

Understanding The Commodity Boom

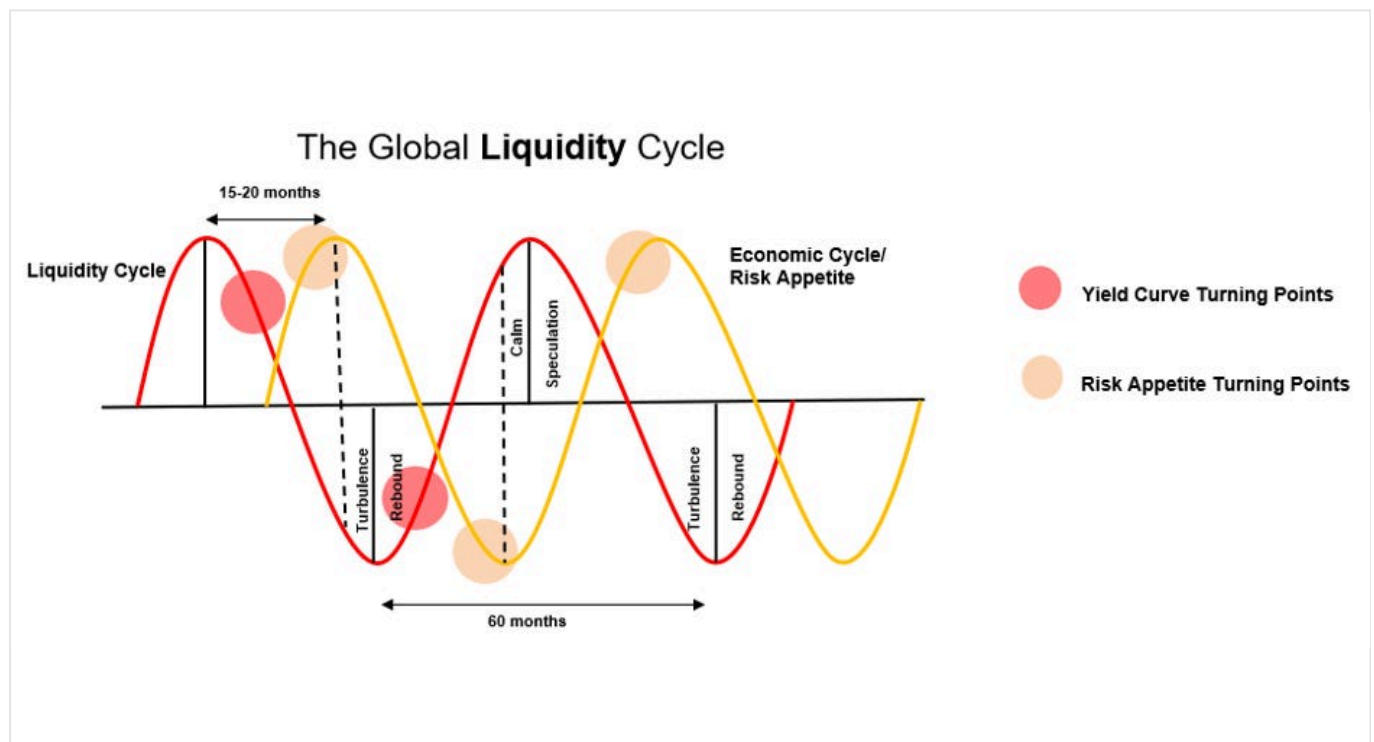
A Tale Of Two Monies

Asset Allocation Background: Two Monies

Guiding our investment views for 2026 was the simple observation that **all money that is anywhere must be somewhere**.

Liquidity cannot simultaneously reside in both financial markets and the real economy. Capital is constantly being allocated between these competing destinations. Strong bond markets and expanding valuation multiples (P/Es) reflect the concentration of liquidity within financial assets. Conversely, accelerating economic activity, robust earnings growth (E) and rising commodity prices signal liquidity flowing into the real economy.

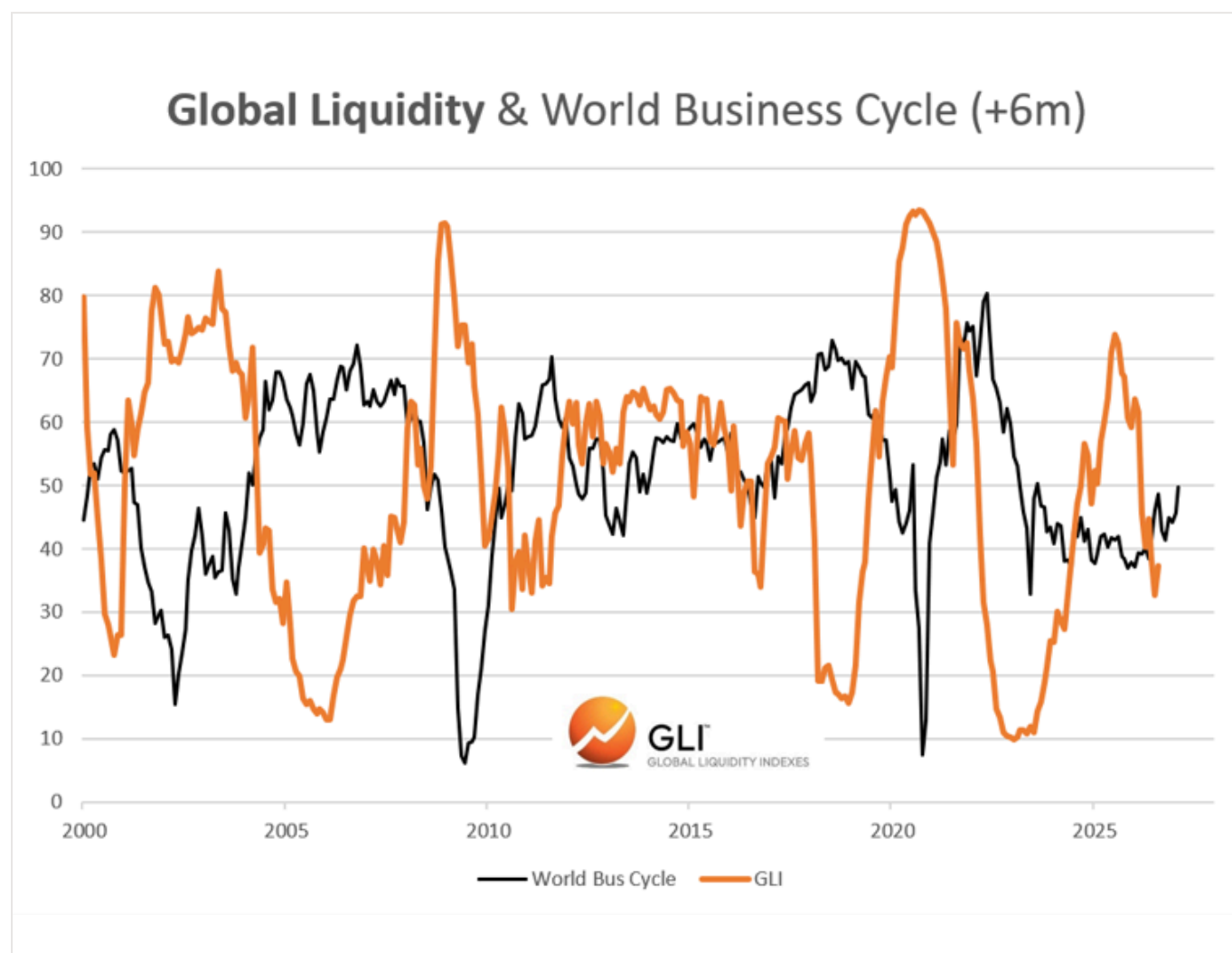
Historically, these regimes represent two separate money pools: financial liquidity and industrial liquidity. They are distinct, sequential and rarely overlap. Consider, the schematic diagram:



The start of 2026 evidenced a peak in the Global Liquidity cycle (red line). Hence, we anticipated a transition away from financial assets and towards faster economic activity (yellow line). Our expectation has been for stronger growth, rising commodity prices, higher bond yields and lower equity valuations as liquidity migrated into productive investment and consumption. This is the so-called 'Speculation' investment regime

Subscribed

Despite being unpopular even as recently as six months ago, that view has proved broadly correct: **bond prices have slumped and commodities have soared**. Consider, the chart below which confirms how, using latest data, the World economy (black line) is expanding at the same time that Global Liquidity (orange line) is skidding lower.



Yet, our error in 2026 lies in underestimating the pace of earnings growth. Some now expect a whopping 35% EPS gains this year. Valuation multiples (P/Es) have compressed as expected, yet corporate earnings (E) have expanded far more rapidly than anticipated, fuelled by AI investment. Consequently, equities and notably technology stocks have continued to rise despite the P/E multiple contraction that we believed would limit returns.

Looking ahead, the underlying Global Liquidity drivers remain intact.

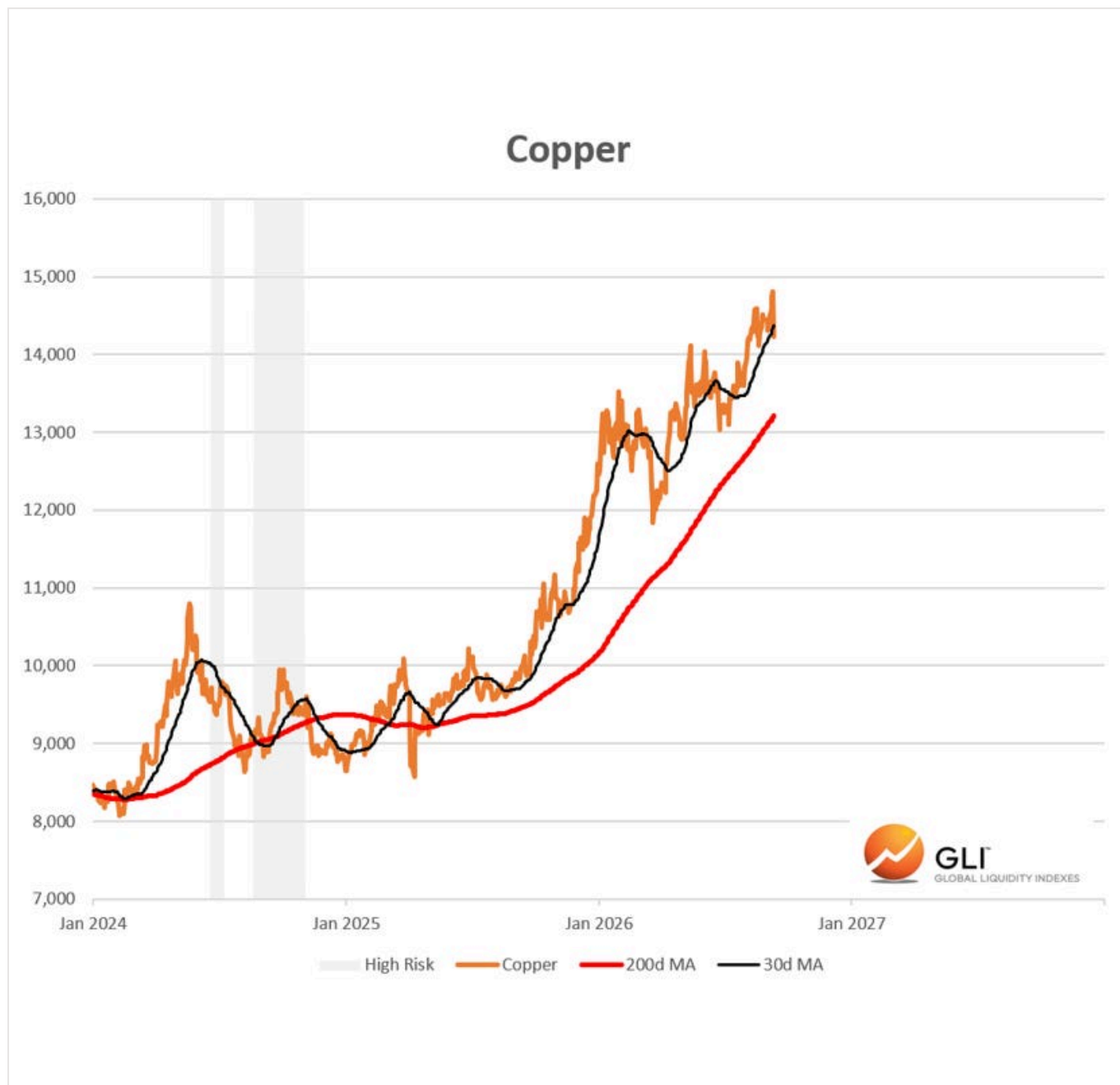
Economic activity continues to expand, US 10-year Treasury yields have decisively moved above 5%, and commodity markets are increasingly exhibiting a classic late-cycle boom. If anything, the economic cycle appears to be extending rather than slowing. Persistent fiscal deficits near 6% of GDP, combined with extraordinary AI-related capital expenditure, have created a powerful source of demand that continues to support growth.

Importantly, this investment boom is increasingly being financed through short-term debt markets rather than through internally generated cash flows. Inevitably, this creates vulnerabilities. The AI investment cycle, and the earnings acceleration associated with it, could eventually prove unsustainable. The most obvious risks are that capital spending peaks sharply during 2027 and higher energy prices fuel inflation and strangle economic growth.

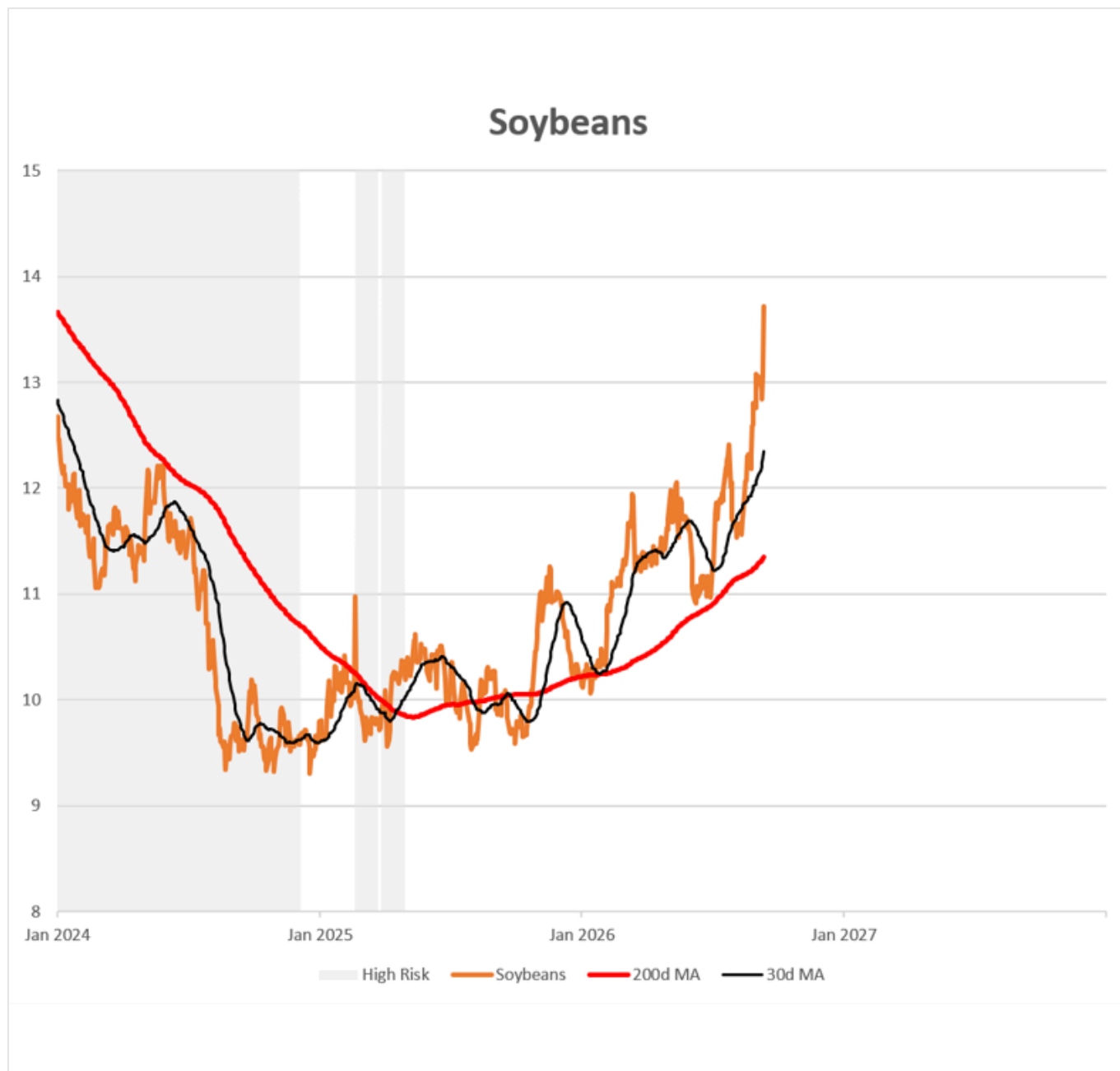
Nevertheless, the probability of an aggressive policy tightening cycle appears low. Political, fiscal and geopolitical incentives remain aligned towards maintaining economic momentum rather than restraining it. In effect, policymakers appear willing to tolerate a hotter economy for longer.

The implication is straightforward: commodities are likely to continue outperforming while bond yields still remain under upward pressure.

Consider, the breakout in copper prices, which sharply gathered momentum from late-2025. They are trading comfortably above both the 30-day and 200-day moving averages and already show a 50% gain.



More recently, agricultural markets have also pushed higher, evidenced in the chart of soybeans below. They have broken out from a multi-year downtrend, and although enjoying slightly lesser gains than copper this year they are nonetheless still ahead by around 40%.



Key Points

- Global liquidity continues to point towards a broad-based commodity boom extending through 2026 and beyond. Indexes show a whopping near-50% rise this year. Strength is already evident across copper, energy and agricultural markets, suggesting the upswing is becoming increasingly synchronised.
- Investment markets are in a typical late-cycle “speculation” phase. Historically, these periods generate the strongest returns for commodities and real assets as liquidity migrates from financial markets into the real economy.
- Copper remains in a powerful uptrend, trading comfortably above both its 30-day and 200-day moving averages. This price action signals persistent industrial demand and positive growth expectations.

- Soybeans have broken out from a multi-year downtrend, indicating that commodity strength is no longer confined to industrial metals but is spreading across the broader complex.
- Diesel markets continue to imply substantially higher oil prices than current spot levels, supporting a constructive outlook for the wider energy sector.
- The Commodities-to-Gold ratio has turned decisively higher after a prolonged decline. This suggests investors are rotating away from monetary assets and towards economically sensitive assets, a pattern typically associated with accelerating nominal GDP growth.
- The liquidity cycle remains the dominant driver across both financial and industrial markets. Historical evidence shows that changes in liquidity typically lead both global business activity and commodity market performance.
- Investors should remain positioned for a late-cycle expansion. While such periods often deliver exceptional commodity returns, they are also characterised by increasing volatility and the risk of eventual policy or market-induced reversals.

Commodities Boom In ‘Speculation’

The **Global Liquidity Cycle** strongly influences our investment views.

Our asset allocation has focused on how liquidity moves between the **financial** and **real-economy** circuits. As liquidity leaves financial assets and enters productive activity, growth accelerates, commodity demand rises and main street inflation becomes embedded.

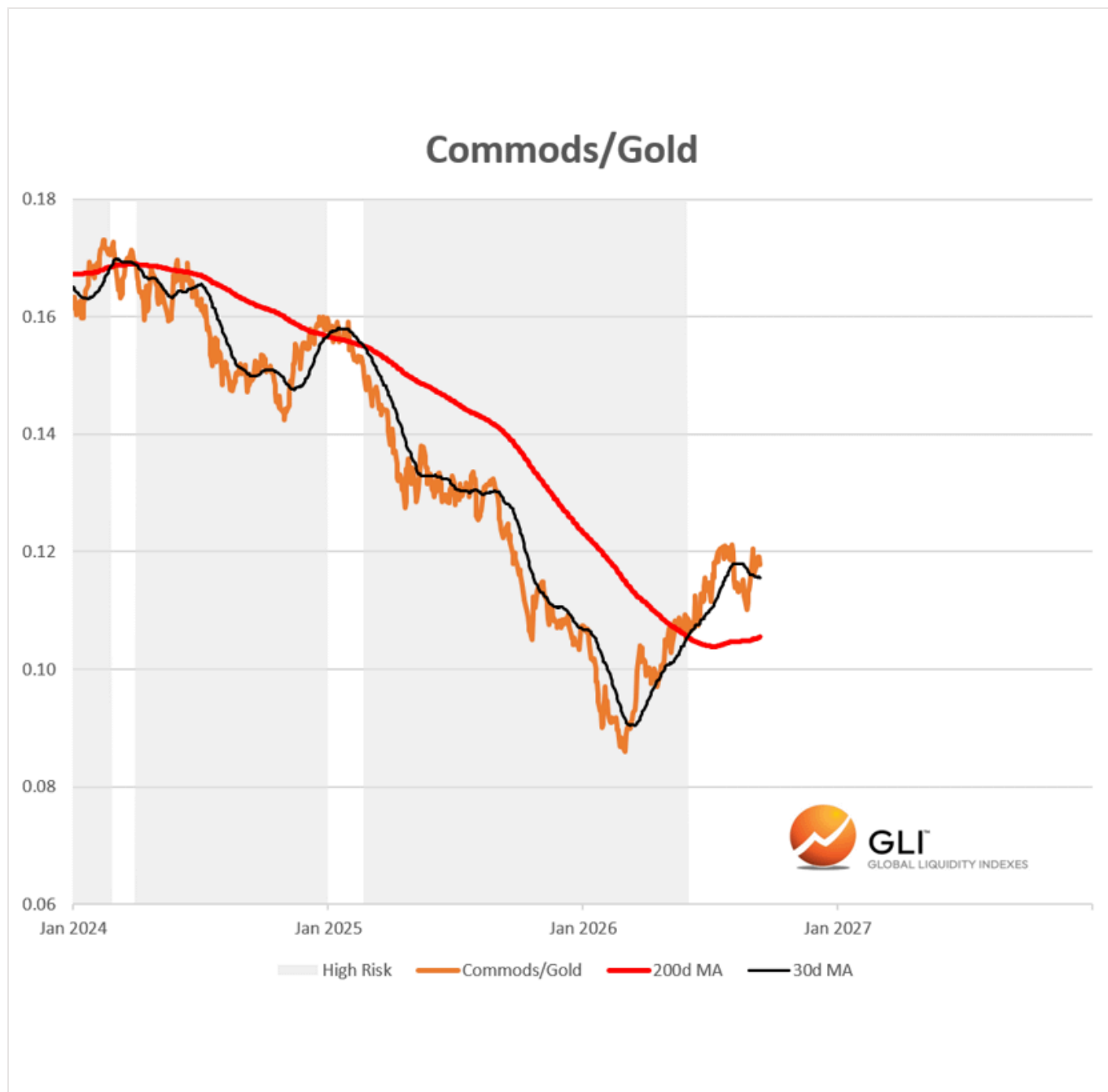
Think of commodity movements as a two-stage process involving two moving parts: (1) a **currency of denomination effect**, e.g. the nominal US dollar gold price, which measures the scale of monetary inflation or monetary deflation, and (2) a **real exchange ratio**, e.g. the gold/ oil ratio.

Commodity price = gold price x commodity/ gold ratio

This analysis can be generalized to explain the overall price level, respectively, in terms of a monetary component and a cost component. **Put another way, main street inflation is a cocktail of monetary inflation, following Central Bank money printing, and cost inflation, say, from higher oil prices or lower productivity.**

Inflation typically starts with a **monetary shock**. Rising liquidity lifts nominal asset prices, including gold and commodities. Put differently, gold is a monetary commodity whose price is determined in the financial circuit.

Next, there is a **real-economy effect**. As liquidity spills over into the industrial circuit, business growth strengthens and economically-sensitive commodities begin to outperform monetary assets. This is visible through ratios such as Gold/Oil or Gold/Copper, which capture changing demand conditions within the productive economy. Evidence the ratio between general commodities and gold in the next chart. This ratio broke higher almost exactly coincident with the peak in Global Liquidity in late-2025:



Hence, commodity bull markets often begin with rising gold and silver prices and evolve into broader commodity outperformance as industrial demand accelerates.

The Gold/Oil ratio provides a useful illustration. Over the long term, this ratio is anchored by production technologies and resource economics. During recessions, weak energy demand typically pushes the ratio higher as oil underperforms. During economic expansions, stronger industrial activity drives oil demand higher and causes the ratio to fall.

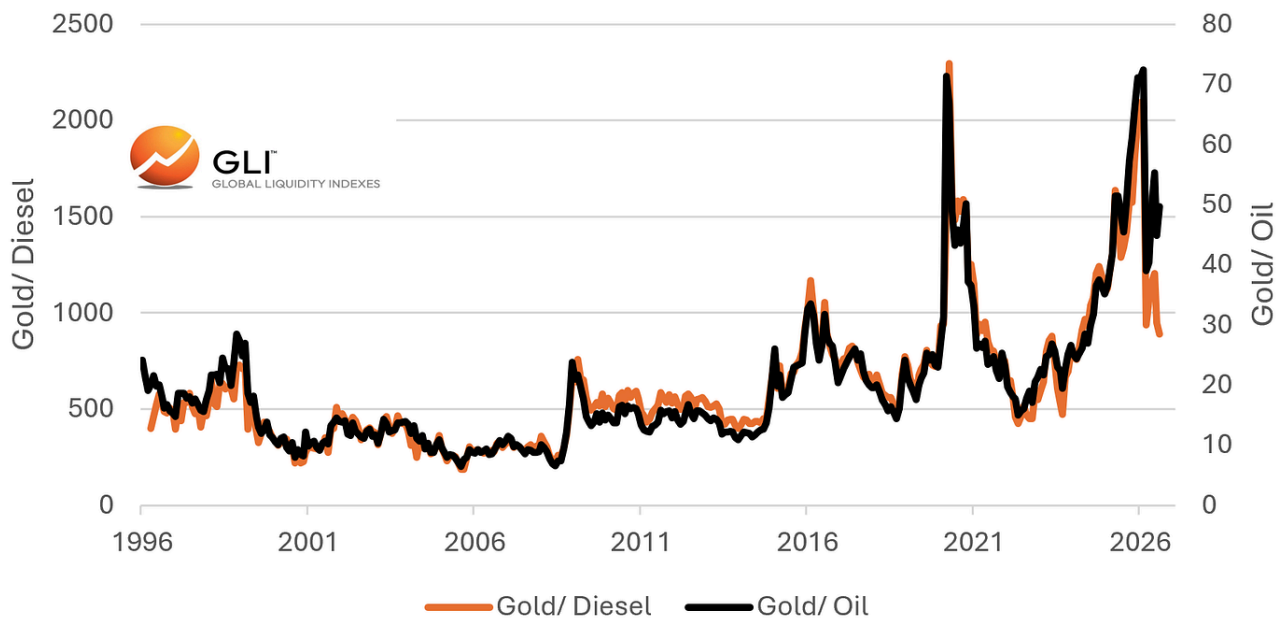
Historically, the ratio has centred around approximately 20x, fluctuating within a broad range of 10x to 30x. \ [Statistical analysis estimates an equilibrium at 19.6x.] Prior to the breakdown of Bretton Woods in 1971, the gold price was fixed at US\$35/oz and the oil price (WTI) stood at around US\$2.50/bbl, i.e. 14x. Sustained declines in the ratio have generally coincided with periods of strong economic activity and commodity price strength.

This relationship is representative and relevant because energy costs sit near the centre of the global production system. Evidence how higher oil prices increase transportation, manufacturing and fertiliser costs. Those pressures then cascade through the spectrum of industrial metals, such as copper and aluminium, agricultural commodities and food production. What begins as strength in energy markets ultimately spreads throughout the commodity complex, creating the broad-based advances typically associated with business expansions.

Looking ahead, if the current downswing in the Global Liquidity Cycle continues to reflect accelerating economic activity, then the Gold/Oil ratio should continue moving lower as energy demand strengthens. Critically, gold prices do not necessarily need to fall, because in 9/10 previous cycles gold has traded sideways while industrial commodities have risen more rapidly.

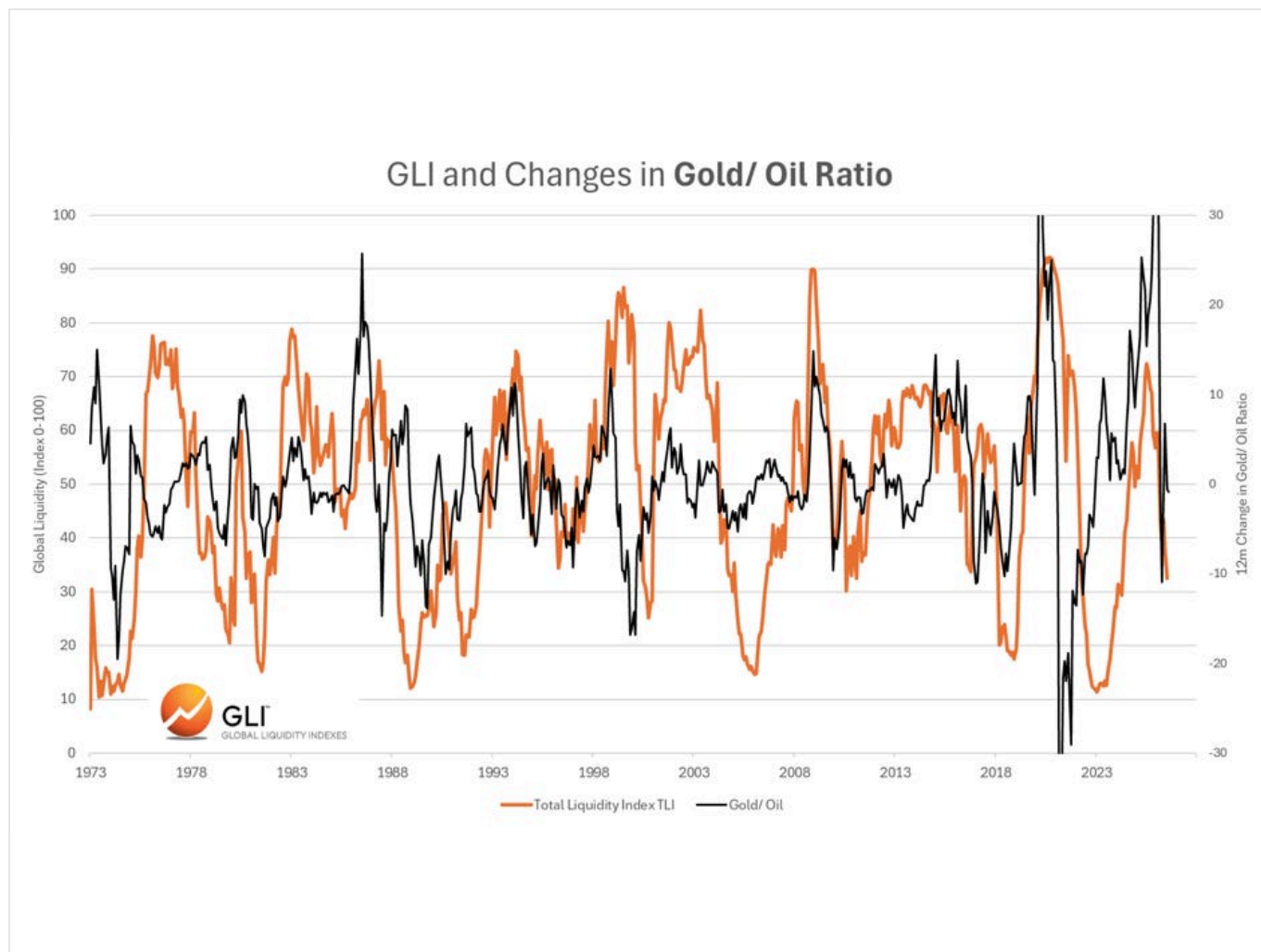
This seems to be exactly the environment unfolding today. Oil prices have recently tested US\$105/bbl, which represents a still high gold/oil ratio of around 42 times. However, not only is gold broadly holding its gains, as history suggests, but the ratio is adjusting lower from its recent peak, as expected, and if soaring diesel prices are used to cross-reference crude oil prices the 'true' gold/oil ratio may already be down to 27 times. See chart.

Gold/ Diesel & Gold/ Oil



The result is a powerful two-stage commodity bull market reflecting commodities' two moving parts: initially driven by the expansion of financial liquidity and rising gold prices, and later reinforced by accelerating real-economy demand – a falling gold/ commodity ratio.

This neatly aligns with the Global Liquidity cycle, as the next chart shows. The gold/ oil ratio rises early in the liquidity cycle as gold is pushed higher, and then liquidity spills into the real economy and drives up the oil price, so the fall in the gold/ oil ratio coincides with liquidity leaving the financial circuit.



That second phase of the commodity bull market may now be underway. **'Speculation' is the phase in which industrial commodities typically deliver their strongest gains.** Policy makers appear to be trying to extend this phase, but after 'Speculation' comes the 'Turbulence' investment phase. That is our next story...