



The Deflation Message From The Commodities Market

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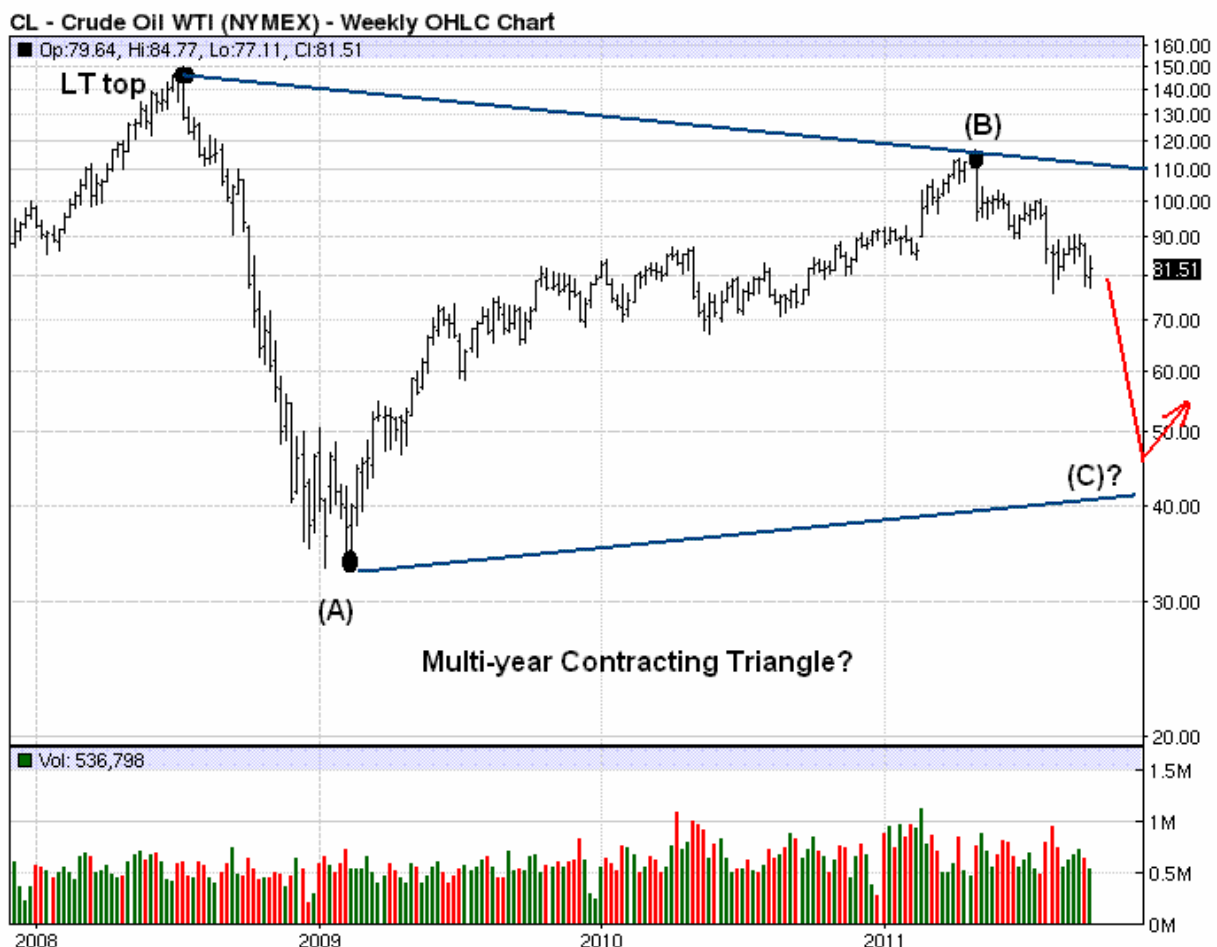
Most of the commodities markets topped out earlier this year and have declined since then. If the recent declines in crude oil and copper (probably the most important industrial commodities) are to continue, these would be clear signs of slow economic activity and deflationary environment. Gold is usually the ultimate safe-haven but since it is overextended on the upside (after its 10-year+ bull market) it may not be so stable this time. This article takes a look at the Long-Term trends in crude oil, copper and gold.



Commodities are usually the last asset class that tops out and enters a bear market. Of course there are exceptions to this rule, but that is something that is seen quite often. This year commodities started very strong, then some of them topped out together with the stock market in May. Some commodities declined sharply initially (silver, crude oil) and have remained weak since then. Others had been more resilient but recently broke down too. In this article I take a view at the long- to medium- term trends in crude oil, copper and gold. The other markets are also important but it is the decline in these three commodities that brings out the topic of deflation. If the recent declines in crude oil and copper are to continue, these would be clear signs of slow economic activity and deflationary environment. Gold is usually the ultimate safe-haven but since it is overextended on the upside (after its 10-year+ bull market) it may not be so stable this time.

Let's start our analysis of Long-Term trends with the chart of Light Crude Oil. As you remember, crude oil had been in strong persistent uptrend from early 2003 to mid-2008. Then it topped near \$145 and simply crashed to below \$35 in just several months. From early 2009 we had seen a persistent growth to \$115 but then the trend reversed in early May of 2011. If you can look at the decline from the May 2011 top, there is a clear series of lower lows and lower highs – the definition of the downtrend. The question is how far this downtrend can go.

Long-Term Trends in Light Crude Oil:



Source: <http://www.commoditycharts.com>

I have never believed the strong rally from early 2009 was the beginning of a Long-Term bull market. When you see a crash like the one in late 2008-early 2009, the prices cannot simply turn

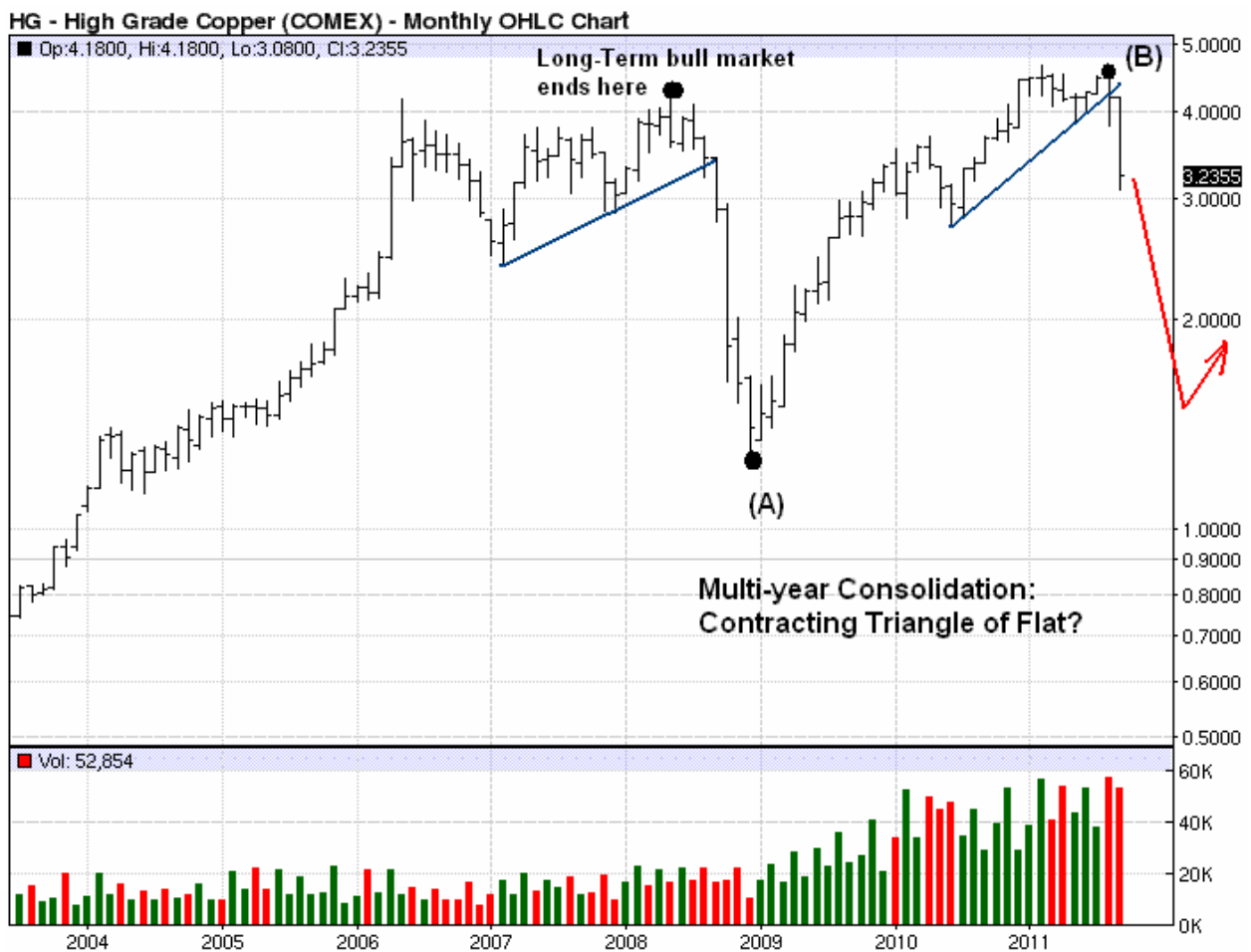


higher and go up straight up for years. From an Elliott Wave perspective, a sharp decline like the one from \$145 to \$35 (the 2008-2009 fall) is usually just wave A of a Flat or a Contracting Triangle. And following the guidelines in wave theory, B-waves are usually take much longer than A-waves and that was exactly what happened during the 2009-2011 mini bull market. The decline since the May 2011 top is a strong signal wave (B) has ended and if that's the case, the market is now in wave (C) down of a Multi-year Contracting Triangle (or Flat pattern). That in turn suggests lower prices for the next 12-18 months. Based on the pattern requirements, the minimum downside target is at lower \$60s, but a decline to \$50s or \$40s cannot be ruled out either. And that is definitely a deflation message and a negative sign for the economic activity.

Copper was much stronger in its 2009-2011 bull market but basically the price pattern is the same:

The Long-Term bull market topped out in mid-2008 and then we saw a crash-type decline in just a few months. This 2008 decline was wave (A) of a Flat or Contracting Triangle consolidation pattern. The rally from the early 2009 was strong and the metal made a new all-time high earlier this year. But the collapse in September confirms wave (B) has likely ended and the market is now in wave (C) down. And if correct, that suggests huge downside potential for copper prices. And remember, copper is one of the most used industrial metals, so if the expected strong decline materializes in the next several months we can expect a severe decline in the economic activity too.

Long-Term Trends in Copper:



Source: <http://www.commoditycharts.com>



And finally, gold:

Gold has been in an uptrend since early 2001. This 10-year uptrend has been spectacular. Even the 2008 financial crisis brought only a 30% pullback that was quickly retraced completely. Gold made a top in early September 2011 at \$1920 per ounce and then declined sharply almost \$400 in just a couple of weeks. Still, this decline in percentage terms was much smaller than the 2008 decline, so theoretically gold is still in bull market. Notice on the chart that its prices are holding well above the rising trendline from the 2008 low and above the longer-term moving averages (100-week and 200-week moving averages). But even if the Long-Term uptrend in gold is still intact, several months of sideways consolidation can be expected which again supports the deflationary argument.

Gold is still in bull market despite its recent brutal sell-off:



Source: www.stockcharts.com

Conclusion

The Long-Term bull markets in crude oil and copper ended in 2008. Since 2008 top we have entered a period of broad sideways consolidation that is likely to last for many years. Our analysis shows that the Medium-Term rise from early 2009 low likely ended earlier this year. And if that's the case, these markets have entered into another bearish phase that is likely to bring significant weakness in the next 12-18 months. And that strongly suggests a slow economic activity coupled with deflation for the U.S. economy and for the other developed markets' economies. The gold



market remains in uptrend for now but even gold may not serve its safe-heaven role for some time as some broad consolidation is likely in store for the bullion as well.



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