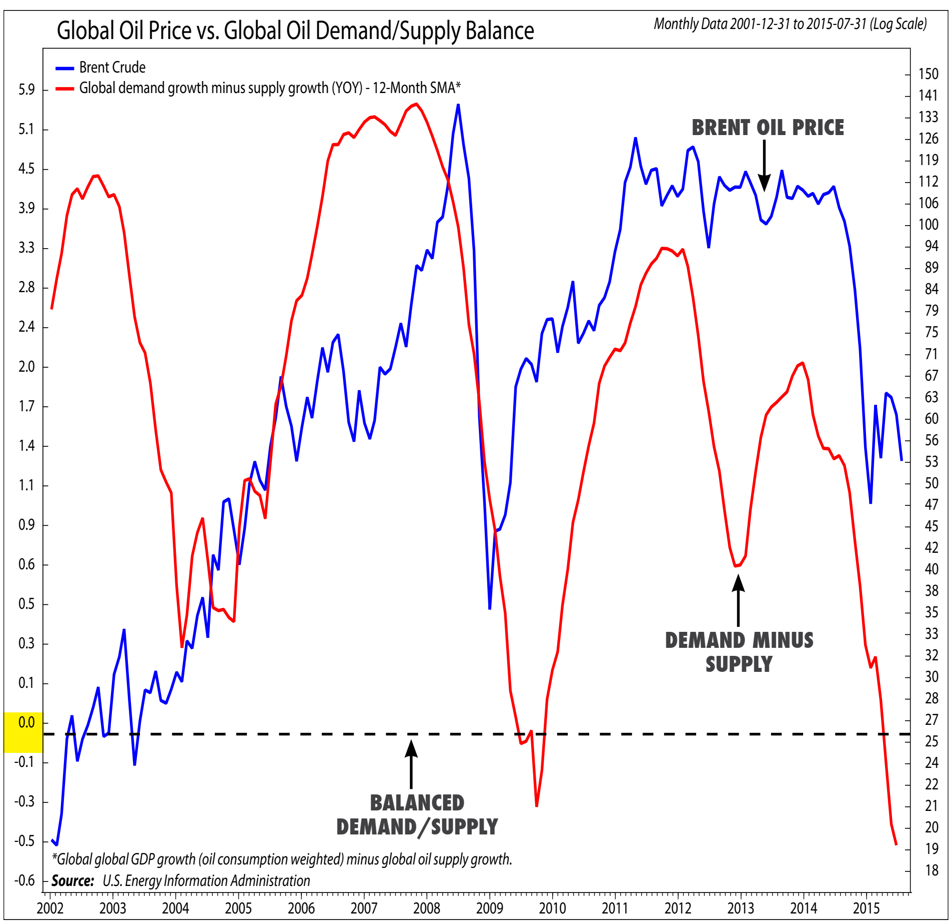
Another point to keep in mind is that much of the price carnage has taken place. But don't let that suck you in. Many commodities will continue to grind lower, but some, like oil, may just grind sideways. Don't let the "this isn't so bad" action trick you into over-allocating to the space. Either way (down or sideways) is bad news for those looking to add exposure. **In essence, allocating to the commodity space over the next few years, stocks and futures generally, will likely be opportunity lost.** The chart, spanning the 1980s and 1990s, makes this plainly evident. The red line represents energy stocks; the green line energy stocks vs. other stocks in the S&P 500.





OIL BOTTOMING, BUT LOW $40s MAY NOT BE ULTIMATE LOW

I do still believe oil is in a major bottoming process. The sheer number of extremes says to me that oil appears close to a bottom. The big extreme, the balance between global supply and global demand growth, is shown in the top chart. The two lines are year/year changes, smoothed over twelve months. Global supply growth (blue line), has crossed a point it rarely crosses (above global demand growth). This is the point where supply and demand are typically forced to balance.



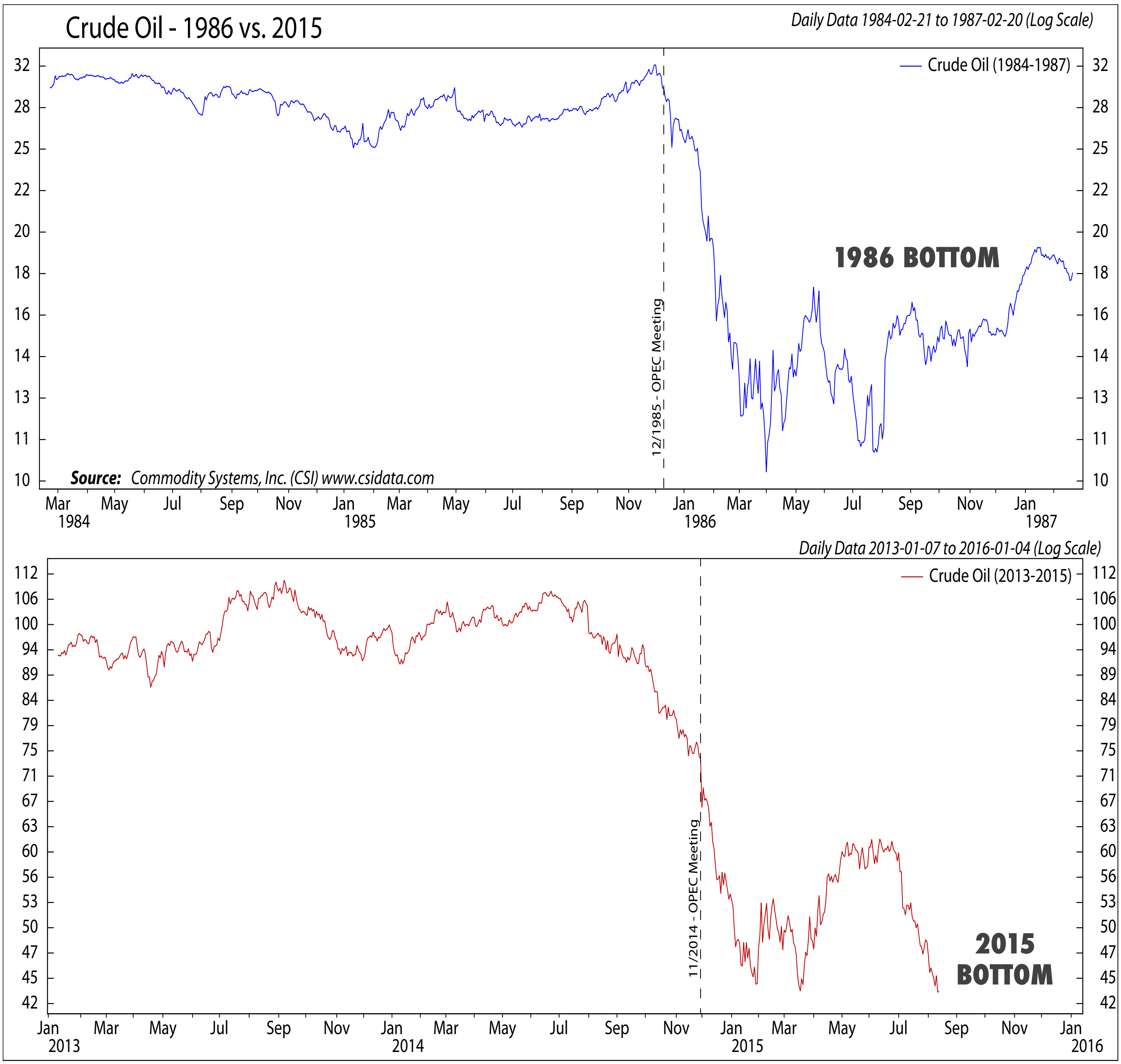
Forcing the balance is normally good for oil prices. The bottom chart plots the price of Brent oil (blue line) against the global supply/demand balance (red line). An imbalance to this degree does help better understand when a rebalance should take place. It is not, however, an exact timing tool.

I've been saying since April that "March 17th was the likely low". This is now wrong as spot found a new low on August 11th, and then again yesterday.

I have two comments on the new low. The first one is mea culpa. Prior to NDR, I was a PM. I fully understand the importance and value of timing. The miss is not taken lightly. It will be added to the ever growing pile of lessons learned. **Second, the recent price action has me worried that new lows may be in the cards.** A sharp shake-out well below the $42-$43 area may be needed to get global supply and demand to balance. Let me explain.

CONCERN #1 – OVERALL PRICE ACTION

To be clear, the marginal break in the last three days is not my main issue. It is how the new low has evolved, since July. I'll use the major bottom in 1986 to explain. 1986 is shown in the top clip, while 2015 sits in the bottom clip. 1986 witnessed a process of (1) low hit, (2) bounce, (3) low retest, (4) bounce, (5) consolidation at higher level, (6) eventual move higher to confirm that the low was in place. 2015 witnessed the first five steps, but failed miserably at step (6). **Not only did price not move to a higher level, it reversed, setting a new marginal low in the process.**



COMF201411111H_C_1986

CONCERN #2 - SUPPLY

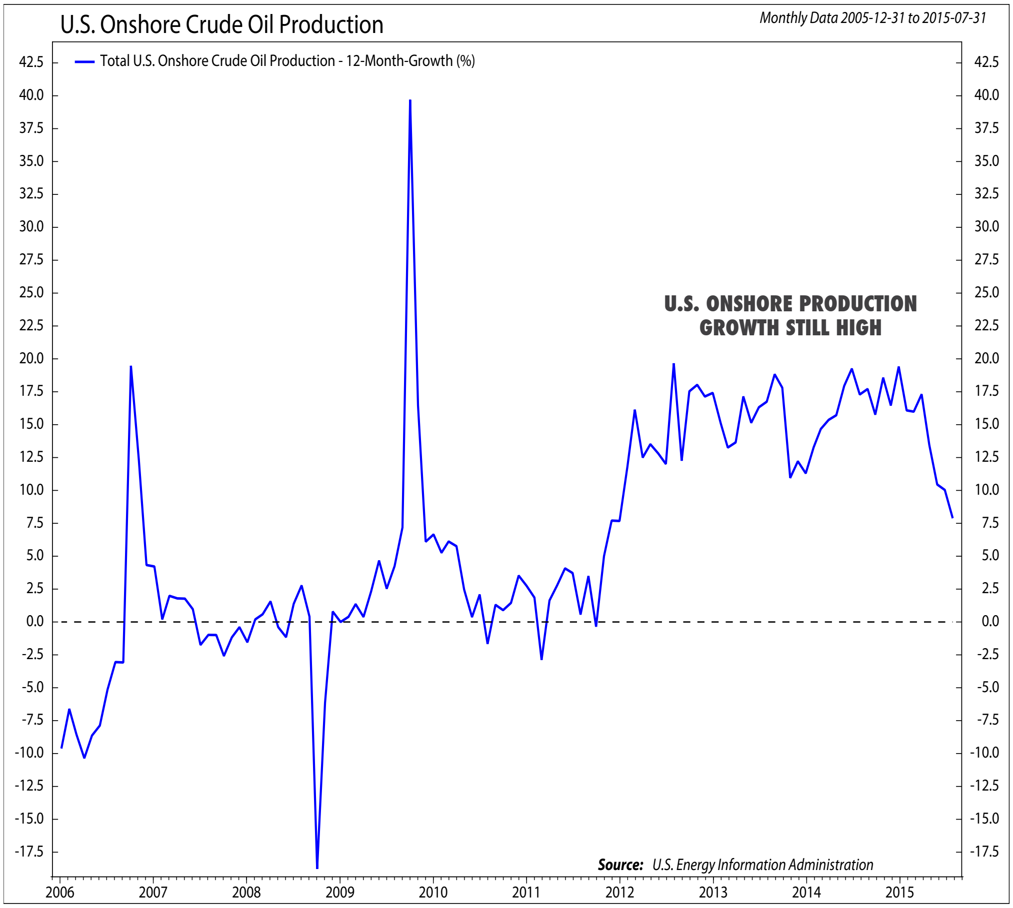
It is well known at this point that shale production has slowed, but not by much considering the $63/barrel price drop. The top view shows U.S. oil production growth year/year. Year/year growth has slowed to 7.5%, but it is still comfortably in the positive as the side scale indicates. It appears that production growth is taking a Sunday stroll; unaware that WTI is a few minor steps away from the $30s.

Supply growth doesn't appear much better on a global basis. The blue line in the bottom chart shows global supply growth year/year at 2.8%, within shouting distance of its 2014 and 2015 highs. It has stopped going higher, but does the blue line look like it is making big strides toward balancing with demand? Maybe you see it…we don't.

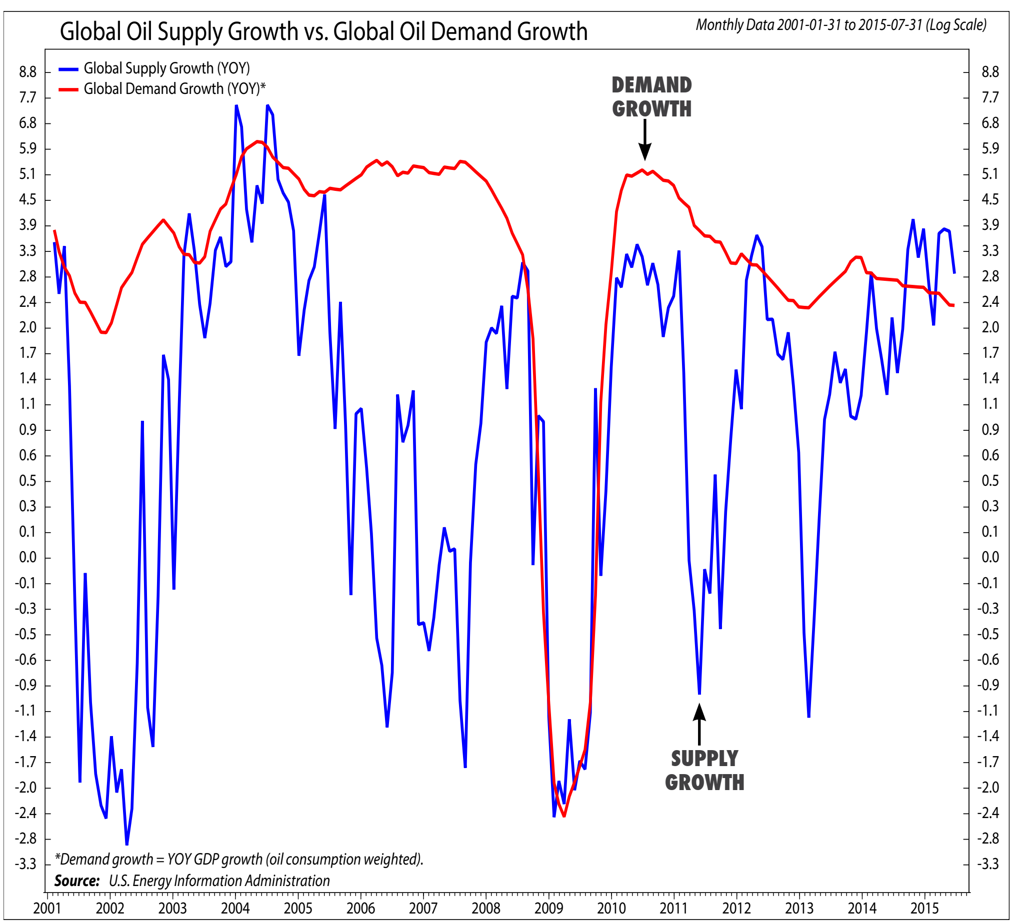
CONCERN #3 - DEMAND

Is demand growth quickly adjusting to balance the equation? Not really. The red line in the bottom chart plots the year/year change in global demand growth (if this chart looks somewhat familiar, it is the sister chart to the one on Page 4, which is additionally smoothed by 12-months). Global demand growth is clearly not helping balance the equation at 2.4% year/year, and steadily falling. In fact, it appears unaffected by what is happening with supply.

To be fair, the equation is starting to balance. The blue and red lines are closing their gap, just not with the urgency we expected after a $63/barrel drop.

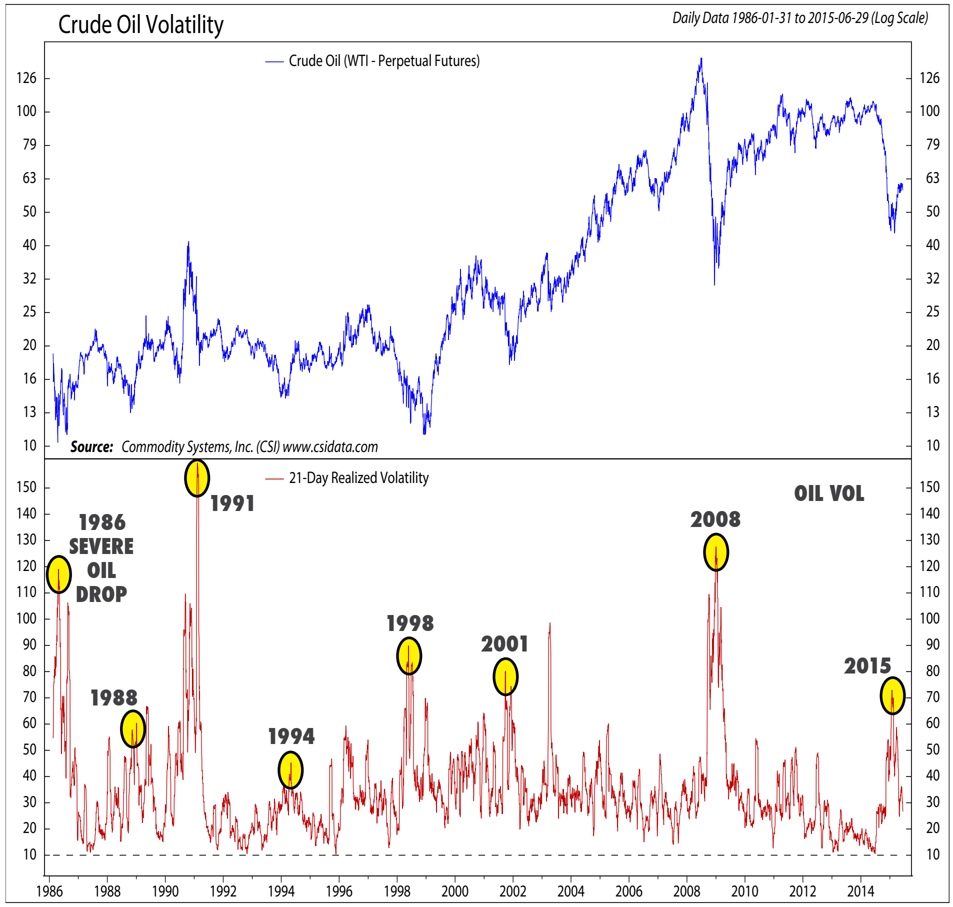


COMF201508131A_C

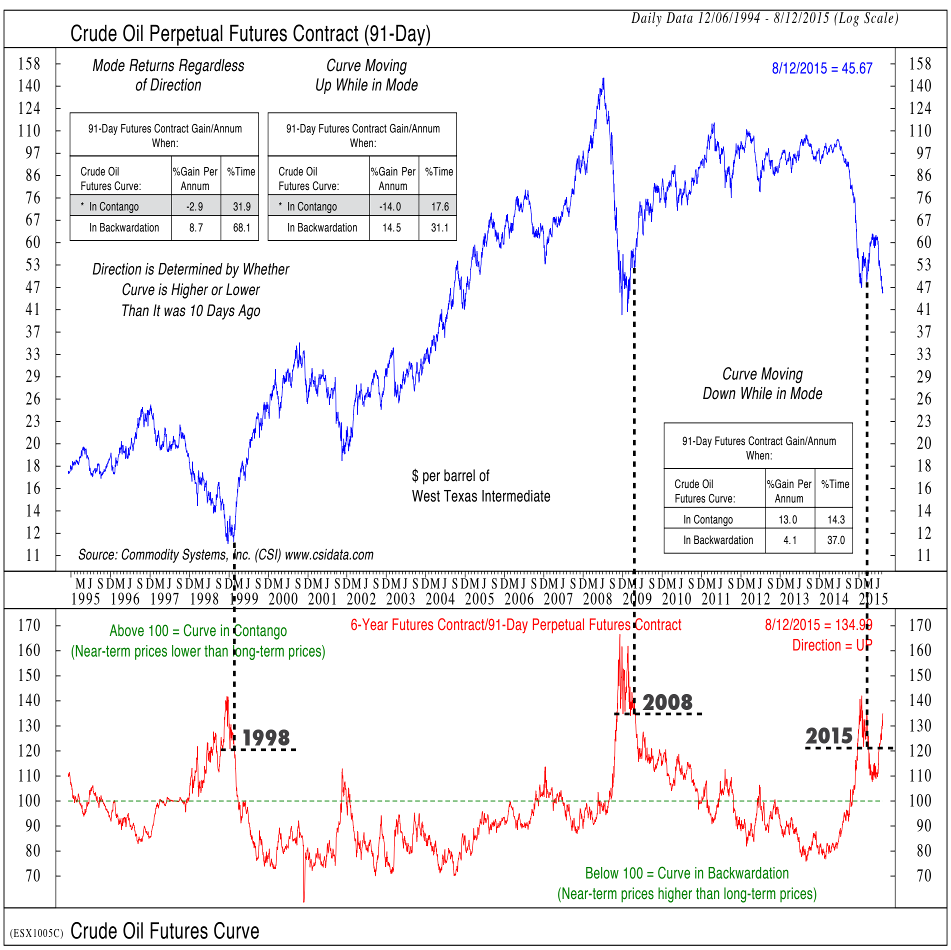


COM30720D

There are perspectives that still say March should have been the low, no matter recent weakness. Volatility, in the top chart, is one of those. The March 17th low is marked by the vertical black dashed line. Volatility in recent months has not come close to what we saw in the spring. Of course, a sharp drop into the $30s would probably take care of that.



COMF201411111H_C



The oil futures curve is another angle that says March was the odds on favorite to be the ultimate low (bottom chart). In the last month, the curve has moved back into extreme contango positioning, yet not as steep as March (bottom chart, bottom clip). Still, the shape of the curve has made a surprising come-back, which is not exactly a bullish sign.

We'll leave you with a freshly marked-up chart of WTI, so you can see the key support zones. The $40s supports are holding, so there is no need to panic yet. That said, the price action, since July, has been uninspiring for someone looking for a major price low. If only supply and demand growth would pick-up their leisurely stroll toward balancing, I wouldn't be so worried. **My fear is that a quick, steep shake-out may be needed, which is why I have a nervous eye on the 2008 lows.**

Maybe I'm just being overly cautious. Maybe in the end oil does bottom in the $42-$43 neighborhood, and my March low call wasn't that far off. At that point, I could become known as the Bob Uecker (in the movie ***Major League***) of commodities, "…just a bit outside."

And please remember: keep this in context to the overall dying commodity super-cycle.

COMF201205301B_C_NEW

NED DAVIS RESEARCH GROUP

sales @ndr.com
www.ndr.com
(800) 241-0621

VENICE
600 Bird Bay Drive West
Venice, FL 34285
(941) 412-2300

BOSTON
50 Federal Street
6th Floor
Boston, MA 02110
(617) 279-4860

ATLANTA
2100 RiverEdge Parkway
Suite 750
Atlanta, GA 30328
(770) 308-1128

SAN FRANCISCO
50 California Street
Suite 1500
San Francisco, CA 94111
(415) 277-5477

LONDON
8 Bouverie Street
London
EC4Y 8AX
+44 (0)20 7779 8579

Ned Davis Research Group

DISCLAIMER

The data and analysis contained herein are provided "as is" and without warranty of any kind, either expressed or implied. Ned Davis Research, Inc. (NDR), d.b.a. Ned Davis Research Group (NDRG), any NDRG affiliates or employees, or any third-party data provider, shall not have any liability for any loss sustained by anyone who has relied on the information contained in any NDRG publication. NDRG disclaims any and all express or implied warranties, including, but not limited to, any warranties of merchantability, suitability or fitness for a particular purpose or use.

NDRG's past recommendations and model results are not a guarantee of future results. This communication reflects our analysts' opinions as of the date of this communication and will not necessarily be updated as views or information change. All opinions expressed herein are subject to change without notice. NDRG or its affiliated companies or their respective shareholders, directors, officers and/or **employees, may have long or short positions in the securities discussed herein and may purchase or sell such securities without notice.**

Using any graph, chart, formula or other device to assist in deciding which securities to trade or when to trade them presents many difficulties and their effectiveness has significant limitations, including that prior patterns may not repeat themselves continuously or on any particular occasion. In addition, market participants using such devices can impact the market in a way that changes the effectiveness of such device.

Further distribution prohibited without prior permission. For data vendor disclaimers, refer to www.ndr.com/vendorinfo.

Generate alpha. Identify risk. Choose Ned Davis Research.

Founded in 1980, Ned Davis Research Group is a leading independent research firm with over 1,100 institutional clients in over three dozen countries. With a range of products and services utilizing a 360° methodology, we deliver award-winning solutions to the world's leading investment management companies. Our clients include professionals from global investment firms, banks, insurance companies, mutual funds, hedge funds, pension and endowment funds, and registered investment advisors.