Is JIT dead?

Rising commodity prices may signal the end of lean inventories, analyst says.

Just-in-time (JIT) inventory practices should be confined to the dust heap of history. That’s the contention of a leading financial analyst and economist who believes that the just-in-time strategy has “outlived its usefulness.”

Instead, manufacturers should begin stockpiling inventories as a hedge against rapidly rising commodity prices, suggests Donald Cove, a global portfolio strategist with BMO Harris Investment Management in Chicago. “By running lean and mean, JIT is hurting companies,” says Cove, whose book, The New Reality of Wall Street, outlines his global investment outlook for the future.

Although slender inventories made sense two decades ago when commodity prices were declining, that’s no longer the case, Cove believes. Today, China’s rapid growth as a manufacturing center is placing heavy demand for raw materials on suppliers around the world. “We are in the early stages of the biggest commodity boom in history, driven by China and India,” he asserts. “We’re going to add a half billion people to the world’s middle class in the next 15 years. The squeeze on soy beans, natural grains, and coal will be monumental.”

Cove sees trouble brewing as worldwide demand for commodities remains high even as many companies have record-low inventories on hand. Equally worrisome is that China’s voracious appetite for raw materials is pushing up commodity prices. But the low-cost output from Chinese factories is forcing global manufacturers to hold down prices for finished goods.

“The price of raw materials is rising nine times faster than prices for finished goods,” Cove says. “Companies should be maintaining inventories at a time when they’re replacing supplies at much higher prices.”

Indeed, during the first five months of 2004, commodity prices have skyrocketed. Purchasing reported that during the past 12 weeks alone, prices for steel scrap increased by 80 percent. Ethylene prices were 30 percent, while lumber and nonferrous metals were up 25 percent and 22 percent, respectively. (Purchasing is owned by Reed Business Information, LM’s parent company.)

Manufacturers can expect to pay higher prices for materials replenishment; thus tomorrow’s purchases will cost more than today’s stock. Cove, for one, does not think that situation will change any time soon. In fact, the analyst foresees no abatement in the rise-up in commodity prices for the foreseeable future.

“The only commodity in oversupply right now,” he says, “is political hot air.”

—James Cooke