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Commodities

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1 One of the most intriguing anomalies in the market (continued). Last week's short squeeze in copper is just the latest sign of the unfolding supply shock. Mining shares are breaking out, confirming that the bull market has entered the "recognition stage."

We have often noted that gold leads all commodities and, **when a bull market in commodities gets going, all commodities eventually participate**. Copper is an excellent case in point, as it has risen over 25% since last December.

Last week's short-squeeze on COMEX copper, when it briefly traded at an abnormally-high, 50-cent-plus/lb. premium to LME copper, is a harbinger. Market watchers are dismissing the squeeze as the result of speculation that is likely to unwind in the coming weeks. While that may be the case in the very short term, **it would be unwise to ignore the underlying trends that brought the market to this point, as we have chronicled in these pages.**

The loss of nearly 600,000 mt of expected incremental mine supply this year is just one indication of more profound trends underneath the surface. While the growth in copper output is at a post-pandemic low, Chinese refined copper demand growth is near a post-pandemic high.

BHP's $43 billion bid for Anglo American—specifically targeting Anglo's copper assets—also underscores how the people who really understand the mining

business are preparing for a tighter supply climate as the energy transition accelerates. Washington is also moving to facilitate investments, in conjunction with private companies or allied governments, in copper mines in far-away places such as Zambia and Congo, in an effort to guarantee future copper supplies.

And, as we wrote in *WILTW* May 9, 2024, **the growth in demand for data centers, especially for Generative AI, could result in a tripling of related power consumption, to 390 Terawatt hours, or 7.5% of U.S. power demand, by 2030.** *This would be equivalent to the electricity used by 40 million homes and would require massive investments in power generation and transmission infrastructure—a huge incremental boost for copper demand.*

Copper is in the early stages of a bull market that could see prices eventually double or triple from their current levels, if not more. When capital is driven away from a sector over a long period of time, the resulting upswing in prices can reach higher levels that last for longer than anyone could have anticipated at the nadir. The point is that **once the bull market takes off, investor and commercial-user psychology could drive prices far beyond what economics might dictate.**

In *WILTW* December 7, 2023, we highlighted the bullish set-up being signaled by the diamond consolidation pattern in the **Global X Copper Miners ETF** (COPX). It has clearly broken out of its horizontal resistance area, and has risen 42% since then, compared to a gain of 26% for physical copper.

We launched the 13D Copper Strategy Index on March 13, 2024, with Copper Futures, the Global X Copper Miners ETF and ATEX Resources Inc as equally-weighted components. **Since its launch, the strategy has returned 19.7%.**

2 A new report from the World Bank explains why gold is the ultimate predictor of reflation and why emerging-market central banks have been accumulating the metal since the GFC. Another buy signal for gold-mining stocks?

The World Bank's recently-released "Gold Investing Handbook for Asset Managers" was significant in a number of respects. First, **it is tantamount to explicit permission—and even encouragement—from global financial policymakers for asset managers to invest in gold bullion.** Second, it highlighted multiple reasons behind emerging markets' increasing affinity for gold as a reserve asset. And third, it underscored our oft-stated thesis that **gold is the best indicator of reflation and deflation.**

The World Bank also studied the trend of **gold purchases by central banks, which have broken records in the last two years.** But it also highlighted a key element, namely the concentration of purchases by emerging markets in particular. We quote: "[T]he rise in EMDE gold holdings during the post-crisis era is closely linked to the significant expansion of the balance sheets of advanced-economy central banks and the consequent surge in global liquidity."

While EMs account for well under 50% of central-bank gold holdings, their share has grown significantly faster than the world total. With China, India, and Saudi Arabia holding less than 10% of their official reserves in gold, the EM percentage has significant room to advance.

Another interesting observation from the report, which we have noted previously, highlights **how gold has generated positive returns through low, moderate and high inflation environments, with high inflation performing the best of the three.** We quote: "Notably, aggregate U.S. Treasuries produced positive real returns only during periods of low inflation, whereas **broad U.S. equities, while offering high returns during periods of low and moderate inflation, typically**

suffer from large losses when inflation exceeds 3 percent on a consistent basis." *Moreover, gold has outperformed U.S. Treasuries for over 50 years, ever since President Nixon closed the gold window in 1971.*

This brings us to the case for gold miners, which have shown strong relative strength in recent months, though it is still early in their cycle. For instance, **Orla Mining** (ORLA US; OLA CN) has gained 24% so far this year, compared to 12% for the S&P 500. Although the stock was sold-off heavily during the second half of 2023, the company's Camino Rojo project in Zacatecas, Mexico, has continued to exceed production and cash flow targets.

Orla is generating massive amounts of cash flow. Gold production was up 28% y/y in Q1, to 33,223 ounces, and the average realized gold price of $2,059 was more than double the AISC of $909. **With an AISC margin of $1,150/ounce, the company was able to generate $23.9 million of free cash flow during the quarter.**

3 A growing number of countries are repatriating their gold from the U.S. What are the implications?

Reports of gold repatriation come within the broader context of two key trends. First, demand for the yellow metal from central banks continues to set records. Second, since 2013, foreign central banks have been net sellers of U.S. Treasuries and net buyers of gold. It is within this context that we highlight four themes arising from countries repatriating gold.

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