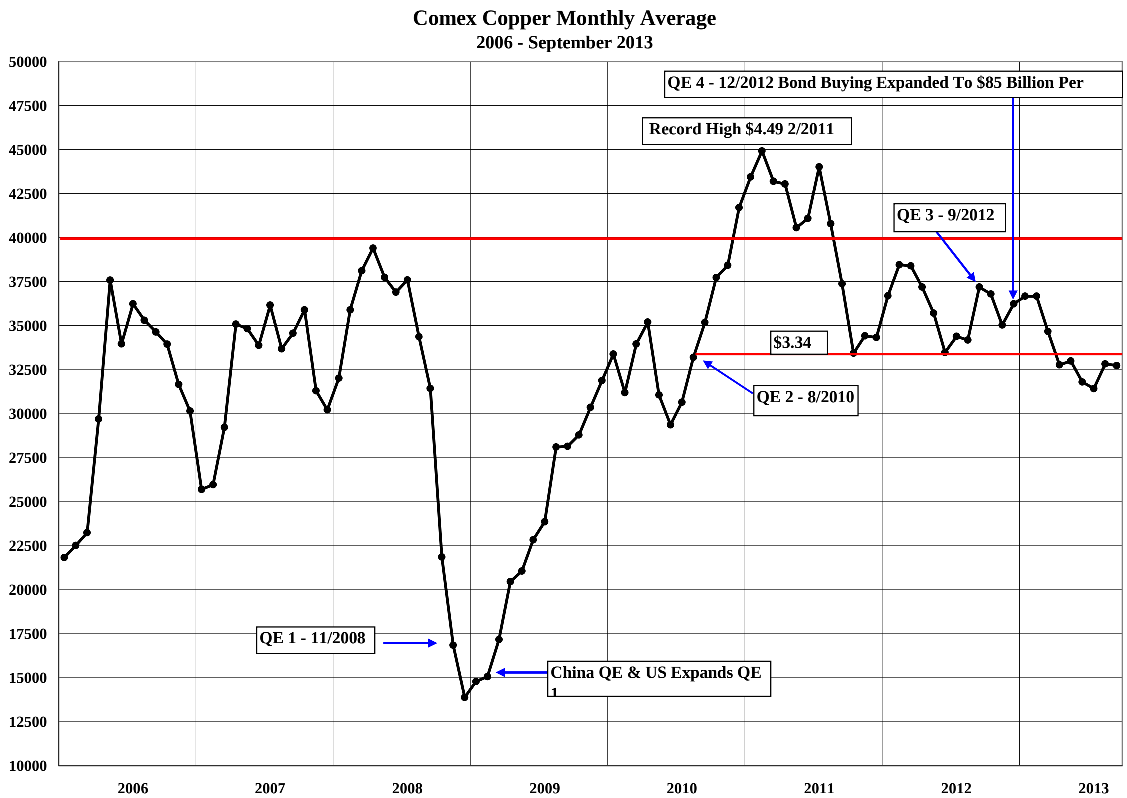
What Is Driving The Metal Markets?

In all likelihood, Mark Twain did not have metal markets in mind when he said, “history does not repeat itself, but it does rhyme”

Nevertheless, it seems as though we are watching his assessment play out as recent similarities among the non-ferrous and precious metals are displaying an uncanny resemblance to each other, as well as to the distant past. Necessarily, this raises the question of how and why it is happening, and if in fact the markets will indeed rhyme if not repeat their historic configurations.

As a case in point, copper, nickel, and zinc prices peaked in February 2011, while aluminum, lead and tin followed suite in April 2011, despite continued quantative easing as the copper chart illustrates. Just as important, the price of copper fell below a key support line at $3.34 indicating the potential for further downward movement if the market is unable to get back over this line.



The gold market provides an excellent longer term example as a test case to examine market structure, expectations, and the evolution of prices over a protracted period of time. More specifically, it seems that an argument can be made that the gold market of 1970 – 1983 is very similar to the 2000 – 2013 market, not in terms of actual price, but rather formation of the price pattern. Further, this analysis does not look at or take into account fundamental, economic, or geopolitical considerations that prevailed at the time, but simply the very broad technical aspects of the price charts.

Notice that the monthly average price of gold was trading in the $35 range in early 1970 and rose about $150 to a record high $185 by December 1974. For some it was a time to take their profits and run, while for others who sold short into the rising market thinking it could go no higher, they had to cut their losses.

Thus, a correction ensued with the market falling $75 or 41% to $110 in August 1976. Why it stopped there is anyone's guess, but a level of support was established, thereby giving bullish traders the courage to buy into what they perceived to be a market with the potential to move higher still. Two years later, in 1978, gold broke the $200 barrier rising to $228 and once again pulled back, but also found a new higher level of support at $200.

From here, the market rapidly climbed higher in a near vertical formation to reach a new high of $672 in January 1980.

With the heightened level of volatility throughout 1980, it was a tug of war between the bulls who saw gold going to $1,000 and the bears who were determined that the highs had been made.

Initially, the bears prevailed as gold fell back to $515 during April, but in September 1980 gold rose again to the +/- $675 level, however, it was unable to move much beyond the previous high, thereby creating a double top formation and the beginning of a long term bear market that would persist for the next twenty years.

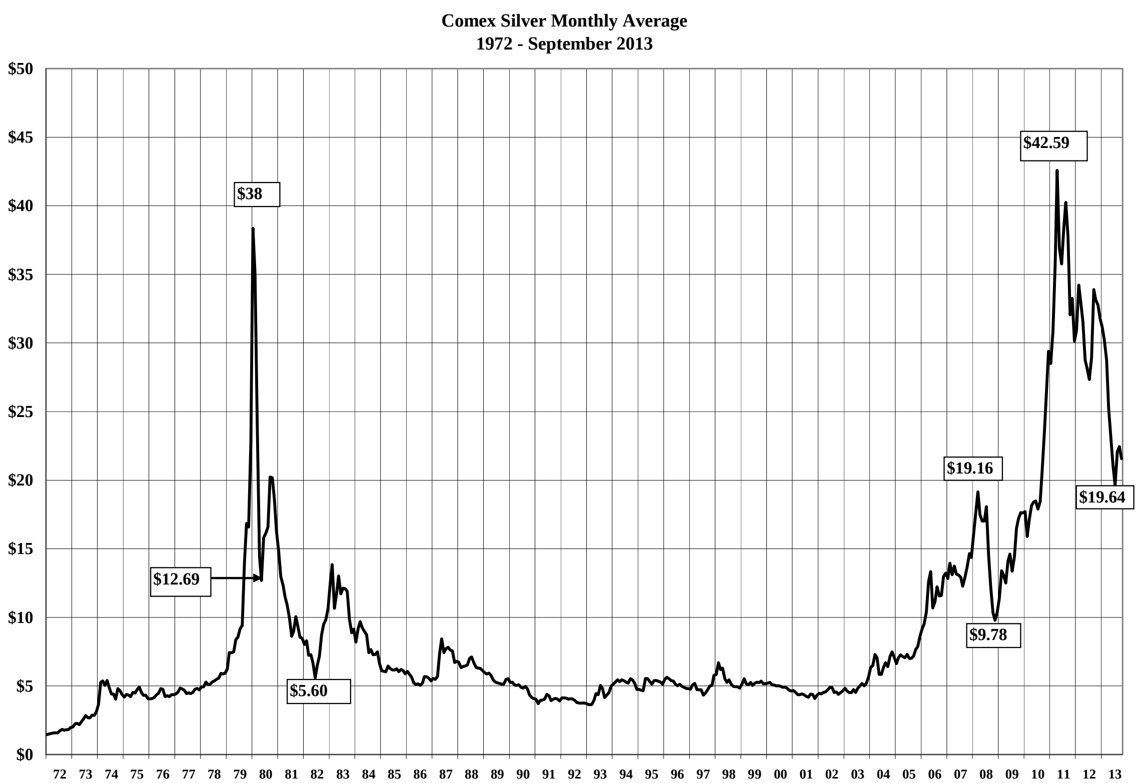
Indeed, from the $675 high, gold ultimately fell almost $420 or 62% to just $257 by July 1999.

How does this compare to the 2000 – 2013 market? From the $285 opening in January 2000, gold fell to a low of $260 in April 2001, thereby holding the previous low of $257 in 1999. From here, it was onward and upward as gold marched higher. By May 2006 it hit $675; pulled back and found support just below $600 to form a base upon which to move higher again. The same thing happened when gold got into the $900 region, and initially was unable to get through the $1,000 level.

Once it breached $1,000 and held support, there was nowhere else to go but up. Once again, as we saw in the 1970's, the market went into a vertical formation to reach an all time monthly average high of $1,762, while the Spot high close came in at $1889.

As can be seen, gold tried and failed to move beyond the high, similar to what occurred in 1980, with the last attempt a year ago in October 2012 at $1,745.

Since then, gold has given up some $460, or 26% on a monthly average basis as it fell to $1,285 during July 2013. If in the event gold does in fact follow the script from 1980 – 1999, we could be looking at a monthly average price of $670, which would coincide with the high of 1980 and 2006.



Similar to what we saw in gold, silver rose sharply in the late 1970's ostensibly in response to inflationary pressures brought on in large part by rising oil prices and a tense geopolitical situation in the Middle East. However, as we also saw with gold, there was a speculative herd mentality that accompanies certain market movements, creating an unsustainable bubble that ultimately had to burst and end badly for many involved.

From a purely technical point of view, as we saw with gold, following the initial break from the $38 peak in January 1980, silver fell to $12.69 just five months later. It subsequently attempted to rally but was unable to muster enough support to move beyond $20, only to fall back to $5.60 by June 1982, down almost $33, or 85% from the high and spent the next 23 years in bear market territory.

From early 2004 when silver began moving above previous highs going back to the 1980's, the market steadily picked up momentum with higher highs and higher lows to approach $20 in March 2008, coinciding very closely with the previous high in 1980.

Coincident with the global economic meltdown in 2008, wherein all markets suffered dramatic losses, silver fell almost $10 or 50% to average $9.78 in November of that year. Nevertheless, as Central Bankers pumped billions of dollars into the global economy in an attempt to keep it afloat, commodities soared higher across the board and silver was no exception as it climbed 335% to $42.59 just two years later.

While the underlying circumstances were very different between the 1980 and 2011 markets, the outcome for silver and other metals appears to be very similar. That is to say after the markets peaked, they posted lower highs and lower lows as if to signal the end of the bull market. However, this is also where the debate begins within the current market, not only for silver and gold, but for non-ferrous metals as well. Although markets have been trending lower for more than two years now, many traders remain confident that silver and gold will turn back up to post new highs, while the non ferrous complex is expected to be mixed in 2014, but not significantly different from current levels.

Prices

	2012	**2013 YTD**	**2014 Forecast**
Copper	$3.61	$3.35	$3.12
Aluminum	$0.92	$0.85	$0.83
Lead	$0.93	$0.97	$1.06
Tin	$9.57	$10.03	$10.65
Nickel	$7.95	$6.95	$6.92
Zinc	$0.88	$0.87	$0.95

This summary illustrates the monthly average peak in metal prices as compared to the recent low following the 2008 downturn.

	Peak		Recent Low		Change	
Copper	$4.49	Feb 2011	$3.14	July 2013	($1.35)	(30.1%)
Aluminum	$1.21	April 2011	$0.80	Sept 2013	($0.41)	(33.9%)
Lead	$1.24	April 2011	$0.84	June 2013	($0.40)	(32.3%)
Tin	$14.72	April 2011	$8.44	July 2013	($6.28)	(42.7%)
Nickel	$12.81	Feb 2011	$6.22	July 2013	($6.59)	(51.4%)
Zinc	$1.12	Feb 2011	$0.83	May 2013	($0.29)	(25.9%)
Silver	$42.59	April 2011	$19.64	July 2013	($22.95)	(53.9%)
Gold	$1,762.00	Sept 2011	$1,286.00	July 2013	($476.00)	(27.0%)

As an aside, crude oil also peaked in April 2011at $110 per barrel with the Spot market recently testing that high in during September 2013.

Looking back at the events of 2011 in an attempt to determine what caused the markets to turn, there does not seem to be any one single factor, but perhaps a confluence of events as is typically the case. However, the one common dominator between the highs of 2011 and recent lows is found in the US dollar strengthening form a low point in July of 2011 and falling from a recent high in July 2013.

The other significant event within the February – April time frame of 2011 was the devastating earthquake and tsunami in Japan that not only caused enormous destruction, but also affected supply chains throughout the world as well as a rethink about the wisdom of using nuclear energy for power generation.

2011 also saw China displace Japan as the world's second largest economy, a title that Japan held for 40 years. And in 2002 China surpassed the United States as the worlds largest consumer of copper and aluminum in addition to a wide variety of other industrial metals, and since then has continued to expand. It is expected that their share of copper and aluminum will climb to 45% soon and nickel will reach the 50% level.

It goes without saying, that small changes in China, be they political, economic, or social could have very significant ramifications throughout the global metals markets.

Additionally, it is a lengthy list of other considerations that create difficulty in analyzing metal markets. These include but are not limited to a lack of transparency in Chinese statistics, the impact of quantative easing and when it will be wound down; ongoing uncertainty of the US government partial shutdown and rapidly approaching debt limit, as well as disruptive market conditions within the London Metal Exchange warehouse system.

Given the ambiguities and inherent unpredictability of global events, it is perhaps best not to be fixated on forecasts of what prices will do, but rather be guided by history and what the markets are doing and most importantly, have a plan in place to protect your metal assets.

John E Gross
October 15, 2013