Why rising prices are really about humanity versus nature

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Have you heard about the "commodities super cycle" we may be living in right now? It doesn't sound as bad as a bomb cyclone, but it may end up slamming us just as hard.

This super cycle, (or "Super Cycle" to some) has been the talk of Wall Street and business for the past few months. What it simply means is that prices of most commodities — everything from oil to oats to corn to copper, which are at record or multi-year highs right now — are poised to climb much more, not just for a few months, but for years to come.

Obviously if this is the case, there are huge implications for everything from buying a house or car, to the stock market, even to choosing a career. A super cycle would be bad news for commodity consumers (i.e., all of us to a degree), but good news for commodity investors, (with exceptions galore on both sides).

It's also the case that the purported super cycle is connected to supply chain snafus at the ports (as I wrote about recently) and to rising prices we're experiencing at supermarkets and gas pumps. Note the September CPI (inflation) reading of 5.4% is the highest since August 2008. (The October release is on Nov. 10, a week from Wednesday.)

Behind the rise in prices are two factors. COVID-19 of course and all the disruption and friction it's caused. Plus, I would argue a preexisting rise of nationalism and parallel decline of globalism. (The latter can be inflationary because a) nationalism is often accompanied by strong domestic spending programs and b) because in the short run at least, local supply chains are more expensive than cheap global options.)

I've written about both of these forces recently, but what I'm just now realizing is that this commodities super cycle and resulting inflation speak to a fundamental tension between humanity and nature, as well as our flawed understanding of that dynamic. Heady stuff, right? I'll explain all shortly, but first let's tackle the commodity super cycle.

The super cycle has been a hot topic since early spring when commodity prices started to take off. Quick quiz. Q: What stock is up more year-to-date, Exxon (XOM), or any of the Big Tech stocks — Apple (AAPL), Amazon (AMZN), Netflix (NFLX), Microsoft (MSFT), Meta, (FB) or Google parent Alphabet (GOOG, GOOGL)? A: Exxon has climbed 56% this year, more than any of the biggies, except for Alphabet (up 66%).

I recently was sent down a super cycle rabbit hole by Randy Nelson, president of Sanguine Gas Exploration, a Tulsa-based independent oil and gas company, (whom I quoted in this story about Exxon in March). Randy recommended a Bloomberg Odd Lots podcast where Jeff Currie, the global head of commodities research at Goldman Sachs, was interviewed by ever-astute Joe Weisenthal and Tracy Alloway, (transcript here.) Currie, who in January predicted a brisk rise in commodity prices, is very much in the super cycle camp. (I guess we should be wary of a commodities guy who's strongly bullish on his own sector, but that doesn't mean he's wrong.)

Before we get to Currie's thesis, let's distinguish between a super cycle and just a plain vanilla up-cycle. The topic sentence from this Institutional Investor article sums it up quite nicely, "Commodity super cycles are decade-long periods in which commodities trade above their long-term price trend." The piece goes on to point out that the last commodity super cycle, which began in 2000 and lasted well into the 20-teens, was driven by the BRICs. Brazil, Russia, India, and China, which "were on a path of rapid industrialization, which would require an unprecedented amount of raw materials, food and energy commodities."

That rise of the BRICs neatly matches one of Currie's primary and most surprising points: "Every commodity super cycle," Currie told Tracy and Joe, "is driven by low income groups, as well as every bout of inflation. Only the world's low income group can create inflation and commodity [super cycles.] And there is no exception to that."

Currie gives examples of LBJ's War on Poverty in the 1970s, the aforementioned BRICs and prolonged Latin American inflations. Why? Because he says only millions of people receiving millions of dollars (often from a populist government) can drive prices in a sustained manner. So what about now? Currie believes one factor driving up prices is the ESG moves by governments in the U.S. and UK —"green capex," he calls it — which are aimed at creating new jobs. Still, I would argue that massive CARES Act and Fed stimulus programs, plus China's Common Prosperity program, would be bigger factors. (Biden's Billionaires' Tax, which may or may not be still alive, could be an additional element.)

That's the demand part of the equation, which is a bit under the radar. Before I get into supply issues, a quick note about higher labor costs. People want more money to come back to work. That and let's not forget there are actually fewer Americans available. Of the 738,000 dead from COVID-19 in the U.S, some 175,000 of them were between the age of 18 and 64. That's like losing all the nation's dentists (173,000), or librarians (176,000), or dishwashers (184,000) or drywall installers (165,000.) So the very mortality rate part of COVID, it could be argued, is inflationary. (Fewer people to do the work, means they need to get paid more.)

Now back to supply. Besides backed up transport systems (ports, trucks, and rail) that increase costs of commodities, Currie points to some deeper, structural issues originating from China,

which he says have set off a chain reaction. According to Currie, it stems from a Chinese ESG effort starting several years ago, when the government began shutting down hundreds of its most toxic coal mines. A trade dispute with Australia curtailed coal imports into China, further reducing supply.

This has led to a shortage of coal, which meant Chinese industry had to switch to natural gas, which drove up those prices. Then industry switched to oil, which drove up those prices and even created fuel shortages that led to power outages in China. After that comes the chain reaction; soaring energy prices in Europe, for instance, have caused a Belgian Zinc smelter to cut production by 50% (as Tracy noted.) Result: Higher zinc prices. Ditto for Chinese aluminum and a Slovakian aluminum producer (aluminum requires huge amounts of electricity — this one Slovakian company, for instance, uses 8% of that country's electric power.) Result: Higher aluminum prices. And so on.

(NB: Chinese coal prices have dropped some this week, as the government pledged to address shortages, but are still up some 250% this year.)

People gather at the Federal Reserve building to call on financial institutions to divest from fossil fuels on the ninth anniversary of Superstorm Sandy on October 29, 2021 in New York City. Photo by Michael M. Santiago/Getty Images)

The domestic ESG movement also comes into play here. First, whatever you think of crusaders like Tom Steyer and his new investment fund, Galvanize Climate Solutions, or Engine No.1 which is agitating for change at Exxon, as well as Middlebury College professor Bill McKibben (he did an op-ed in the New York Times this week) and their push for companies to either change their strategies, reduce carbon footprints or in the case of endowments, divest, they are raising the cost of capital for carbon-producing companies.

I'm not saying that's good or bad. And I also agree that green energy can be (after an outlay perhaps), and in many cases already is, price competitive. And that I believe that we must greatly reduce or eliminate carbon-producing energy. None of that takes away from the fact that in the short run the green movement could well be an inflationary force. Making supertankers less polluting, for instance, is no small feat, as the Wall Street Journal reports. Again, in no way is that an argument not to do so and it may be a tiny price to pay.

Second, creating the green economy isn't a completely green process. "The energy transition itself is incredibly resource intensive," argues Nelson. "Different types of commodities, including copper, cobalt, aluminum require fossil fuels to be produced. We need those materials to make Teslas, to make wind turbines and solar panels. We're going to have to expand copper mining and lithium mining, and that's going to get expensive. And that's going to translate into inflation." Not that the price of lithium, used for EV batteries, is up fourfold in China this year.)

"The famous author Isaac Asimov once said, 'Life is pleasant, death is peaceful, it's the transition that's troublesome,'" notes Michael Haigh, the global head of commodities at French bank Societe Generale. "This is what's going to happen with commodity markets in the green transition. It's going to be really troublesome. If you remove coal, there's not enough production

of offshore wind farms and solar that can replace it in the short run. There are unintended consequences because by not buying dirty stuff you make it cheaper. By buying more expensive stuff, you make it harder to transition."

Another factor both Currie and Nelson spoke to is the paucity of investment in the old economy over the past decade. Consider Chevron versus Amazon. Why would you have invested in Chevron (up 8% over the past five years) when you could have bought Amazon, (up 339%)? And ESG advocates make investing in Chevron a potential PR nightmare, whereas Amazon mostly isn't. So entities like the Harvard endowment are shunning Big Oil for ESG reasons, and they're gun shy from relative underperformance or outright losses.

Nelson, whose company operates in Oklahoma, offers on-the-ground context and explains what this means for capital flows. "In the 20-teens, the beginning of the shale era, there was an ocean of money thrown at the oil and gas industry in the United States," he says. "Then the business became over-invested, as you get too much supply. A lot of the capital that was invested in domestic exploration and production was destroyed. That came to a crescendo and you actually had negative oil prices in April 2020. In 2018, there were 150 rigs operating within the state of Oklahoma, developing both oil and natural gas, and in the pandemic in 2020 that collapsed down to 11. Today, there's around 40 to 50. So now we're putting capital to work."

(The same kind of underinvestment dynamic exists for supertankers, which I explored in that previously referenced shipping crises piece.)

I should point out there are naysayers here.

"I'm in the camp that we're not in a super cycle but we are in a business cycle uptick," says Jumana Saleheen, chief economist at the global commodity research firm CRU Group, who spent two decades working at the Bank of England. "Our estimates of the Biden infrastructure plan or Biden green spending is that it would be marginal on U.S. metal demand. Something between 2% to 5%, by our calculation. That's not what I would call super cycle numbers."

Still, it is unassailably the case that we're now seeing what Currie calls the "revenge of the old economy." Meaning what? Meaning for example, year-to-date Chevron stock is up 35%, the S&P 22% and Amazon 2%. That's the picture for investors. For consumers? The national average price of gas hit $3.38 a gallon this month (up from $1.96 in May 2020), the highest prices at the pump since January 2014. (Note to self: When gas prices go up, buy oil stocks.)

Don't look for quick fixes here. Jane Fraser, CEO of Citigroup, whom I spoke with at the Yahoo Finance All Markets Summit told me: "We're probably in for a bit of a brutal winter, particularly in the energy markets…" Jan Hatzius, Goldman Sachs' head of Global Investment Research and the firm's chief economist, wrote recently, "We are boosting our sequential inflation assumptions for Q4 and early 2022 to reflect...continued upward price pressures." And Currie again: "Three to six months, I think that's going to be your max pain point."

Some see an even longer time horizon. Duke Energy Lynn Good told Yahoo Finance's Akiko Fujita at our All Markets Summit that she expects the supply and demand imbalance in the

energy markets to continue well into 2022, with full rebalancing not expected until "2022 rolls into 2023."

Steve Hanke, a professor of applied economics at Johns Hopkins and senior fellow at the Cato Institute, takes it further. “The general background is one in which we’ll have in my view persistent inflation for probably the next three year at least. That’s all baked in the cake, at least in the U.S. Inflation will be up around 6% next year, 2022, 2023, with that kind of background these commodities are a good place to put your money.”

Close readers of this column may be feeling triggered. As in, “Hey Serwer, didn’t you say that this inflation thing was no big deal?” I think our hypothetical trigger may be referring to this column from four months ago where I said that the rise of technology was greatest deflationary force of our lifetime and that while COVID was inflationary, technology would overwhelm its effects in short order. In other words, I was arguing that inflation was "transitory" as the dismal scientists term it. Now? Now, I’m less sure. Am I a flip-flopper? No, I would argue that I’m putting forth those same scientists’ timeless line (perhaps from Keynes, perhaps from Samuelson): “When the facts change, I change my mind. What do you do, sir?”

Still, this is a bit of a mea culpa for me. Persistent inflation may be on the rise after all. It was hubris of me to believe that technology had wiped inflation off the face of the Earth, even for a decade or two. And that speaks to the tension I spoke of in the beginning of the piece, that of humanity versus nature.

Simply put, my belief in the triumph of rational technology über alles, reflected a view that human will and ability had overcome nature, albeit even briefly. History tells us that these spells, while blinding to those like me who become enchanted by them, are only temporary. (You couldn’t find a better example of the opposite occurrence, i.e., nature triumphing over technology, than Apple’s and Amazon’s weak quarterly results this week due to supply chain issues and labor shortages brought on by COVID. To paraphrase Bobby Fuller: Big Tech fought nature and nature won.)

It brings me back to a class I had in college taught by professor Willard Wolfe where we learned about positivism as put forth by Auguste Comte, John Stuart Mill and their disciples (forgive me deep thinkers if I’m now above my intellectual pay grade) who argued that humans can and should seek order in the natural world and that this perspective could be used to help build systems, machines and technologies that mitigate against irrationality, war, and other human emotional shortcomings.

For a few decades at the end of the 19th century and beginning of the 20th century, it looked like this view made sense. Rational progress seemed to abound! Then came World War I, and, ah yes, the Spanish Influenza pandemic of 1918-1920. So much for conquering the impulse of war and vagaries of nature. One of my favorite novels, Thomas Mann’s "The Magic Mountain" — set in a TB sanitarium above Davos no less— is at least in part about the decline of positivism.

The positivists would be in retreat again today. COVID has exposed our inability to control disease and strong nationalistic populist elements are on the rise (Regarding the latter, exhibit

A: Josh Hawley's recent opinion piece in the New York Times). I would argue that COVID and nationalism, (and I should add dysfunction in social media and tech itself, i.e. hacking for instance), are inflationary and serve as mitigating forces against rational technology's deflationary sway. Does nature and irrational human behavior always win out over the better aspects of technology and rational human behavior? Not always, but the wild side, the animal spirits, are ever-present and always set to rise.

"We have lived in a low inflation time," says Andrew Busch, who served as the chief market intelligence officer at the Commodity Futures Trading Commission and before that as a policy strategist at the Bank of Montreal. "Now because of COVID and government policies, we've overstimulated the economy massively. How far that plays out, I don't know. Technology overall has clearly made a huge difference in maintaining certain costs. Once inflation starts to wear itself into wage pressures, wages overall, it's really hard to get rid of."

Thirty some years ago, John McPhee wrote "The Control of Nature," a book about the tug-of-war between humans and the natural world. McPhee described three such battles — in Iceland, on the Mississippi River, and in Los Angeles. Spoiler alert: The humans have mixed success.

From what I've seen in the financial markets, that's about as much as we can hope for.