Investing for a world of change

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Eye of the storm: investing in commodities

What's driving commodity markets?

It is 'macro vs. micro'. The macro-economic outlook is fraught, with worries about a global recession, falling demand and de-stocking of commodities. But on the micro side – i.e., specific to natural-resource markets – we have seen huge supply disruption, firstly from COVID and then from the Russia-Ukraine war. So while supply of many commodities is tight, investors are worried about the demand outlook.

Energy has outperformed in the past year. What's your view on the sector?

The prices of oil, gas and other energy commodities have been supported by the war in Ukraine, with buyers rushing to secure supplies ahead of winter in the Northern Hemisphere. Whether the stockpiles are sufficient or excessive will depend on the weather. If it's a mild winter, energy prices could come down quite a bit. But from a longer-term perspective, on a two-year view, the world is still fairly short of energy. And if oil prices do come down, we will probably see the US re-stock its strategic reserves. So we think there is a floor for prices. We expect energy companies will still be able to generate very good cashflows, which they can do all the way down to oil at US$40 or US$50 a barrel.

What about industrial metals?

There is a lot of uncertainty over demand, and particularly over whether China will recover. However, copper markets are very tight. With stocks low, it is going to be difficult to find sufficient metal if demand recovers. There are larger stocks of aluminium, with more supply from China, which has led to price weakness. But there are also doubts over Russian aluminium supply, while smelter shutdowns in the West in response to high energy prices have meant the global market is now balanced and approaching a deficit. Simply put, this is a very uncertain period. I think there is a decent chance of a recovery in some industrial metals markets if we see any sign of demand increasing or a pause in de-stocking.

Where next for gold?

A stronger dollar has led to a weaker gold price – or, more specifically, a weaker USD gold price; in most other currencies, gold is near its highs because the US dollar has been so strong. But most other asset classes have been weak too, and there have not been massive outflows from gold. I think the risks for gold are now more to the upside than the downside. The equities of gold-producing companies, which I invest in, sold off a lot in 2022. In my view they look good value now, and we may see gold rebound quite strongly in 2023.

Overall, what's your commodity outlook for 2023?

After a very positive year for energy commodities, a question for investors is whether they should tilt more towards agricultural commodities or position for a recovery in metals. Conditions are very volatile and there is a lot of macro uncertainty. But while the next few months may be worrying, I think the next five years will be hugely exciting for commodity investors. The energy transition is going to present an enormous number of opportunities, driving structural demand for various metals and other commodities. On a longer-term view, I am more excited about commodities than I have been in many years.

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