

NAVIGATING THE COMMODITY CYCLE AMID TRADE UNCERTAINTY

Supply constraints and infrastructure growth drive a positive outlook for U.S. energy and commodities.

INVESTMENT VIEWS

FROM OUR PARTNERS AT NEWTON
INVESTMENT MANAGEMENT

Newton Global Natural
Resources Team

KEY POINTS

1 The uncertainty surrounding the current U.S. administration's evolving tariff and trade policies, and the ensuing trade war between the U.S. and China, has affected financial markets and investor sentiment, causing oil prices to dip due to fears of reduced energy demand and the risk of a recession.

2 The current commodity cycle is predominantly driven by supply constraints rather than demand factors, with tight supply and higher prices resulting from years of underinvestment in the oil and gas sector.

3 Despite the negative impact of tariffs, Newton believes there has been a positive trend in U.S. energy demand driven by the construction of new infrastructure, such as new plants and tech facilities, which can be demand-intensive.

The uncertainty surrounding the current U.S. administration's evolving tariff and trade policies, and the ensuing trade war between the U.S. and China, has rippled through financial markets, weighing on investor sentiment and fueling concerns over the direction of the global economy. While the White House generally excluded energy commodities from the extensive new import tariffs announced on April 2 — and largely paused a week later — energy markets were not immune from their impacts. Fears of reduced energy demand and the risk of a recession have caused oil prices to dip over the last few weeks. In addition, the

evolving nature of U.S. tariff policies have prompted energy executives to withhold spending, further dragging on demand.

Despite the recent underperformance, Newton's outlook on the oil and gas industry remains constructive. While sentiment has been weak, there has been no meaningful impact on demand at this point, according to industry data. We believe the supply-driven characteristics of the current commodity cycle, coupled with the U.S. administration's pro-growth stance, suggest that commodities are likely to see higher prices in the coming years.

Supply-driven commodity cycle

Actions by the current U.S. administration may sway commodity prices in the short term, with potential for both positive and negative effects; however, their overall impact on the long-term trajectory of the commodity cycle is likely to be minimal, in our view.

The commodities market tends to operate in cycles that typically span 10 to 12 years. Most recently, we ended a down cycle and began an up cycle in 2020, following the initial impact of the Covid-19 pandemic.

We are currently in year five of a cycle that has been predominantly driven by supply-versus-demand factors. Unlike the early 2000s, when economic expansion in China caused commodity demand to surge, this cycle has been a product of supply constraints. Following years of underinvestment, the lack of capital expenditure (CapEx) in the oil and gas sector has led to tight supply and higher prices. As companies continue to hold the line on CapEx in the wake of U.S. tariffs, we expect this trend to continue.

Infrastructure and demand growth potential

Despite the negative impact of tariffs, there has been a positive trend in U.S. energy demand, driven by the construction of new infrastructure. We see companies building new plants, tech facilities and production capabilities, which all can be demand-intensive. For instance, a multinational automotive giant just opened a new manufacturing facility for electric and hybrid vehicles in Georgia, representing the greatest single investment in the state's history. Large-scale infrastructure developments such as this could lead to increased demand for commodities.

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Natural gas and electricity demand

U.S. electricity demand grew in 2024 for the first time in two decades,* while the era of energy efficiency improvements — installing smart thermostats and switching to LED light bulbs — appears to be waning. We are now witnessing a return to a gross domestic product-linked electricity growth profile. Additionally, the rise of artificial intelligence (AI) has substantially boosted global electricity requirements.

In our opinion, natural gas has emerged as a key component in meeting this growing appetite for electricity in the short term. The natural-gas industry, particularly in the U.S., has seen an upsurge in consolidation in recent years, as companies aim to increase operational efficiencies, gain access to resources and reduce costs. The rise in merger-and-acquisition activity has led to an overall reduction in production and capacity, with more assets in the hands of large public companies that appear to be prioritizing financial performance and shareholder value over growth. By increasing capital discipline, and thereby by limiting investments in new projects, these companies may constrain overall supply.

Additionally, liquefied natural gas export capacity is expected to double over the next five years. The increase in outlets for supply is likely to put upward pressure on domestic natural-gas prices. Following a winter of frigid temperatures across much of the U.S., inventories are currently below five-year averages.**

Commodities vs. stocks

Commodities, as represented by the S&P GSCI, have recently broken a multi-year downtrend versus stocks, as represented by the S&P 500.¹ Newton believes that commodities have the potential to provide a compelling source of alpha and return generation. They may also offer risk mitigation during market downturns, as we saw during the sell-off in early April.

Oil equities are currently offering free cash flow yields of 12–15% at a \$70 per barrel oil price,² which is considered the floor price for oil, in our view. If the \$70 floor is accurate, as oil prices rise, these stocks are likely to become less expensive. Furthermore, it appears that company fundamentals have improved; many companies are now better managed and focused on return on capital, which may add to their potential upside. Additionally, relative to past oil sell-offs, we believe that the recent decline in oil equities is overdone.

The current U.S. administration's pro-U.S. growth agenda could lift demand for commodities, as could any fiscal stimulus that European and Chinese governments implement in response.

Key drivers of the commodities market

The commodities market is a dynamic and often unpredictable space, influenced by myriad factors ranging from geopolitical events to technological advancements. The current U.S. administration's pro-U.S. growth agenda could lift demand for commodities, as could any fiscal stimulus that European and Chinese governments implement in response. Conversely, U.S. tariffs and the ongoing trade conflict with China could drag on commodity demand.

While the uncertainty surrounding the U.S. administration's evolving policies has affected financial markets and investor sentiment, Newton believes the long-term trajectory of the commodity cycle remains largely unaffected. The market has been structurally undersupplied for years due to a lack of funding for new production, growth projects and infrastructure. In addition, the construction of new infrastructure and the rise of AI have driven positive trends in U.S. energy demand, particularly for natural gas and electricity. Newton believes these conditions are likely to support attractive commodity prices through 2025.

About Newton

Newton is the active equity investment firm within BNY Investments.

¹ Source: Bloomberg, April 29, 2025.

² Source: Newton, March 27, 2025.

* Source: U.S. Energy Information Administration, "After more than a decade of little change, U.S. electricity consumption is rising again," 5/13/25.

** Source: U.S. Energy Information Administration, Weekly Natural Gas Storage Report, 5/23/25.

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