Commodity Prices Battling Stronger U.S. Dollar Among Other Things

View from the Observation Deck

1. Commodity prices, on the aggregate, have declined by 13.8% over the past two years (thru 5/8), as measured by the Reuters/Jefferies CRB Index. The index is down 1.4% so far in 2013.

2. While we only displayed photos (see chart) of four of the commodity components (crude oil, corn, coffee and gold) tracked by the index, there are in fact a total of 19 that capture a broad universe of activity.

3. On a year-to-date basis, very few components are up. The following five are higher: Natural Gas (+18.6%); Cotton (+17.0%); Crude Oil (+4.5%); Coffee (+2.9%); and Gasoline (+2.3%), according to Bloomberg.

4. Many things can impact the direction of commodity prices. Some of them include supply/demand, infrastructure spending initiatives, inflationary pressures and currencies, particularly the U.S. dollar.

5. The U.S. dollar remains the world’s reserve currency. Commodities are still priced in U.S. dollars. Commodity prices tend to share an inverse relationship with the dollar (see chart).

6. When the value of the U.S. dollar falls, foreign buyers gain more buying power when purchasing commodities and vice versa. More dollars pursuing commodities tends to drive commodity prices higher and vice versa.

7. The combination of a stronger U.S. dollar, relatively low inflationary pressures, the ongoing European debt crisis and tempered economic growth in China has dampened demand for commodities, in our opinion.

8. We believe that while most mining companies’ equity valuations look more compelling today than in 2008, investors might be best served by monitoring the influences we have noted and wait for them to turn for the better.

This chart is for illustrative purposes only and not indicative of any actual investment. The illustration excludes the effects of taxes and brokerage commissions or other expenses incurred when investing. Investors cannot invest directly in an index. The Thomson/Reuters CRB Commodity Index is an average of commodity futures prices with monthly rebalancing, while the U.S. Dollar Index (DXY) indicates the general international value of the U.S. dollar relative to a basket of major world currencies.