Commentities Insights – The First 100 Days February 2017

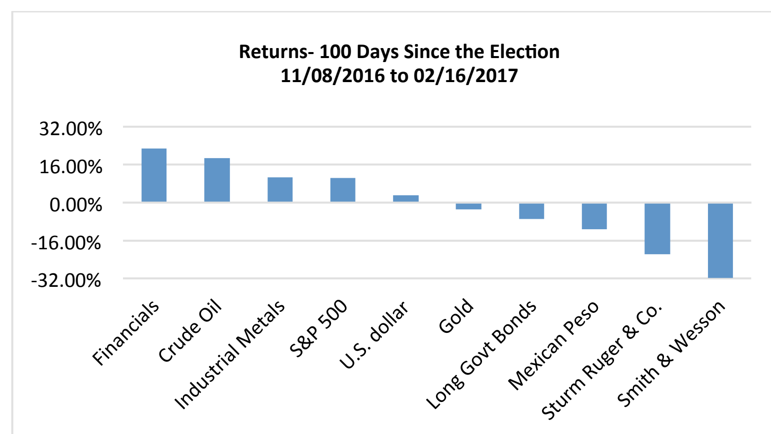
Key Takeaways

- In the first 100 days since the U.S. election, markets are broadly higher but there are notable exceptions.
- Despite a stronger U.S. dollar, all commodity sectors posted positive returns except precious metals.
- Industrial metals prices have been rising on improving fundamentals, with additional support from President Trump's infrastructure spending campaign pledge.
- The oil rally is attributable to OPEC, not the election, and will require additional bullish inputs to be sustained.

The "First 100 Days" of a new government normally begins with an incoming President's inauguration, but these aren't normal times. Meetings with foreign leaders and corporate executives -- not to mention a steady stream of market moving tweets -- became a daily occurrence for President-elect Trump immediately after the election. As such, let's reflect on how markets have reacted to this "First 100 Days".

To set the stage, it's fascinating to contrast the current market climate with pre-election sentiment. During the fall campaign, a clear trend had emerged with an inverse correlation between the direction of candidate Trump's polling numbers and the direction of U.S. equity, and many other, markets. MacroEconomic Advisors produced an analysis suggesting a 4% stock market advance on a Trump loss and a 7% decline on a Trump win[i]. The New York Times published an even larger 10% to 12% stock market decline forecast should candidate Trump win the election[ii]. The pre-election trends held form as voting results rolled-in. By midnight on November 8th, S&P 500 futures were more than 4% lower, Japan's Nikkei 225 was off 6%, and the Mexican Peso was down 12% versus the U.S. dollar. Gold, by contrast, was up almost 4%.

The reversal in sentiment was just as pronounced as the late-night plunge. The S&P 500 turned positive and gold made a round trip to unchanged status by the close of business on November 9th. The chart below offers a few examples of what has transpired since the election.



Source: Bloomberg As of 02/16/2017
Past performance is no guarantee of future results.

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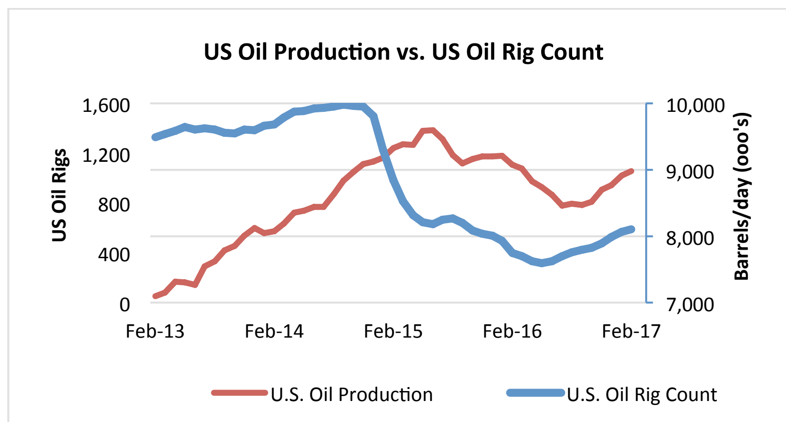
Consistent with rising markets, measures of risk have fallen. Gold is 3% lower since the election, credit spreads are significantly lower, and the VIX (CBOE Volatility Index) has fallen from 18.74 to 11.76, approaching all-time lows. While markets are clearly pricing expectations of less regulation and lower corporate taxes above trade policy and geopolitical uncertainty, I would caution against complacency as higher levels of volatility may lie ahead. In our view, diversification across asset classes remains a prudent investment strategy.

Historically, commodities have been a solid diversifier against rising inflation and geopolitical uncertainty. This is especially true of energy. As the chart above shows, oil has been a major winner since the election. President Trump's hard line on Iran is bullish for oil as it raises the risk of lower export volumes. However, prices are being driven by factors beyond the election. West Texas Intermediate Crude Oil (WTI) increased less than 1% in the three weeks following the election. From November 29 through February 16, WTI advanced 18%. One-half of the gain occurred November 30th, when OPEC and several non-OPEC producers agreed to cut 1.8 million bbl (barrels)/day. The other half of the move occurred in December. Prices have been range-bound since the beginning of 2017. OPEC announced that member compliance reached 90% in January, exceeding the markets expectations. (This topic will be addressed in more detail in our next quarterly piece.)

With seasonal builds taking place, global oil inventories are at all-time highs; however, many market analysts believe OPEC's recent cuts have brought supply and demand into balance (on a deseasonalized basis) and expect inventories to trend lower by mid-year. One region bucking this lower supply trend is the U.S. The U.S. energy industry responded to lower prices with such dramatic cost reductions and efficiency gains that most on-shore regions are once again profitable at current prices. OPEC announcements continue to move markets, but short-cycle U.S. shale is increasingly influencing global oil prices. The chart below shows the dramatic swings to U.S. oil rig counts and production.



Source: Energy Information Administration, Bloomberg As of 02/16/2017

If inventory data begins to reflect the market's expected draws, prices will likely grind higher. In the meantime, the market will be focused on May's OPEC meeting, excessive long positions currently held by speculators, and what's likely to be upward revisions to U.S. shale supply figures. While oil may deliver significant investment and hedging benefits, we feel a diversified basket of commodities remains a prudent approach to sourcing exposure for a long-term strategic allocation.

Kevin Baum
Chief Investment Officer

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Definitions:

VIX: A trademarked ticker symbol for the CBOE Volatility Index, a popular measure of the implied volatility of S&P 500 index options; the **VIX** is calculated by the Chicago Board Options Exchange (CBOE).

S&P Futures: A type of capital asset contract that provides a buyer the right to a predetermined selection of stocks and on a predetermined future date listed on the S&P 500 stock market index.

S&P 500 Index: The S&P 500 stands for the Standard and Poor 500. It is a stock market index that tracks the 500 most widely held stocks on the New York Stock Exchange or NASDAQ. It seeks to represent the entire stock market by reflecting the risk and return of all large cap companies.

Japan Nikkei 225: The leading and most-respected index of Japanese stocks. It is a price-weighted index comprised of Japan's top 225 blue-chip companies traded on the Tokyo Stock Exchange. The Nikkei is equivalent to the Dow Jones Industrial Average Index in the United States.

One cannot invest directly in an index.

Diversification does not eliminate the risk of experiencing investment loss.

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[i] MacroEconomic Advisors issued their analysis on Wednesday, October 5,2016. Forecast reported Thursday, October 6, 2016 on Forbes.com.
[ii] The New York Times, September 30, 2016.