“All that glisters is not gold;

Often have you heard that told:

Many a man his life hath sold

But my outside to behold:

Gilded tombs do worms enfold.”

- William Shakespeare, *The Merchant of Venice*

This quote from Shakespeare’s *Merchant of Venice* is apropos given the nosedive in the gold markets today. In our 2013 Best Ideas piece we labeled gold a neutral as gold had not had a significant correction since 2008. Our research indicated a significant slowing of bullion purchases by gold Exchange Traded Funds (ETFs) in 2012 versus 2011. We looked for a correction and now need to contemplate whether we are in the end of the commodity bull market or merely a pause that refreshes.

Part of our hypothesis on the continued secular bull market for commodities in general centers on the exceptional easing that the world central banks are doing. As world central banks attempt to stamp out deflation they have engaged in monetary policy designed to increase inflation expectations. In short, currency creation is inflationary in nature and a world full of quantitative easing (QE) should be friendly to hard assets, especially gold. Secondly, we note that the continued expansion in Asia and South America continues to make use of a great number of basic materials. Over the past year a construction expansion in the United States has begun adding to the demand for resources. Short-term expansion of resource stockpiles can cause huge price swings in the underlying spot markets. Lower prices spur demand and construction.

So, is the bull market dead for gold and materials? Is the news from China indicative that they too will continue to slow? We don’t think so. In fact, we think this is an attractive entry point for both the BRIC countries (Brazil, Russia, India & China) as well as natural resources. Analysts estimate that the expected earnings growth for the materials sector will actually be above 20%, yet this is a lagging performer thus far in 2013. Higher earnings expectations should lead to higher prices. It is interesting
that many of the steel producer stocks are selling at prices that we last saw at the market bottom in 2009.

Remember, the final days of a correction are the steepest and scariest. It appears that we are in this stage for most materials. As the world becomes a safer place many “gold bugs” have weak hands and pile on in the selling. Additionally, margin calls will force even more selling. Markets generally take the stairway up in price direction and take a high-speed elevator down. There is no need to jump in quickly, but it is time to consider over-weighting this sector.

All of the factors that make this group attractive are still in effect. Demand is being stimulated and will likely be rising. China and the other BRIC countries will likely continue to stimulate. Japan just got into the game besting the U.S. Fed in QE monetary stimulation. The Fed will certainly not slow its QE activity due to fear that the U.S. economy might slow. So, our view is that global monetary easing plus likely return to growth in the developing and emerging markets should conclude this move in basic materials to be just a correction.

Most secular moves in commodities historically have been around 18-20 years in length. This cycle started in 2000 and is only 13 years old. Most of the time, the fireworks generally come in price movement in the final months of a secular cycle. We think this phase is likely in front of us and not behind us.

We reiterate our bullish stance for basic materials and note that this juncture provides a good point to build a position. We note that we are still not a “gold bug” for 2013, but other basic materials have great risk/reward basis.

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