

## Lumen funds

Lumen – the Latin word for light

Registered Investment Advisor

### Commodities – the inevitable

With major market indices hitting multi-year lows, now may seem like a great time for bargain hunters to invest. However, with the global economy teetering between a recession and a small depression, the market may keep falling and satisfactory return may not come about for many years. Fortunately, amid uncertainty, there is one asset class that stands a better chance than others to emerge victorious - commodities. To understand the reason, let us examine commodities in two scenarios: 1) a recession with a quick recovery, 2) a depression with a long recovery.

The first scenario is relatively straightforward. The economy slows and then rebounds. Economic activities revive within a year or two, and demand for raw materials returns to pre-recession level. So commodity prices, after having fallen nearly 60% since last summer's peak, rebound swiftly.

The second scenario, with the dreaded D word, requires more analysis. On one hand, demand for all things, including commodities, are bound to fall during a depression. On the other hand, the demand for many commodities is not very 'elastic', meaning that demand will not fall off the cliff. Take food for example. No matter what the crisis, people have to eat, and they can cut back consumption only so much. At the same time, food supply will likely fall faster than demand during a depression. This is due to two reasons. First, falling demand leads to falling prices; and falling prices lead farmers to produce less. Second, as the financial crisis deepens, banks become less willing to lend to everyone including farmers. Already, farmers worldwide are having difficulty obtaining loans to buy seeds, fertilizer, and farm equipment. Without the needed capital to increase planting, future food supply will shrink. With food inventories at 50-year low even before the financial crisis, the lack of financing will only exacerbate food shortages. As a result, food prices will have to rise to induce farmers to grow more. Finally, governments around the world are providing a tail wind for commodity prices. All the major countries are trying to solve the financial crisis by printing massive amount of money. The worse the crisis gets, the more money will be printed. Money printing devalues currencies and will lead to inflation down the road. In this environment, it is better to hold real assets such as commodities than paper currencies.

After the market decline in the last 18 months, it is hard to see why one asset class will do better than another. After all, almost everything has tumbled. However, the heavy selling in the recent past was caused by panic or forced selling that has little to do with fundamentals. Once the panic subsides, fundamentals will drive the market once again. When that happens, whether there is a recession or a small depression, commodity prices will rise. It will only be a matter of how much and how fast.