

Greed vs. Fear in the Commodity Pits

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Gold, silver, and copper have all experienced meaningful price appreciation over the past several years, with prices recently accelerating to historical highs while taking on increased volatility. This has occurred against the backdrop of rising stock prices, indicating some of the traditional relationships between capital markets and commodity markets may have broken down, at least temporarily. In more normal conditions, it would be expected that precious metals, and gold in particular, act as a hedge against falling stock prices, rising inflation, and other fears. Some of the reasons for this disconnect, factors driving the rally, and what makes this time unique are discussed below.

The Big Three: The three metals drawing the most attention are gold, silver, and copper. These commodities have experienced price increases of over 150%, 250%, and 45%, respectively over the past three years. This reflects a combination of macroeconomic and behavioral factors including inflation, confidence in the U.S. dollar, and speculation.

U.S. inflation expectations often play a role in commodity pricing, as commodities are priced in dollars. Put simply, when the purchasing power of the dollar declines, it takes more dollars to buy the same amount of that asset, leading to an increase in price. Part of the reason the dollar has declined recently relates to concerns regarding the U.S.'s long-term fiscal sustainability and rising government debt levels. These concerns have garnered discussion about currency debasement, which is a term used to describe the erosion of a currency's real value over time. In periods when investors believe the monetary system is at risk, or inflation may persist or accelerate, demand for assets perceived as stores of value, such as gold, is likely to increase. Rising demand for these stores of value can create upward price momentum, attracting additional capital and reinforcing price appreciation.

It should be noted that silver and copper have seen similar price dynamics to gold, yet they have slightly different characteristics. Both metals benefit from industrial demand in addition to their roles as financial assets. Copper is a critical input in electrical infrastructure and manufacturing, while silver plays a role across electronics and other industrial uses, both of which are related to AI spending. These use cases meaningfully differentiate them from gold and do add nuance to the discussion. Even so, we believe the speed and magnitude of recent price moves suggest that enthusiasm has extended beyond purely fundamental demand. There is likely a considerable amount of speculation in these markets.

Conflicting Signals: Here's where the current environment becomes particularly interesting to us. Gold is often viewed as a portfolio hedge, not necessarily against any single outcome, but against uncertainty, declining real

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returns, or erosion of purchasing power. Historically, demand for such hedges has tended to rise during periods of economic stress, market dislocation, or equity underperformance. None of those is the case today. Yet gold is rallying amidst a 3-year period in which risk assets have delivered very strong returns and broader investor risk appetite remains high. Rather than responding to stress, gold appears to be participating alongside equities in the run-up. That coexistence is not unprecedented, but it is less indicative of purely defensive behavior and informs us that the traditional relationship has broken down.

This does not mean gold is priced incorrectly, nor does it imply a view on future price direction. It simply suggests to us that the motivation for ownership has shifted from protection toward participation. We are observing similar dynamics in silver and copper, where compelling long-term themes coexist with shorter-term price action that appears increasingly sensitive to sentiment. We are not addressing Bitcoin, another commodity that has been subject to wide price swings and has represented the “tip of the spear” in terms of speculative vehicles.

Staying Disciplined: Our experience has reinforced the value of remaining disciplined to our core philosophy, particularly during periods when markets reward short-term participation in popular trades. That discipline has allowed us to avoid emotionally driven decisions and remain focused on income-producing stocks and bonds that we believe offer more transparent risk-return profiles. We are admittedly surprised by the extent of recent commodity performance, but we know these markets are characterized by big moves both up and down, while providing no income or internal return generating mechanism that companies offer. We remind ourselves, however, that our record has depended not on participating in every rally or trying to gain broad exposure to each asset sub-category, but rather on being selective about which risks we choose to take, and how we pursue them. In the case of commodities, we are comfortable leaving this type of “investment” to others and staying within our “circle of competence.”

Warren Buffett often refers to the circle of competence principle that states that investors should focus on areas they understand deeply and recognize the boundaries of that understanding. We have applied this discipline intentionally for many years, and our focus is centered on owning assets that generate sustainable cash flows. When a business is profitable, there is both an internal return generating mechanism and an accompanying framework for determining its value based on how much it earns or is expected to earn. This method becomes even more reliable when cash flows are consistent and predictable. These are the types of companies we prefer. Assets that do not generate cash must instead be evaluated largely on what someone else may be willing to pay in the future. That dynamic applies to collectibles, artwork, cryptocurrencies, and commodities. These assets are invested in for price appreciation alone. For long-term investors, we believe the most reliable way to compound wealth is to own high-quality businesses, and we will continue to invest according to our long-held discipline.

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