

## **AMP, Marc Faber Cite 1920s Theory for Commodity-Stock Optimism**

**By Malcolm Scott**

May 2 (Bloomberg) -- Russian economist Nikolai Kondratiev argued in the 1920s that commodities move in 50- to 60-year cycles. His analysis suggested prices would rise early this century. They did.

Now investors Shane Oliver and Marc Faber are using his theory to back their bets that the 5 1/2-year-old rally in commodity-related stocks is only just the beginning.

"The norm in financial markets is to look at very short-term cycles," said Oliver, who helps oversee \$83 billion at AMP Capital Investors in Sydney. "I think that's wrong. Kondratiev allows you to view these things in a broader context." BHP Billiton Ltd., the world's biggest mining company, and Rio Tinto Group, the third-largest, are among AMP's top 10 holdings.

Shares of companies that produce raw materials have leaped 173 percent and energy stocks have jumped 118 percent since October 2001, when commodity prices began rising. The two groups have had the biggest gains in Morgan Stanley Capital International's World Index since then. Shares of Melbourne-based BHP have almost quadrupled, while those of London-based Rio have almost tripled.

Oliver and Faber, a Hong Kong-based money manager, are among a new generation of "super cycle" proponents that also includes strategists at Citigroup Inc., Deutsche Bank AG and Goldman, Sachs & Co. They say that supply shortages and growing economies in China and India will send prices higher for years to come.

### Looking Ahead

Their intellectual ancestor, Kondratiev, founded the Institute of Conjuncture in Moscow in 1920. He argued in books and papers such as "The Major Economic Cycles," published in 1925, that long waves in economies and prices are inherent in the capitalist system. Upswings are caused by increased capital investment, and downswings arise as those investments lose value. New markets and new technologies also push prices up during the expansionary phase.

He observed three upswings: 1789 to 1814, spanning the French revolution and Napoleonic wars; 1849 to 1873, an era of European industrialization; and 1896 to 1920, when the U.S. emerged as the world's largest economy. Each was followed by a commodities decline of between 23 and 35 years. The average decline lasted 29 years, the average upswing 24 years.

Using Kondratiev's analysis to project forward, a 29-year slump was due from 1920 to 1949 -- a span that includes the Great Depression and World War II.

A full 53-year up-and-down cycle followed, making another upswing due in 2002.

### Changing the Rules

"I agree that commodity prices move in long cycles," said Faber, who manages \$300 million at Marc Faber Ltd. "The up wave of the Kondratiev cycle is likely to last for at least another 15 to 20 years."

Faber devoted a 35-page chapter of his 2001 book "Tomorrow's Gold" to Kondratiev and other long-wave theorists, writing that once the cycle turned higher, "it will change the entire rules of investing, because in a rising wave, commodity prices will rise, inflation will accelerate and interest rates will increase."

The Reuters/Jefferies CRB index of 19 commodities has surged 139 percent since October 2001; copper has jumped five-fold, while oil prices have more than tripled. The U.S. Federal Reserve has raised its benchmark interest rate to 5.25 percent, from a low of 1 percent in 2003.

Faber owns mining stocks, which he declined to name, as well as gold, rare metals and agricultural land. He's underweight bonds, which he said don't perform well in a rising Kondratiev wave.

### Not a Believer

The best-performing commodity-related stocks since the rally started include Phoenix-based Freeport-McMoRan Copper & Gold Inc., up 505 percent; Valero Energy Corp. of San Antonio, up 647 percent; Seoul-based Korea Zinc Co., up 988 percent; German steelmaker Salzgitter AG, up 1,247 percent; and Indonesian coal exporter PT Bumi Resources, up 2,100 percent. The MSCI World Index is up 67 percent in the same period.

Angus Gluskie, who helps manage about \$380 million at White Funds Management in Sydney, hasn't heard of Kondratiev and isn't a believer in the long rally. He expects central banks around the world will raise interest rates in the face of higher inflation, slowing global growth and demand for raw materials.

"Things don't go on forever," he said. "The reason these things are called cycles is because they run out of steam. In the next 6 to 12 months I see a much tougher environment for commodities and resources companies."

That means that commodities may already have peaked. The CRB index has slipped 10 percent from its May 2006 high. Gluskie said he's "neutral" on mining stocks, expecting strong earnings for the first three months of this year. Beyond that, he's "anxious" not to be left owning too many shares exposed to the global economy, he said.

China, India

Proponents of a super cycle, including Alan Heap at Citigroup in Sydney, Melbourne-based Peter Richardson and London-based Michael Lewis of Deutsche Bank, and Goldman's Jeff Currie in London, say the pullback since May is just a blip in a longer rally. Australia's central bank shares their optimism.

“The rapid growth in world demand for metals and other resources appears to be showing little sign of abating,” the Reserve Bank of Australia wrote in its monthly bulletin published April 19. “There are good reasons to believe that strong demand, from emerging economies in particular, may continue for several decades.”

China's economy has grown 10-fold since the late 1970s, when leader Deng Xiaoping began adopting market-based policies. It has grown an average 9 percent annually for the past decade, fueling demand for copper, iron ore and other commodity imports it needs to sustain its manufacturing-based expansion.

‘Hocus-Pocus Stuff’

India's economy has grown an average 8.6 percent annually in the past four years, the quickest pace since independence in 1947 and behind only China among the world's major economies. Goldman Sachs expects India's growth to average 8 percent a year until 2020.

Kondratiev himself didn't profit from his analysis. He was convicted for championing private farm ownership in the 1930s and executed during Josef Stalin's great purge in 1938 at the age of 46. Joseph Schumpeter, an Austrian economist, pursued Kondratiev's ideas in the 1930s.

AMP's Oliver, when making presentations to clients, includes a slide titled “The Latest Long Wave Upturn,” inspired by Kondratiev. Its saw-tooth graph traces the global economy since 1785, with wave points marked at 40- to 60-year intervals. A red dotted line continues north until 2020.

“A lot of people at my level see it as hocus-pocus stuff, only slightly better than charting,” said Oliver. “But it is something you can't ignore.”

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*Last Updated: May 1, 2007 11:49 EDT*

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