

The Outlook: Dec. 16, 2016

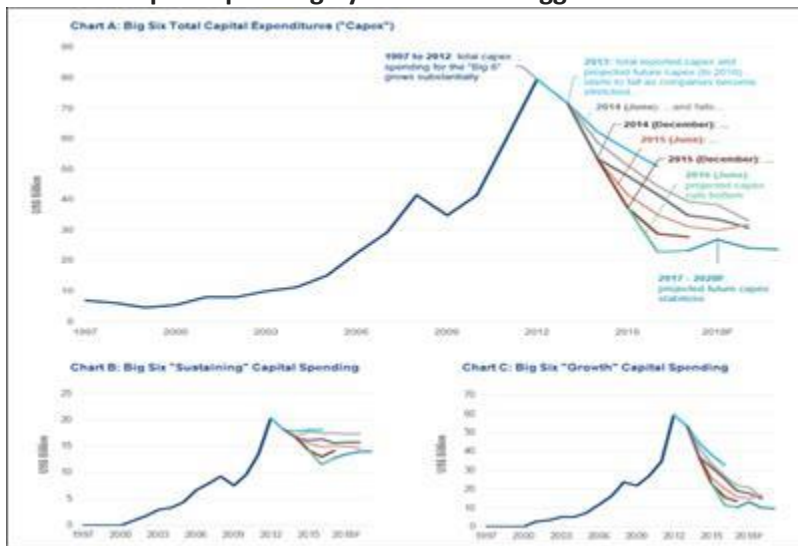
Betting on the laws of supply and demand: Freeport, Caterpillar, Deere, Conoco and friends.

Free markets work so well because all kinds of people react sensibly and predictably to significant changes in free-market prices. Prices fall? Buyers buy more, sellers make and sell less . . . eventually. Prices rise? Buyers buy less, sellers make and sell more . . . eventually. Those changes in demand and supply cause free-market prices to change direction . . . eventually. Hence the very old and deep truth: “the cure for low prices is low prices,” and vice versa.

It’s mighty simple—but “old and deep truth” or not, the world contains vast crowds of expert commentators (and market speculators) who do not appear to believe it. Their main problem is that word: “eventually.” When the “cure” might happen next week, or might wait until next year; and when our dearly-earned cash feels as if it’s riding on exactly “when;” we tend to lose our thin-stretched patience and find it easy to believe those crowds of experts citing piles of facts and figures proving that this time, the laws of supply and demand won’t work the same.

Let’s glance at a chart which strongly suggests they will work the same.

Capital Spending by the World’s Biggest Miners



The top section is enough. It shows the 12-year, tremendous growth in exploration-and-production spending by the world’s biggest miners, from 2000 to 2012. Then it shows the 70% plunge in such spending, over the past 4 years. Notable in the bottom right chart is the 83% drop in “growth” spending: meaning creation of new mines or significant expansion of existing ones. As an investment firm named VanEyk (which produced these charts) said, “This effectively means the mining industry simply canceled most growth projects.” Outlook core company Freeport-McMoran has made the same point rather often, concluding in a nutshell that “long-term new copper supply will not happen,” while long-term copper growth must happen, as the world keeps urbanizing and industrializing.

All we long-term investors had to do, as we bought the hammered-down stocks of good businesses fighting through the 5-year commodity downturn, was bear in mind that word, “eventually,” and grit our teeth as the market tried to frighten us (successfully, sometimes.) Free markets are working again. Falling

prices made suppliers take truly dramatic actions, as we can see above. Those actions will have their effect on future supply, and on future prices . . . and finally, on the rising earnings and stock prices of our long-suffering companies. We've seen that begin to happen this year. It won't proceed smoothly, but will be the usual roller-coaster. But the cure for low prices is low prices, and what comes next is higher prices . . . eventually.

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