

A **Global Perspectives** White Paper



Global Perspectives

“The Daily 200,000”

Why the Commodities Supercycle is just beginning

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"The world population grows some 200,000 each day. 7 days a week, 365 days a year. This year, next year, the year after that....."

I would counter the world is just starting a Supercycle in commodities. Just depends on your timeframe.

10 years from now we will need more grain, more water, more oil, more copper than we use today".

"Tas10", Seeking Alpha.com, 2011

Introduction

The summer of 2012 began with widespread reports in the press that the Commodity Supercycle that had been in place since the turn of the century was now coming to an end.

The slowdown in China and some of the other BRIC countries meant that the cycle had concluded and the price of commodities would now decline in the decades ahead as they had (bar oil) for the whole of the 20th Century.

This fundamentally misunderstands what is happening in the long-term global economy.

To understand why this is nonsense it is important to explain where we are now in the commodities cycle and what is going to happen in the years ahead. These are some of the most important developments for mankind and will have a huge impact on populations worldwide.

Like all economic cycles, it will also open up many investment opportunities for both asset managers & investors.

This White Paper is intended as an introduction to our forthcoming e-book on this topic.

Shane Brett from Global Perspectives will be publishing this e-book later this year which will provide a comprehensive analysis of the Commodity Supercycle, as well as specific recommendations for investment opportunities in the commodities sector.

Where we are now

The reports of the end of the Commodity Supercycle comes after a period of intense economic uncertainty, huge aversion to risk in the markets and the collapse in the value of many smaller resource companies.

Prices of many important commodities like Copper (the traditional bellwether of economic health) and Iron Ore had begun to fall from their highs of 2011.

Most importantly, it looked like China, with its seemingly bottomless demand for the world's commodities, was finally slowing down. This would greatly reduce its demand for so much of the world's mineral resources.

Put simply, after a decade of rapid expansion, commodities have become unfashionable.

As we shall see, the problem with this viewpoint is that the timeframe is **far too short**.

It completely overlooks the scale of the changes taking place in the global economy right now, which will proceed for at least the next 3 or 4 decades and throughout the whole first half of the 21st century.

In the months since the Commodity Supercycle was declared dead, we have already seen a number of events in the world economy that make a mockery of this thesis.

A horrendous drought in the US, coupled with a poor Indian Monsoon means food prices are set to rise sharply in the months ahead (just as they did in 2008 - abating only when the world's worst Post-War economic crisis sated demand).

The price of Corn alone has increased by 60% in the summer of 2012 and unfortunately the very real risk of significant developing country unrest is

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looking more likely in the months ahead (just as was experienced in 2008).

Why the Commodities Supercycle is just beginning

Even though short term commodity prices may decline slightly due to the Chinese economic slowdown, the world is about to enter a new era of explosive growth in commodity prices.

We have identified 5 main reasons that the commodity Supercycle will accelerate in the years and decades ahead. This will be a period of much higher prices for minerals, metals and most importantly, food.

1. "The Daily 200,000".

The most important fact in understanding why the demand for commodities will grow hugely this century is simply this – the world's population increases by **200,000 each day**.

That's every day of the week, 365 days a year.

It equates to 75 million people born annually (i.e. a new Germany every 12 months).

There is no debate over these numbers. It is not something that can be brushed away or misinterpreted. It is a fact.

These children exist, they are being born - and will continue to be born in these numbers until the middle of the century when the world's population stabilizes (and when finally this Supercycle *may* start to end).

More importantly, these children will need food and clothes; they will need housing and energy: they will need transport and education. They will also be the best educated, healthiest, longest lived and richest generation in human history.

Unlike previous generations, vast numbers of these children are not dying in infancy or succumbing to infectious diseases or starvation.

These numbers are largely surviving into adulthood and globally will live far longer lives than in even the last century (current world life expectancy is 67 years - compared to only 28 in 1800).

The survival of huge numbers of healthy children into adulthood is without precedent in the history of mankind.

While this is great news for humanity it is going to exert incredible pressure on our planets resources.

Merely by virtue of their existence “the daily 200,000” will hugely increase demand for all the main commodities in the decades ahead.

2. Growth in the Developing World.

The vast majority of this “daily 200,000” are being born into the developing world.

This is a part of the world that has experienced major economic growth and opportunities on a scale unknown in their recent history (7 of the 10 fastest economies in the last decade were in Africa).

It can be hard to fully appreciate this from inside a debt-ridden, economically stagnant and gloomy first world cocoon.

Worldwide more people than ever before are set to enjoy a higher standard of living than their parents.

In the BRIC countries this means people will have the possibility of owning their own washing machines and traveling by air plane. They are the first generation whose future prospects are unlikely to be totally destroyed by gross economic mismanagement, hyper inflation or even war (as it was so often for their parents).

Crucially, their higher level of health, literacy and education means they will

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live longer, healthier lives. They will seek (and generate) employment that is higher up the value chain. Accordingly they will be better paid. They will have **more income**.

With this will come increased economic demand. Just as in the first world, these people will want to use their increased disposable income to improve their lives and the lives of their families.

This means they will want (and demand) the trappings of first world comfort - their own transportation, better housing, more protein, wider dietary choices, increased leisure options etc. It will be up the world to try and supply the resources to satisfy these demands.

This mass adoption of Western consumer culture will equate to a huge surge in the demand for the planet’s resources. For its agriculture to feed them, for its energy to transport them and for its minerals to build the homes that they will live in.

3. The rush to urbanize.

As of 2011 half of the world’s population now lives in cities. Quite rightly this event was widely covered in the media as a landmark in the development of our race.

What was less widely noted was that this is merely a marker on a continuing headlong rush to the cities by tens of millions of people (primarily in the developing world).

By the middle of this century an incredible 70% of humankind is expected to live in cities.

In the first decade of this century China moved 200 million people off the land and into its cities. We all observed what this did to the prices of hard commodities like Iron Ore and Copper.

China alone is currently planning to move 250 million more people to move its cities in the next 15 years (i.e. almost the population of the US excluding California).

Even if a short-term economic slowdown slightly delays this process, the sheer scale of this migration is unprecedented in human history.

And it is not just in China. In Africa and the other BRIC countries the number of people moving to urban environments has exploded in the last few decades. The majority of the world's very big cities are already in the fast growing countries of the developing world.

The demand this urban rush will place on supplies of steel, iron and copper will be colossal.

4. The demographic dividend

The "demographic dividend" is the period in a country's development where the number of working people increases in relation to the number of people they support (children & the elderly). It occurs where there has been a decline in the fertility rate.

As women have fewer children and the number of people of working age increases, the general income of the country quickly starts to rise. The number of elderly people to be looked after is still small so the society's healthcare costs remain low. Similarly the number of children to be educated drops so education costs are contained.

This bulge of working age people is often described as a once off opportunity for countries to make a substantial leap in their development. Some countries in South East Asia successfully made this transition in the second half of the last century. Many countries in Africa and Asia will be among the next to benefit (not China however - its population is too old)

As these societies start to become wealthier they automatically start to consume and demand more resources (meat, metals, and energy). This additional income from the "demographic dividend" will translate into a surge of commodity demand in the decades ahead.

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5. Mismatch between Resource Supply and Consumer Demand.

Our first 4 factors have focused on the reasons there will be an increased demand for the world's commodities in the decades ahead. To understand the effect this will have on the price of commodities (and more importantly the scale of this impact) it is important to consider the supply of resources that will actually be available.

The primary reason why commodity prices will be far higher in the years ahead is because surging demand on one side will be met by declining, erratic or stagnant supply on the other.

This is the single most important factor for commodity prices in the decades ahead.

It won't just be higher demand that will force up prices; it will be when it is met by falling supply that the price of certain resources will increase exponentially.

We have already seen in recent decades what relatively small supply shocks to vital commodities like oil, coal or food stuffs can do to their price. In 2012 we are experiencing something similar for Corn and Soya beans.

Ironically, periods of lower commodity prices lead to a drastic underinvestment in new mines, commodity exploration and even the mothballing of existing facilities. The Great Recession and its half decade of sluggish growth in the West have led to a recent slowdown in commodity prices. Many important resources have moved sharply back from the record highs of only a few years ago. This has been reflected in the share price collapse of many smaller mining companies. Banks are far more risk averse and funding is hard to find for new commodity exploration and production opportunities.

Across many commodities this is storing up significant supply side shortages for the future.

An increasingly volatile climate, lower returns on fertilizers as well as the erosion of existing water supplies, means the price of foodstuffs will increase while the supply becomes more

volatile. This is why China has bought up huge tracts of arable land globally. They understand that in a future food crisis, exports from many countries would simply be banned (like in 2008) and they would not be able to buy enough food for their population at any price.

The cost of mineral extraction will also accelerate for most metals. We have already extracted the easy to find minerals (Iron Ore, Cooper etc) from rich countries with good governments in easy geographical environments (e.g. why go digging in Congo or Angola when you can go to Canada or Australia). Ominously for some commodities, miners are also having to dig out more ore from the earth to return the same amount of metal.

The price of finding and producing a barrel of oil has been steadily increasing. The break-even point now stands at somewhere between \$70-\$80 dollars a barrel. We are still finding more oil, but it is no accident that it is in hard to reach places (like below the Atlantic Ocean floor 300 miles off the coast of Brazil). The easy oil has been consumed.

Also, the geographical concentration of some important commodities will affect their future availability (for example 75% of all Phosphates are in Morocco & 90% of Rare Earth minerals are in China). This means that even commodities which have ample supply may not actually be available to buy on the world market.

The Good News

We should never underestimate human ingenuity.

Over the last 70 years our ability to create new ways to feed, house, heal, transport and communicate with each other has been astounding.

The great irony here is that just when human development has finally starting to significantly expand beyond the privileged West and out to the rest of humanity; the sheer numbers of us make the availability of the world's resources all the more precarious and threatens our long term future.

The good news is that despite a massive increase in world population over the last couple of decades, there has also been a huge drop in global fertility (Iran now has a lower fertility rate than Ireland). This means by the middle of this century our population – and with it our resource demand – should start to stabilize.

We are also still finding huge amount of certain resources in some parts of the world. Specifically the incredible gas bonanza opening up before our eyes in the US has the potential to transform its economy and provide cheap energy to the US and the world for decades to come. The potential of this opportunity should not be underestimated.

Work is also advancing to re-engineer many seeds of our most basic foodstuffs (like Wheat - with a view to increasing its yield by up to 50%). This could help feed the 10 or 11 billion people that will be on our planet by 2050.

There is also plenty of opportunity to use our resources more efficiently (the food industry, for example, is notoriously wasteful). The size of the resource price shocks in the decades ahead will force people, governments and companies to consume commodities far more carefully.

In this the Market can be a great motivator.

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Investment Strategy

The growth of an enormous new middle class in the developing world which is hungry for commodities means there will be many new investment opportunities for asset managers.

Which commodities will be most in demand or especially prone to supply shortages? Which resources should be invested into or are best avoided? Which specific commodities will offer the best hedge against inflation?

The forthcoming Global Perspectives e-book by Shane Brett (Q4 2012) will analyze all these and related trends in much more detail, as well as providing clear recommendations regarding the best commodity investment opportunities in the years and decades ahead.

Conclusion

In the future, mankind will no doubt find and extract huge quantities of commodities. However the current indications are that for many resources the costs of production is set to increase, while the demand for these resources will continue to grow.

The growing scarcity of key minerals, metals and agriculture will mean much higher base prices for most commodities.

In the West we need to take a much longer term view. Those who have predicted the end of the Commodities Supercycle are using far too short a timescale. We need to stand further back and see the big picture and in this demography always leads the way.

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“The Daily 200,000” will continue to be born regardless of our current stage in the economic boom and bust cycle.

The challenge for our planet is to meet the rising resource demands of 10+ billion people, who through the advances of education and medicine are living far longer, healthier and more literate lives.

The challenge for investors is to analyse these trends and make the best investment allocations appropriately.

Look out for our forthcoming e-book in Q4 2012 “-

“The Daily 200,000 - Why the Commodities Supercycle is just beginning & which commodities you need to buy”.

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