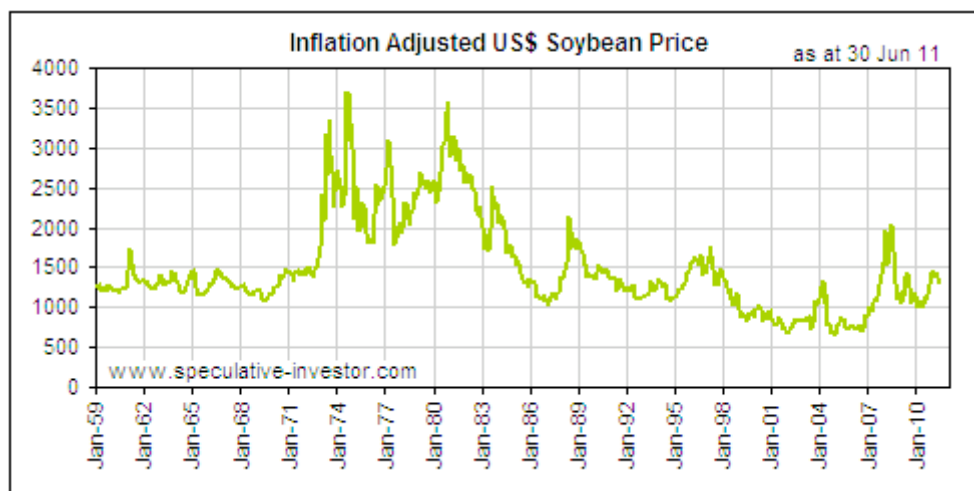
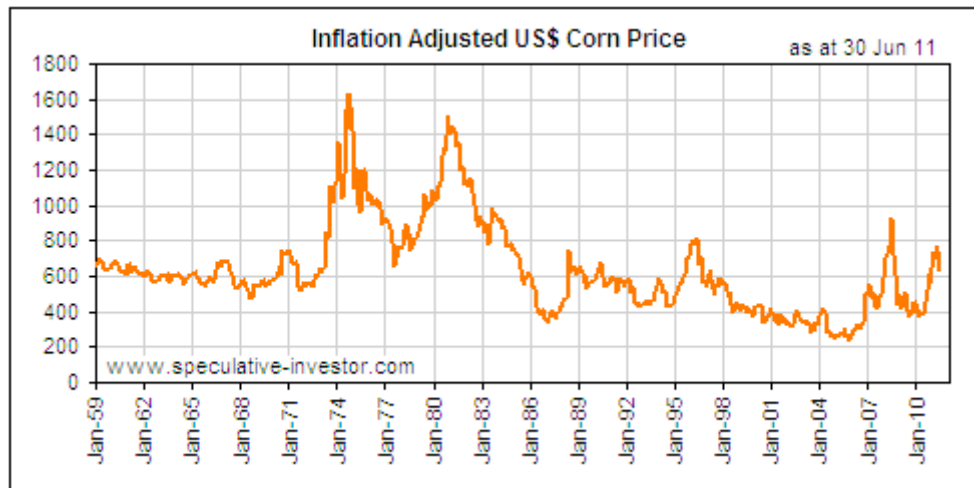


## Real Performance

We'll now step back and review some 'big picture' inflation-adjusted (IA) charts. These charts show monthly prices in June-2011 dollars, using our own inflation index to adjust historical data for the estimated loss over time in the US dollar's purchasing power. As discussed in earlier commentaries, our inflation index is based on the assumption that the rate at which a currency loses purchasing power over the long term will be roughly equal to the rate of increase in its supply minus the rates of growth in productivity and population.

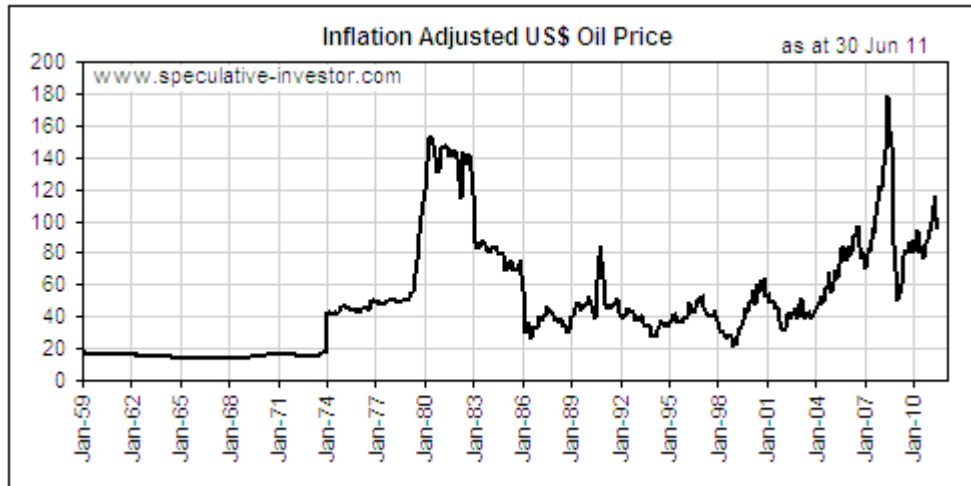
Let's begin with two of the world's most important agricultural commodities -- corn and soybeans. We often read that soaring food prices are a major problem, but the following charts tell us that the REAL prices of corn and soybeans are no higher today than they were 40 years ago. This, in turn, suggests that the main reason for today's apparently high food prices isn't increasing population or increasing prosperity or disruptive weather patterns or a shortage of arable land. It isn't even the disastrous government policies that cause about 40% of the US corn crop to be consumed in the production of fuel, although these policies have certainly exacerbated the problem. The reality is that the loss of currency purchasing power resulting from monetary inflation is the dominant reason that food prices are troublingly high today.



Next, we have the world's most important industrial commodity -- oil. The IA oil price 'went vertical' during 2007-2008, and in the process handily exceeded its 1980 peak. Vertical price advances such as this are usually followed by crashes, and so it was with the oil market during the second half of 2008. Having returned to 2004 levels in a big hurry, the IA oil price began to rebound and

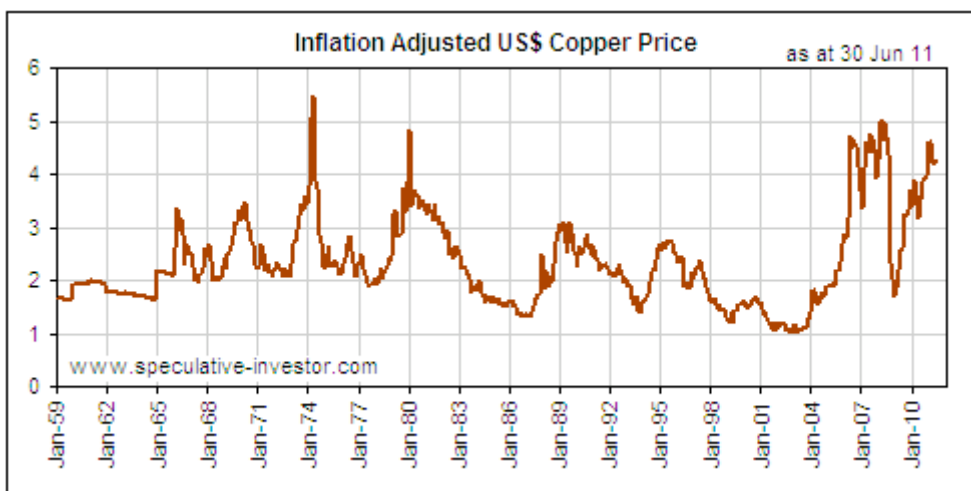
managed to recoup about half of its crash-related losses before reversing downward along with many other markets at the beginning of May-2011.

We suspect that getting the IA oil price above its 2008 peak would require a huge war-related supply disruption, which is unfortunately not out of the question. Absent such a disruption, oil will probably remain in the \$60-\$140 range in June-2011 dollar terms. In current dollar terms, the upper and lower bounds of oil's expected price range will naturally rise as the US\$ is depreciated by the Fed.



Like the IA oil price, the IA copper price crashed to 2004 levels during the second half of 2008. Unlike the IA oil price, the IA copper price didn't quite reach an all-time high in 2008 and has since recouped almost all of its crash-related losses.

In our opinion, the IA copper price is dangerously high. We expect a huge decline to begin from near the current level, but we don't expect the decline from this year's peak to unfold anywhere near as rapidly as the decline from the 2008 peak.



The chart of the IA gold price displayed below looks very different from the oil and copper charts displayed above. Absent from the IA gold chart is a spectacular advance and collapse during 2006-2008. Also, the IA gold chart reveals a market that has continued to make new multi-decade highs over the past two years while remaining well below its 1980 peak (in June-2011 dollar terms, the Jan-1980 peak in the gold price was around \$2600/oz). The oil and copper charts, on the other hand, show markets that peaked in 2008 -- above the 1980 peaks.

The above-mentioned differences in performance stem from the fact that most of the demand for gold is for investment, monetary or store-of-value purposes, whereas almost all the oil and copper that gets produced each year is consumed during the same year in industrial/commercial processes. Whereas gold tends to do relatively well when economic confidence is on the decline and there is a general increase in the perceived need for financial security/safety (the 'bust' phase of inflation-fueled boom/bust cycle), oil and copper tend to do relatively well before the inflation-fueled boom turns to bust. That's why the financial crisis of 2008 created dramatic reversals in the IA oil and IA copper charts but looks like nothing more than a bump in the road on the IA gold chart.

At no stage during the current bull market has the IA gold price experienced the sort of spectacular price advance that we would expect to occur prior to a major peak.

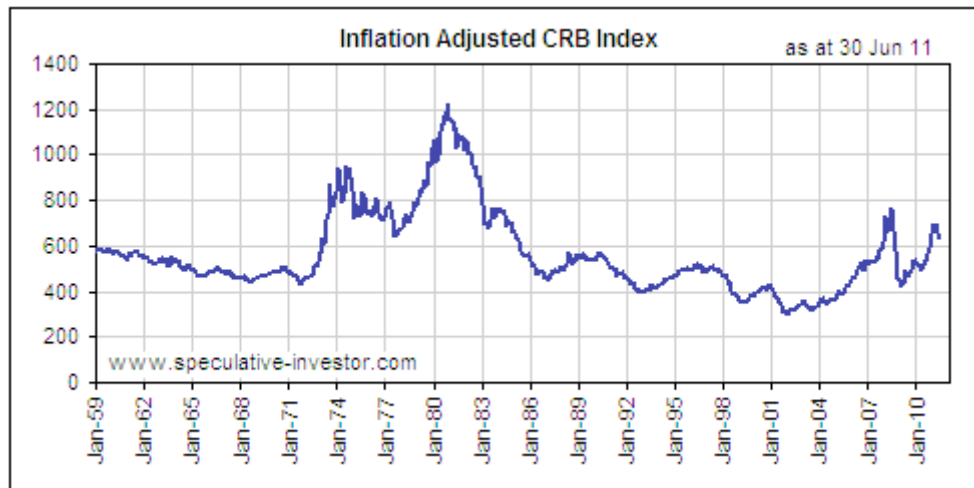


Silver is the metal with the split personality -- part industrial metal (like copper) and part monetary metal (like gold). In addition, the silver market is a lot smaller than the copper and gold markets, which means that it responds faster to incremental changes in supply and demand.

The following chart shows that the huge rise in the IA silver price between early-September of last year and late-April of this year pales in comparison with the 1978-1980 rise. This suggests the potential for significant additional gains in the IA silver price over the years ahead, but it should be kept in mind that the > 600% increase of 1978-1980 was a reaction to an unusual set of circumstances that may not occur again.

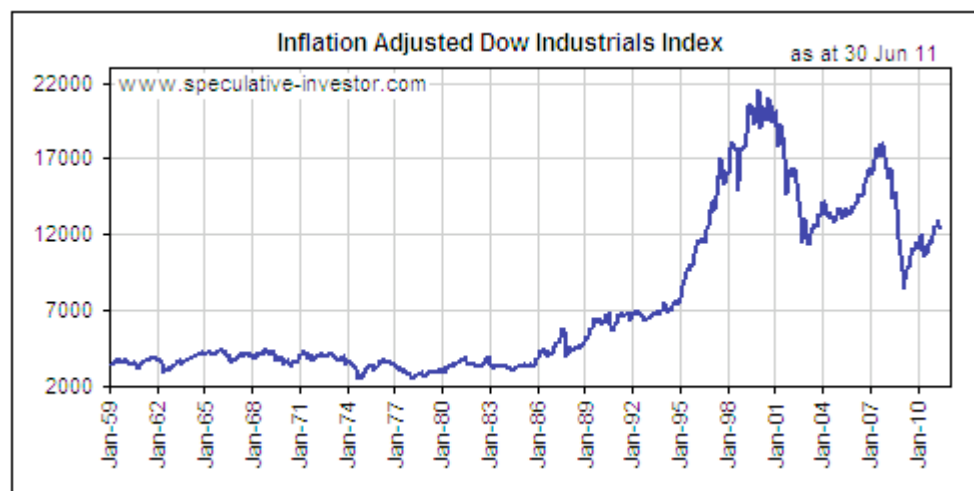


Our second-to-last inflation-adjusted chart reveals that the commodity universe, as represented by the CRB Index, made a new ALL-TIME low in real terms in 2001. Given that the bull market of 2001-2008 peaked a long way below the 1980 peak, there is no evidence at this time -- notwithstanding Jeremy Grantham's assertions to the contrary -- that the multi-century downward trend in real commodity prices has come to an end.



The last in our series of charts shows the inflation-adjusted Dow Industrials Index. This chart illustrates the extraordinary extent of the 1995-2000 advance and makes it crystal clear that a secular bear market commenced in 2000.

It's very likely that the IA Dow will make new multi-decade lows within the next two years.



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