Key takeaways

- After a decade of poor performance, we believe commodities look poised to outperform other assets (possibly for a decade or more).
- Commodity prices tend to move together over multi-year periods, called super cycles. We believe 2020 marked the start of a new bull super cycle.
- Today, we will discuss the bullish signs that we are seeing, and why super cycles matter.

“Any good thing that dies inside can rise again, if you want it hard enough. ... It’s not what it was. It’s always different. It’s always something else.” - Gregory David Roberts, The Mountain Shadow

This publication could be one of the more important ones we write this year – maybe for this decade. The reason is that since 2012, we spent a great deal of time advising investors to steer clear of commodities. Our tune finally began to change last year, and on March 12, 2020, we upgraded Commodities to Favorable on a tactical basis (6-18 months). Today, we are officially calling the end of the commodity bear super-cycle that started around 2011. We expect that this will be a strategic call (10+ years), and if correct, could lead to meaningfully higher commodity prices over the next decade. Today we will discuss why super cycles matter, what we are seeing that has changed our minds, and what it means for investors.
What this super cycle stuff is all about

Commodities generally do not act like other major asset classes, like stocks or bonds. Commodities typically move together, like a big family, through long boom (bull markets) and bust (bear markets) cycles. Because each cycle typically lasts between 15 to 20 years, we call them super cycles. Using data back to the year 1800, we can see in Chart 1, and in Tables 1 and 2, that the average bull super cycle (white areas in chart) has lasted 17 years, while the average bear super cycle (shaded areas in chart) has lasted 20 years.

Chart 1: Commodity bear market super cycles

Table 1

<table>
<thead>
<tr>
<th>Commodity bull super-cycles</th>
<th>Percentage gain</th>
<th>Length (years)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1791-1814</td>
<td>132.5%</td>
<td>23.5</td>
</tr>
<tr>
<td>1843-1864</td>
<td>208.2%</td>
<td>21.6</td>
</tr>
<tr>
<td>1896-1920</td>
<td>269.7%</td>
<td>24.0</td>
</tr>
<tr>
<td>1933-1951</td>
<td>331.5%</td>
<td>18.3</td>
</tr>
<tr>
<td>1971-1980</td>
<td>249.5%</td>
<td>9.1</td>
</tr>
<tr>
<td>1999-2008</td>
<td>291.8%</td>
<td>9.0</td>
</tr>
<tr>
<td><strong>Average Bull</strong></td>
<td><strong>247.2%</strong></td>
<td><strong>17.6</strong></td>
</tr>
</tbody>
</table>

Table 2

<table>
<thead>
<tr>
<th>Commodity bear super-cycles</th>
<th>Percentage gain</th>
<th>Length (years)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1814-1843</td>
<td>-62.2%</td>
<td>28.3</td>
</tr>
<tr>
<td>1864-1896</td>
<td>-70.7%</td>
<td>31.8</td>
</tr>
<tr>
<td>1920-1933</td>
<td>-65.7%</td>
<td>12.8</td>
</tr>
<tr>
<td>1951-1971</td>
<td>-38.6%</td>
<td>20.4</td>
</tr>
<tr>
<td>1980-1999</td>
<td>-45.7%</td>
<td>18.6</td>
</tr>
<tr>
<td>2008-2020</td>
<td>-73.2%</td>
<td>11.7</td>
</tr>
<tr>
<td><strong>Average Bear</strong></td>
<td><strong>-59.4%</strong></td>
<td><strong>20.6</strong></td>
</tr>
</tbody>
</table>

Sources: Bloomberg, Wells Fargo Investment Institute. Performance is based on the Commodity Composite. An index is unmanaged and not available for direct investment. Past performance is no guarantee of future results.
Commodities typically move together as a family

Super cycles are like black holes. Escaping the gravity of a super cycle is difficult for the individual commodity. Understanding which super cycle investors are in, bull or bear, can often dictate whether they make or lose money, no matter the individual commodity. Chart 2 captures rolling 10-year performance returns between energy commodities (purple line), food commodities (green line), and the commodity complex as a whole (blue line). Notice that over these rolling 10-year periods, all commodity groups tended to follow each other around.

Chart 2: Commodity momentum since 1800 — 10-year moving average of annual rate of change

Why we’ve been bearish for so long

Starting at the turn of this century, commodity prices broadly started to spike. A new super cycle bull market had been stoked, and it lasted from roughly 1999 to 2011. (The Bloomberg Commodity Index began to peak around 2008.) Chart 3 highlights how a bull super cycle can impact individual commodities. Inside Chart 3 we can see that during the period from 1999 through 2011, oil prices jumped from $10 to $150 per barrel, copper from $0.6 to $4.60 per pound, gold from $250 to $1900 per ounce, and corn from $2 to $8 per bushel.

It was around 2012 that we started getting worried that prices had run too far too fast, which invited lots of competition, substitution, and political blowback. By 2012, nearly every commodity we followed was starting to roll-over. As heartbreaking as this can be to witness in real time, it was not unexpected. This is how commodity boom and bust cycles work – they sow the seeds of their own destruction. Or as the old commodity saying goes, “high prices cure high prices”.

Chart 3: Oil, gold, copper, and corn (1914-present)

Sources: Bloomberg, Kitco, U.S. Department of Agriculture (USDA), U.S. Geological Survey (USGS), Wells Fargo Investment Institute. Monthly data: January 31, 1914 - June 30, 2021. Values shown in log scale. Indexed to 100 as of start date. The price of gold prior to 1920 is represented by the average London fix price as reported by Kitco. Gold price from 1920 on is the spot price. The price of copper prior to 1988 is represented by the annual average U.S. producer copper price as provided by USGS. Copper price 1988 on is the copper front month futures price. The price of corn prior to 1960 is represented by the average price of corn received by farmers as reported by the USDA. From 1960 on is the corn front month futures contract price. Crude oil prices prior to 1950 are taken from BP statistical review; from 1951 to April 1983 are Bloomberg Arabian Gulf Arab Light Crude Spot prices, and prices from May 1983 to today are Bloomberg West Texas Intermediate Cushing crude spot price. Past performance is no guarantee of future results.
2012 was one of those moments when it was helpful to understand the differences between commodities and other assets, such as stocks. Stock markets have their bear markets too, but stocks have a history of picking themselves up relatively quickly. Commodity bears typically do no such thing. Commodity prices can fall swiftly, but it often takes years before excess supplies, built-up during the bull years, are worked off. The history of commodity super cycle bears is remarkably consistent in that once prices start to fall, a new bull market is often more than a decade away. If that is not enough to scare investors away during commodity bear super cycles, maybe this one will — over the last decade, commodity prices have lost investors, on average, 6% per year (Chart 4, bottom panel).

Chart 4: Commodities, stocks and bonds: ten-year average annual total returns

What has changed our minds in 2021

Super cycles provide signs that they are shifting, and key indicators today are signaling that the bear is dead.

Table 3 is a checklist of bull super cycle signs that matter most to us. To be clear, not all signs are flashing “go” at the start of a bull. Some signs we look for early in a bull, while others are used later for confirmation. Patterns in price movements can be particularly important in the beginning — things like washed-out prices, bottoming price action, and strong breadth can be critical to pinpointing a turn. The reason we watch these technical indicators first is because price often leads fundamental supply-demand factors at major turns. Technical indicators can act like an early warning system of sorts. They can give us an early “heads-up” that the underlying fundamentals are beginning to shift. Fundamentals — such as “restrained supply response” or “rising costs” — can take years to evolve into new secular trends, and if we relied on them exclusively, we could end-up years behind in calling the bull. The bottom line is that the key, early, technical indicators are confirming to us that a new super cycle likely began in 2020.

Table 3

<table>
<thead>
<tr>
<th>Condition</th>
<th>Comment</th>
<th>Condition met</th>
<th>Early or later bull sign</th>
</tr>
</thead>
<tbody>
<tr>
<td>Duration</td>
<td>Current bear matches shortest record (12 years).</td>
<td>Yes</td>
<td>Early</td>
</tr>
<tr>
<td>Washed-out prices</td>
<td>Poor absolute and relative performance versus other assets has been typical this cycle (~73% versus -60% average bear performance).</td>
<td>Yes</td>
<td>Early</td>
</tr>
<tr>
<td>Washed-out sentiment</td>
<td>Underinvestment and fund outflows have been rampant.</td>
<td>Yes</td>
<td>Early</td>
</tr>
<tr>
<td>Strong breadth</td>
<td>Nearly all commodities have participated in the rally since the 2020 low.</td>
<td>Yes</td>
<td>Early</td>
</tr>
<tr>
<td>Key commodity leadership</td>
<td>Gold broke out to an all-time high in 2020, while other commodities like silver, corn, copper, and soybeans have broken out to cycle highs.</td>
<td>Yes</td>
<td>Early</td>
</tr>
<tr>
<td>Price firming</td>
<td>Will prices hold consistently above long-term averages?</td>
<td>TBD</td>
<td>Later</td>
</tr>
<tr>
<td>Rising production costs</td>
<td>Will production costs increase after years of efficiency gains?</td>
<td>TBD</td>
<td>Later</td>
</tr>
<tr>
<td>Slow persistent investment flows</td>
<td>After over a decade of outflows, will the money start trickling back?</td>
<td>TBD</td>
<td>Later</td>
</tr>
<tr>
<td>New demand</td>
<td>China, infrastructure spending, and the global green energy transition are candidates that may drive demand over the next bull super cycle.</td>
<td>TBD</td>
<td>Later</td>
</tr>
<tr>
<td>Restrained supply response</td>
<td>Will demand be able to overwhelm the supply response to spark a new bull super cycle?</td>
<td>TBD</td>
<td>Later</td>
</tr>
</tbody>
</table>

Low Prices Cure Low Prices

While we could show charts for each item on the checklist, we would rather not turn this publication into a novel. There is one item on the checklist, though, that we believe is good to visualize. Without it, we could not make the call for a new super-cycle bull market. On the checklist, we call it “washed-out sentiment.” The “washed-out” process goes something like this. Near the end of commodity bull super cycle, prices go so high that oversupplies become rampant and need to be worked-off. Investment dollars stop flowing into commodity production. After a period of years, supplies eventually decline. By this point, though, prices have stayed too low for too long, and investors have lost interest in investing. Now many years into this process, possibly a decade, and commodities become prone to supply shortages, with no quick way to bring production back. As the other old commodity saying goes, “low commodity prices cure low commodity prices.” Commodity bull super cycles are sparked this way, and we are seeing similar broad supply growth issues in 2021.

Charts 5 and 6 are the supply growth charts for corn and gold — two very different commodities. The bottom panel in each chart highlights the trend in supply growth for each commodity. Both commodities show supply growth rates that have turned negative in recent years. Both showed similar conditions at the start of the last bull super cycle that began around 1999.

**Chart 5: Corn inventory trend**

![Chart 5: Corn inventory trend](image-url)

Chart 6: Gold production trend

What this may mean for your portfolio

Super cycles send investors signals that they are shifting, and the shift to a bull super cycle has implications for portfolio diversification, which can offer the potential for better returns with less risk. The ideal investment portfolio, in our view, is one that has a mixture of assets, preferably those that are not highly correlated. In other words, assets that don’t necessarily move together over time. Diversification, historically speaking, has led to better portfolio returns over the long term with lower risk.¹

Commodities can be strong portfolio diversifiers, as their prices typically move quite differently than stocks and bonds over the long-run. Chart 7 highlights commodities (top panel) stocks (middle panel), and bonds (bottom panel), since the year 1900. Each of these asset groups has its own super cycle, and their cycles are quite different from one another. The shaded areas represent bear super cycles, and white areas represent bull super cycles. Notice that the shaded and white areas give the chart a checkered look. This is one of the best ways to visualize just how different major asset classes can behave over the long-run.

Chart 7: Super cycles: commodities, stocks, and bonds


¹ Diversification cannot eliminate the risk of fluctuating prices and uncertain returns and does not guarantee profit or protect against loss in declining markets and does not guarantee profit or protect against loss in declining markets.
The main bull risk — This cycle could be different

Take today’s economic backdrop as an example. We’ve seen nothing like it before. With such ample global liquidity available, it’s possible that we’ll see commodity and equity prices moving higher together. This could undercut diversification benefits.

Another trend that could make this cycle different is the speed of technological advances. In past centuries, commodity supplies took years, sometimes a decade or more, to respond to accelerating demand. Extra demand was typically met with extra labor, then technological advancements, and finally, if prices went too high, substitutes were found. This process has been compressed greatly in recent years. There is a counter argument to this, of course, in that the easy-to-extract commodities have been found, and for each subsequent cycle, increased technological advances and higher prices are required to meet demand. Only time can tell us which argument will be right.

All of that said, our best guess is that this new bull super cycle will likely follow a path similar to past bull markets. There are good reasons why super cycles evolve over 10+ year periods, and not shorter ones. So, we will conclude with what a future commodity super-cycle bull could look like. Chart 8 maps the last two commodity bull super cycles, which began in 1971 (blue dashed line) and 1999 (solid grey line). The thick solid red line is the new bull super cycle that we believe began in 2020.

There are two critical points of focus on this chart. First, 2020 was an incredible year for commodity prices. If it truly was the start of a new bull super cycle, then history suggests that there could be more to come. Second, past bull super cycles have not been straight shots to the moon. We expect to see dips, lulls, and pauses in commodity prices. Part of what makes bull super cycles last so long is that each dip, lull, and pause makes investors question the bull, which often keeps excess supply firmly in the ground. Gold is a prime example. The yellow metal has had a great three-year run, ultimately hitting a new all-time high last year, reaching over $2,100 per ounce. Yet, as Chart 6 highlights, gold’s supply growth remains negative in 2021.

Chart 8: Modern commodity bull super cycles

John LaForge
Head of Real Asset Strategy

John LaForge is the head of real asset strategy for Wells Fargo Investment Institute (WFII), a wholly-owned subsidiary of Wells Fargo Bank N.A., which is focused on delivering the highest quality investment expertise and advice to help investors manage risk and succeed financially. WFII serves Wealth and Investment Management, a division of Wells Fargo & Company comprised of Wells Fargo Private Bank, Wells Fargo Advisors, and Abbot Downing businesses.

Mr. LaForge is part of the leadership team that develops recommendations and market commentary for real assets, including commodities, real estate investment trusts, and master limited partnerships. He provides commentary and strategy across the commodity spectrum, covering the most widely followed energy, metals, agricultural, and soft groups. Mr. LaForge has been featured in various media outlets, including The Wall Street Journal, The New York Times, USA Today, CNBC, and Bloomberg Television.

Mr. LaForge earned a Bachelor of Science in Finance and a Master of Business Administration from the University of Tampa. He is based in Sarasota, Florida.
Risk Considerations

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. *Stock markets*, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. Bonds are subject to market, interest rate, price, credit/default, liquidity, inflation and other risks. Prices tend to be inversely affected by changes in interest rates. Although Treasuries are considered free from credit risk they are subject to other types of risks. These risks include interest rate risk, which may cause the underlying value of the bond to fluctuate.

Investing in commodities is not appropriate for all investors. Exposure to the commodities markets may subject an investment to greater share price volatility than an investment in traditional equity or debt securities. The prices of various commodities may fluctuate based on numerous factors including changes in supply and demand relationships, weather and acts of nature, agricultural conditions, international trade conditions, fiscal monetary and exchange control programs, domestic and foreign political and economic events and policies, and changes in interest rates or sectors affecting a particular industry or commodity. Products that invest in commodities may employ more complex strategies which may expose investors to additional risks, including futures roll yield risk. Investing in *gold or other precious metals* involves special risk considerations such as severe price fluctuations and adverse economic and regulatory developments affecting the sector or industry.

Definitions

**Bloomberg Commodity Index** is comprised of 22 exchange-traded futures on commodity markets and represents 20 commodities weighted to account for economic significance and market liquidity.

**Commodity Composite** measures a basket of commodity prices as well as inflation. It blends the historical commodity index introduced by George F. Warren & Frank A. Pearson, former academics at Cornell, collected and published commodity price data in their book, Prices, and the producer price index for commodities (PPI-Commodities), and the National Bureau of Economic Research (NBER) Index of Wholesale Prices of 15 Commodities, the Reuters Continuous Commodity Index, and the Bloomberg Commodity Index Total Return. The index components and weightings, from Warren and Pearson’s Prices, change over time but the 11 commodity groups used from 1786-1932 are: Farm Products, Foods, Hides and Leather products, Textile Products, Fuel and Lighting Metals and Products, Building Materials, Chemicals and Drugs, Spirits, Stopped tracking 1890, House furnishing Goods, and Miscellaneous. The PPI-Commodities is compiled by the Bureau of Labor Statistics and shows the average price change from the previous month for commodities such as energy, coal, crude oil and the steel scrap. The NBER Index of Wholesale Prices of 15 Commodities is a measure of price movements of 15 sensitive basic commodities whose markets are presumed to be among the first to be influenced by changes in economic conditions. The Reuters Continuous Commodity Index comprises 17 commodity futures that are continuously rebalanced: cocoa, coffee, copper, corn, cotton, crude oil, gold, heating oil, live cattle, Live hogs, natural gas, orange juice, platinum, silver, soybeans, sugar no. 11, and wheat.


**Dow Jones Industrial Average** is an unweighted index of 30 "blue-chip" industrial U.S. stocks.

**NDR Commodity Composite** measures a basket of commodity prices as well as inflation. It blends the prices obtain by George F. Warren & Frank A. Pearson, the purchasing manager index (PPI) and the Reuter's Continuous Commodity Index. George F. Warren & Frank A. Pearson, former academics at Cornell, collected and published commodity price data over a period of time, from 1749 through 1932. The PPI measures the average changes in prices received by domestic producers for their output. The Thompson Reuters Equal Weighted Continuous Commodity Index comprises 17 commodity futures that are continuously rebalanced: Cocoa, Coffee Copper, Corn, Cotton, Crude Oil, Gold, Heating Oil, Live Cattle, Live Hogs, Natural Gas, Orange juice, Platinum, Silver, Soybeans, Sugar No. 11, and Wheat.

**NDR Energy Commodity Composite** is an equal-weighted basket of the energy commodities in the Reuters Continuous Commodity Index.

**NDR Food Commodity Composite** is an equal-weighted basket of the food commodities in the Reuter's Continuous Commodity Index.

**S&P 500 Index** is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the U.S. stock market. An index is unmanaged and not available for direct investment.

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