

2025 Outlook

GLOBAL NATURAL RESOURCES: NAVIGATING THE MULTI-YEAR COMMODITIES CYCLE

INVESTMENT INSIGHTS
FROM OUR PARTNERS AT NEWTON
INVESTMENT MANAGEMENT

Cyclical and secular forces continue to support longer runways of growth for select commodities.

KEY POINTS

1 Commodities continue to offer a good source of diversification and income, especially in the current environment of more persistent inflation and higher interest rates.

2 Longer term, we continue to see investment opportunities across the natural-resources sector and foresee a tight supply/demand environment across select commodities in the coming years.

3 We believe this sector should continue to be a source of alpha and return generation when the opportunities and valuations are appropriate.

In our view, commodities continue to offer a good source of diversification and income, particularly in the current environment of persistent inflation and higher interest rates. As we look ahead to 2025, the range of returns across the commodity market and within its sectors remains broad, setting up a favorable environment for active managers to identify attractive alpha opportunities. We continue to believe that we are in the midst of a multi-year commodities cycle. In our opinion, despite ongoing volatility in the global natural resources sector, themes like decarbonization are likely to extend the investment horizons for these diverse assets.

We constantly monitor macroeconomic factors, including global and regional economic growth, interest rates and inflation. Our investment process and style remain consistent, and we

continue to look for opportunities where the commodity macroeconomic conditions and company-specific factors are aligned.

Early Days of a Commodity Bull Market

We continue to believe that we are in the early stages of a commodity bull market, supported by cyclical and secular forces with longer runways of growth. While these cycles tend to last about seven to ten years, we believe this current cycle could extend beyond the typical time frame, as the natural-resources sector has undergone a decade of underinvestment. The lack of funding for new production, growth projects and infrastructure has contributed to a structurally undersupplied market, which we believe should support higher commodity prices into 2025.

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While slowing economic growth in some regions has sparked demand concerns, affecting commodity prices, our outlook on the demand picture, particularly with oil, is far from doom and gloom. Over the past 25 years, oil demand has only contracted twice: first, during the 2008 global financial crisis, when the global financial system froze, and second, during the first quarter of 2020, when the Covid-19 pandemic shut down the global economy. In each case, demand rebounded quickly.

On the supply side, the Organization of the Petroleum Exporting Countries (OPEC) has effectively become the supplier of last resort, setting the floor at around \$70 per barrel for West Texas Intermediate (WTI) crude oil. If prices remain low, producers are likely to cut back on production. Recent earnings reports show that most producers have not increased their annual capital-expenditure (capex) or production guidance, suggesting that supply is likely to remain stable or decline, which should help balance the market. Additionally, many producers have become more disciplined in managing capital and production over the last decade, prioritizing balance-sheet improvements and capital return to shareholders over increasing production. As a result, oil could drop to \$50 per barrel, and these companies would still be free-cash-flow positive.

We believe gold and precious metals have the potential to provide defensive exposure in the event of a negative global economic shock or an abrupt reversal in central bank policy, although this is not our current “base case.” While we were previously bullish on gold, we now view it to be less favorable given falling interest rates.

Agriculture and Forest Products

Our long-term secular view on the agriculture sector remains favorable, as we believe food security and scarcity may be important topics in the coming years. However, we believe timing is important, given how much seasonality and inventory de-stocking can affect shorter-term stock price movement. We also favor the sector because agriculture and food demand tend to be more resilient during the peaks and valleys of economic cycles. Regardless of the pace or direction of monetary policy worldwide, the global population continues to grow; likewise, we believe food demand should continue to increase unabatedly. However, unstable growing conditions across various parts of the world could impede production. Across the globe, weather continues to be volatile, and we believe that climate change may be a structural driver for the agriculture sector.

We have become increasingly bullish on the paper sector, as demand growth, which has appeared to have bottomed, is starting to inflect higher and companies are now able to raise and maintain prices.

Energy

Despite depressed near-term investor sentiment on cyclical demand, we believe the fundamentally tight supply/demand dynamic within energy should continue, perhaps becoming more apparent in the coming years. For an accurate representation of the energy market, it is necessary to separate hearsay from reputable research and data. According to fundamental analysis, US demand for energy commodities (particularly for gasoline and distillates) is hovering near its five-to-ten-year average. Data from China also contradicts the downbeat market narrative, as Chinese import numbers remain near historical averages.

On the supply side, OPEC has worked effectively to regulate supply and seeks to remain in control. Russian production has started to fade, as Russia abides by broader OPEC production limits and as the ongoing war in Ukraine causes disruptions. Also, the US is running out of core, tier-one acreage in US shale, which should support global oil prices, in our view. We continue to believe there are attractive opportunities in companies with high-quality management teams that control top-tier energy assets, as well as in areas like oilfield services where near-full-capacity utilization has translated into positive earnings revisions.

Natural Gas

In our view, natural gas remains an appealing area of investment. While prices have historically been guided more by inventories and seasonal factors like weather, we believe cyclical and secular drivers should be more prominent in the future. Similar to oil companies, management teams at these companies are prioritizing balance-sheet discipline over production growth, which could limit capital expenditures and new supply coming online. While the price spike that occurred in 2022 may have been an outlier, we appear to be in a “stronger for longer” environment. We believe natural gas should also continue to gain recognition as an important bridge fuel for a decarbonizing world.

Metals and Mining

We continue to have an optimistic, yet selective, view on the metals and mining space. Concerns about global economic growth and mixed Chinese economic data have weighed on investor sentiment recently, and we believe these concerns are likely to persist until confidence in the demand outlook returns. In our experience, these periods of skepticism typically provide good entry points. Additionally, in previous periods of economic uncertainty and/or weakness, there typically have been inventory buildups and an overabundance of supply. Yet, during the current cycle, physical inventories across the metals sector have remained constrained owing to production hurdles.

Select metals and materials have more upside leverage, on both secular and structural levels, and we continue to be most constructive in our outlook for copper. Major producers, such as Chile, have experienced persistent production setbacks in recent years, and supply has struggled to meet demand. Structurally, copper-ore grade, or quality, has fallen steadily over the last 20 years.

We also maintain our positive outlook for uranium. As nuclear power gains further acceptance as a critical fuel on the path to zero emissions, we believe uranium could still be in the relatively early stages of an upward trend. Furthermore, after more than a decade of power-reactor closures following Japan's Fukushima disaster, global utilities and governments are again recognizing the advantages of nuclear power and delaying plant retirements. However, as the supply side has been in a bear market for the last decade, close to 30% of annual refined uranium today is derived from secondary supplies controlled largely by Russia. As global utilities draw down their inventories, we believe a procurement cycle may follow, which should drive prices higher. More recently, we have seen an uptick in power demand across the US, as artificial intelligence data centers pull more power from the grid. We believe nuclear energy, with its potential to deliver clean and reliable power, should be a key beneficiary of this increased demand.

Gold and Precious Metals

In the near term, we believe the price direction of gold and precious metals should largely be determined by monetary policy and whether recent geopolitical events escalate. Gold prices reached all-time highs in 2024 on anticipation that central banks, including the US Federal Reserve (Fed) would start to cut interest rates. Since September, the Fed has cut rates twice, and we took this opportunity to lower our exposure to gold-related securities. According to our analysis, the best time to reduce positioning is when the Fed is partially through a rate-cutting cycle. As we believe the next leg-up for gold is more challenging to predict, we have reallocated to areas with better prospects, in our view.

Longer term, we continue to see investment opportunities across the natural-resources sector and foresee a tight supply/demand environment across select commodities in the coming years.

Over the longer term, we continue to value exposure to gold and precious metals for diversification benefits, especially in periods of heightened economic, financial market and geopolitical volatility. While still not our current base case, we believe gold and precious metals have the potential to provide defensive exposure in the event of a negative global economic shock or an abrupt reversal in central bank policy. Through all periods, we believe selectivity in the space is key to identifying the best investment opportunities. We choose to invest in companies with high-quality assets, efficient operating models, fundamentally robust balance sheets and attractive, shareholder-friendly capital return programs.

Energy Transition

We continue to look for companies leveraged to the energy-transition sector, as we believe this is a long-term secular theme that should be a tailwind for years to come. We invest selectively, when appropriate, in utilities/developers, equipment manufacturers and grid integrators, as well as in energy-transition materials. We believe this sector should continue to be a source of alpha and return generation when the opportunities and valuations are appropriate.

Longer Runway for Growth

Longer term, we continue to see investment opportunities across the natural-resources sector and foresee a tight supply/demand environment across select commodities in the coming years. While inflation has moderated from peak levels, it continues to permeate throughout the global economy, and the supply response could take some time to alleviate these pressures. We believe the rise of environmental, social and governance (ESG) matters should continue to distort price signals to commodity producers, thereby exacerbating supply shortfalls. Our investment process and style remain unchanged, and we continue to seek investments in areas where the commodity macroeconomic and company-specific factors are aligned. In our view, the sector remains a strong source of overall strategy diversification, inflation protection and dividend yield generation.

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