

The Dominant Fundamental Theory

“What are your thoughts on platinum and palladium? Palladium is so overbought it’s ridiculous and I’ve been waiting for a proper correction, but it’s just riding the electric vehicle surge. Do you think a correction is due?”

Last week a friend’s son who had recently started work in the investment industry in London asked my opinion on this trade - as well as on possible oil price behaviour.

“Don't ask other people their opinions and don't desperately try to be right. Firstly, understand how often your investment strategy is right and how often it is wrong and, secondly, how much your strategy makes when it's right and how much it loses when it's wrong - i.e. what the payoff profile is. Then implement the plan. If you're worried about a specific trade, then it's either FOMO (fear of missing out) or you're trading too big with no clear exit plan.”

I was busy at the time with the crucial task of delivering ice (commodities!) for a relative’s wedding, so I was probably more curt than I needed to be. But it is important to be clear on this. The clearer an investment process is, the less need and room there is for discretion and confusion.

In the discussion above, there was confusion about both what was happening and what to do about it - and make no mistake, palladium is overbought. The palladium price has risen by 75% in the last 6 months, and the 30-day RSI is at almost 70 (refer to the lower panel on the chart below). But, unfortunately, it’s even worse that the proverbial broken clock only tells the correct time twice a day, so there is only one ‘overbought/oversold’ indicator that is correct on any given day – and all the rest are wrong. So today is not the day for the 30-day RSI.

The Palladium Price



Source: Bloomberg

To compound matters, the platinum/palladium ratio is also extremely extended and provides no guidance on the direction of either. As per the chart overleaf, the platinum price was \$1719 higher than the palladium price 10 years ago. It is now \$630 lower than the palladium price and shows absolutely no sign of being ‘overbought’ or ‘oversold.’

The Platinum-Palladium spread



Source: Bloomberg

Fortunately, there is a way to understand fundamentals and technicals simultaneously. It is an approach known as the “Dominant Fundamental Theory.” This theory has been articulated since at least 1980 and its essence is described by Peter Brand as follows:

1. All major price cycles (lasting from months to years) are caused by one, and perhaps two, fundamental factors.
2. All other factors were irrelevant, although some of the other factors cause some zigs and zags in price. But in the end, all these other factors — many of which market participants think are important — are just plain noise.
3. The dominant fundamental may be among the things the investment community and financial media talk about, but it is not identified as the real driver until very late in a trend. When the dominant fundamental becomes conventional wisdom, the trend is close to completion.
4. Then a new dominant fundamental will begin driving the market into a new trend to the knowledge of just a select few traders.
5. Market watchers who create huge complicated scenarios with multiple factors to describe price trends are just (ab)using statistics to justify the position they have taken.

As a trader or investor — and be honest about this — do you chase after all sorts of fundamental news in order either to understand the markets or to justify your positions? If you do, you are wasting your time. If this describes you, please know that your constant attempt to “put the pieces together” is wasted effort. Do yourself a favour and find a different hobby. Identify your “dominant fundamental” for peace of mind if you must — use it to stay sane while remaining uncomfortable — but trade off the only absolutely objective information available, namely; price. At the very least, use it to recognise and acknowledge when you are wrong about it.

Right now, the dominant fundamental has indicated for 6 months that demand for palladium has been greater than supply. Just stay long until price indicates that a new dominant fundamental has superseded the current one.



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