Riding the supercycle

With commodities poised to play a key role in the transition to net zero, BRWM demonstrates the benefit of active management in this sector...

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Rightly or wrongly, investors love a catchy buzzword (or two) though admittedly some have more longevity than others. The Magnificent Seven polished off the FAANGs, the BRICS imploded when they admitted four new (vowel-starting) countries and let's not dwell on the GRANOLAS.

But it's time for the acronyms to step aside as there's a new kid on the block: the mega-trend. For the uninitiated, mega-trends have a sustained (and often irreversible) impact on a global scale and, as a result, are a hot topic among investors seeking to leverage long-term, structural tailwinds to drive superior returns.

One of the most far-reaching of the current mega-trends is undoubtedly the transition to clean energy, which may be more akin to a revolution than an evolution. More than 200 countries attended the recent COP28 summit in Dubai with the ambitious target of phasing out the use of fossil fuels to achieve net-zero emissions by 2050.

With commodities set to play a central role in this decarbonisation process, soaring demand for critical minerals could fuel a supercycle into the next decade and beyond.

Up, up, up and away

To be fair, commodities haven't always enjoyed universal popularity among investors, mainly due to their historic cyclicality but this might be about to change. The structural growth drivers underpinning the transition to green energy are expected to support commodity prices throughout the cycle, rather than being subject to the ebbs and flows of the global economy.

Rattling through some of the headline numbers, the International Energy Agency (IEA) forecasts that demand for critical minerals will rise by more than 350% by 2030 to meet net-zero targets. The primary growth drivers are battery storage systems and electric vehicles, in addition to low-emission power generation and electricity networks.

As we know, commodity prices are a function of supply and demand. On the supply side, there has been a decade or more of underinvestment, with the proportion of expansionary capex falling from 76% in 2012 to as little as 14% in 2019, according to RBC. There's also a considerable time lag to open new mines, with S&P Global reporting that the average mine takes 16 years from discovery to production, which will prevent a meaningful increase in supply over the next few years.

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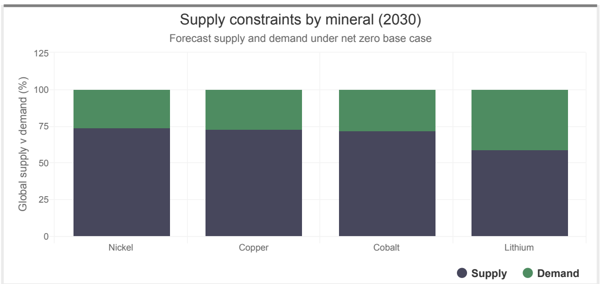
Factoring in the historic low in global inventories, supply constraints are therefore likely to support commodity prices over the longer-term. As shown in the chart below, the IEA is currently forecasting significant deficits in the supply of critical minerals by 2030 under its net-zero emissions by 2050 scenario.

Fig.1: Significant Supply Deficits Are Forecast For Nickel, Copper, Cobalt And Lithium



Source: Net Zero Roadmap, IEA, 2023 (based on demand and primary supply forecasts for 2030)

BlackRock World Mining (BRWM) offers a diversified portfolio of global mining stocks that are well-positioned to benefit from these structural growth drivers, balanced with exposure to precious metals to maximise total returns.

Managers Evy Hambro and Olivia Markham are currently overweight copper due to its critical role in the energy transition, with copper accounting for around a quarter of the portfolio. Copper is the most cost-effective conductive material for the capture, storage and transmission of renewable energy and, according to Goldman Sachs, demand for copper will soar by 600% by 2030 in its base case scenario (rising to 900% in the case of hyper adoption of green technologies).

With continued supply constraints, Goldman Sachs notes: "We see the copper market sleepwalking to a classic case of the 'revenge of the old economy', just as oil did during the 2000s commodity boom. We now estimate a long-term supply gap [of] twice the size of the gap that triggered the bull market in copper in the early 2000s."

Evy also spoke about the brown-to-green theme in our recent **webinar**, whereby mining companies are decarbonising their production processes. This could drive a re-rating in valuations if companies are able to charge a higher premium for low-emission products beyond the purity of the commodity itself.

Why active management matters

Commodities provide an opportunity to diversify into a different asset class to equities and the underlying commodities have often outperformed when equities have underperformed. As we explored in our recent **guide to investing in commodities**, they have also acted as an effective hedge against inflation on occasions.

The commodities sector itself is also diverse, from agricultural products to oil and gas, and base metals to precious metals in the mining sector. Each commodity has a unique set of supply and demand drivers, which can be a barrier to entry for retail investors without the requisite expertise.

As a result, this is a sector that lends itself well to active management. The managers of BRWM have the flexibility to invest across the broad universe of commodities and geographies, enabling them to tactically adjust exposures to exploit valuation opportunities.

By way of example, Evy and Olivia tilted the portfolio towards large-cap mining companies in 2023 with Glencore, BHP, Vale and Freeport-McMoRan comprising the four largest holdings (as at 30/04/2024). The managers feel that the size and strong balance sheets of these companies would enable them to weather any short-term volatility from weak economic growth in the major global economies.

Balance sheet strength is also a theme across the wider BRWM portfolio, with mining companies having demonstrated strong discipline in controlling capital expenditure and paying down debt. As a result, the European mining sector has an average net debt to EBITDA of 0.7 (as at 31/12/2023, Morgan Stanley), considerably below the average of most sectors.

BRWM also holds a significant position in gold miners due to the noticeable divergence between their share prices and the underlying gold price over the last year. Gold currently comprises around 18% of the portfolio, with holdings including Barrick Gold and Wheaton Precious Metals.

The benefit of active management is demonstrated by BRWM delivering a five-year net asset value total return of more than 110% (as at 28/05/2024), comfortably exceeding the return from the MSCI ACWI Metals & Mining Index. Although the trust does not have a progressive dividend policy, it will pay out most of annual net income in the form of dividends, with BRWM currently trading on an attractive dividend yield of 5.6% (as at 28/05/2024).

Looking forward, the sector is well-positioned to ride the tailwinds of strong demand for commodities to support the transition to net-zero. While investors should be cognisant of the higher inherent volatility of commodities, active management can help to protect capital during market downturns.The last word goes to legendary investor Jim Rogers, who advised: "Keep in mind that commodities' prices move not because of magic, but because of shifts in supply and demand. The price of a commodity will never go to zero."

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