ALPS | CoreCommodity Management CompleteCommodities® Strategy Fund

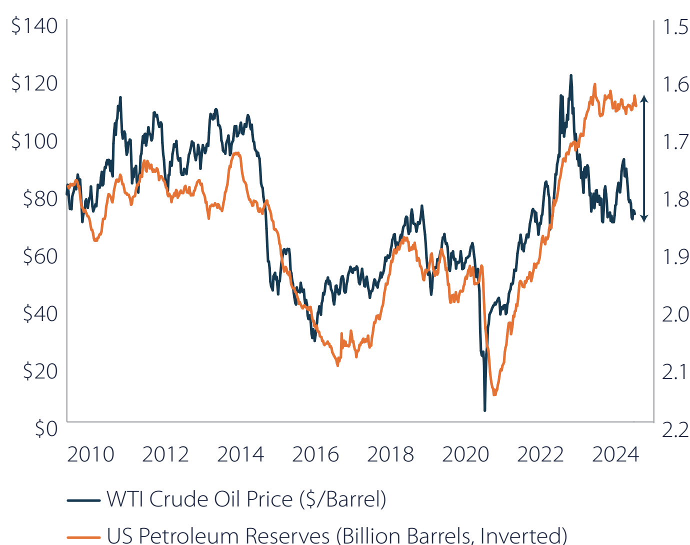
2024 Commodity Outlook | January 2024

2023 was a particularly difficult year for market forecasts. It is never easy to predict the future, but the price action last year surprised market participants on many fronts and continually defied expectations as the seasons progressed. Consensus views were punished, sometimes severely. That said, we are optimistic about the forward outlook for the asset class.

Macro | Several weeks into the new year, the macroeconomic setup for commodities looks accommodative, marking a stark contrast from late-2022 and much of 2023. Last year, the Federal Reserve (Fed) raised rates an additional 100 basis points, the United States experienced a brief but impactful sequence of bank failures, Chinese sentiment soured and most of the Eurozone flirted with a technical recession. Today, many of the headwinds that persisted over the past 18 months have diminished, allowing for market fundamentals to dictate price action once again.

The American economy appears to be transitioning from a mid to late expansionary phase of the business cycle, which, historically, has been the most advantageous period to own commodity exposure. Common to late-cycle periods of the past, economic activity is growing but at a slower pace, consumption is healthy, inflation is elevated (albeit down significantly from the peak), capacity is constrained and labor is tight. Importantly, monetary policy is now easing which may bolster economic activity and encourage inventory restocking. An unwillingness to hold inventory due to high capital costs was a primary reason for available supply and physical weakness in the past year. Now that stockpiles have drawn down considerably across the complex and the Federal Open Market Committee (FOMC) is forecasting a series of rate cuts, we anticipate that pressure to ease (see Figure A).

Figure A: Low Reserves Present Upside Price Risk



Source: EIA, Jan 2010 – Jan 2024

Energy | The energy sector is well-positioned heading into 2024. The price action for crude oil, petroleum products and natural gas was decidedly negative in the fourth quarter of last year, perhaps laying the groundwork for a more supported recovery. The latest projections from the Energy Information Administration (EIA) call for global oil demand to expand at a rate of 1.4 million barrels per day (mbd) this year (400kbd above trend) and for the global balance to maintain a sizeable 800kbd deficit through the end of the first quarter.[1] Demand should benefit from recovering international air travel and sound emerging market growth. Supply is expected to waver as US shale matures, OPEC+ maintains heavy cuts under the market and the Treasury Department imposes stricter enforcement of Russian and Iranian sanctions. While we are less constructive on natural gas fundamentals, low investor positioning and polar vortex conditions have led to a rally in the first few weeks of January. As the winter season progresses, gas upside may be limited given inventories are well above the historical average for this time of the year. Further out, the domestic market should benefit as more liquefied natural gas (LNG) capacity is brought online, amounting to a nearly 50% increase in baseload capacity by the end of 2025.[2]

Although oil prices may be kept in check by elevated spare capacity in certain OPEC+ nations, recent geopolitical developments raise the prospect of a tail-risk event in the energy market. Libya's top oil field recently fell under force majeure due to social unrest, Guyana's vast offshore project is subject to a border dispute with Venezuela, and most notably, confrontation in the Red Sea is intensifying. The Suez Canal, the SUMED pipeline and the Bab el-Mandeb Strait are strategic routes for international energy flows. Together these Red Sea chokepoints account for roughly 12% of total seaborne oil trade and 8% of total LNG trade. Due east of the Red Sea and subject to Iranian influence, the Strait of Hormuz accommodates 20-30% of the global oil market. The impact on physical barrels is being felt already through a rapid increase in shipping costs; however, transportation aside, very little (if any) geopolitical premium is priced into the market. We believe cross-border conflict has the potential to escalate and may hold greater influence over price until tensions cool.

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[1] *Source: EIA, Energy Institute, as of Jan 2024. Trend growth equals the average annual increase in global oil consumption between 1990 – 2022*

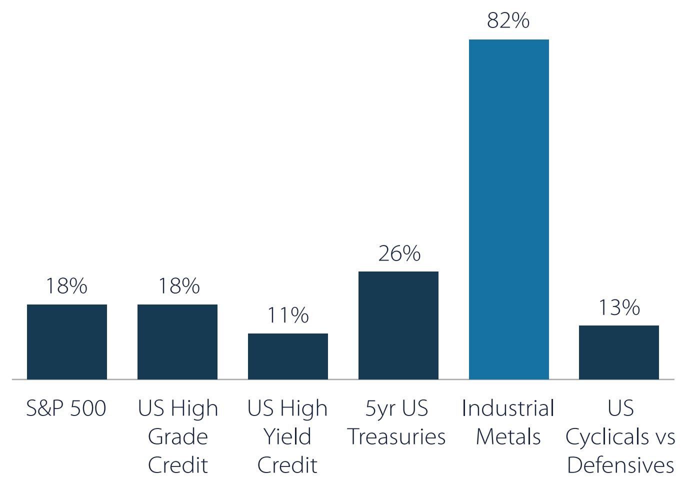
[2] *Source: EIA, "US Liquefaction Capacity Workbook", as of Oct 2023*

Agriculture | In the agriculture space, opportunities exist on a commodity-by-commodity basis and vary considerably between each market. For instance, while diversified commodity performance as measured by the Bloomberg Commodity Index was negative in 2023 (-7.9%), certain soft agricultural products rose to multi-decade highs. Sugar advanced 19%, cocoa prices climbed 69% and frozen concentrated orange juice was up an impressive 104%. For the year ahead, we have pared back projections in those markets nearing a cyclical peak given the threat of demand destruction and speculative positioning. Contrary to the petroleum complex, most grains and oilseeds are well supplied and have recovered from the lingering consequences of the Russia-Ukraine War. El Niño is expected to remain strong into the first quarter but may wane as the year progresses, potentially offering relief to certain equatorial crops. US dollar strength has subsided which may benefit farmers in lifting export sales. The outlook for sugar is favorable as prices have come down sharply and supplies remain challenged by export restrictions.

Longer-term, we see changes in policy, demographics, and climate playing a more acute role in these markets. As of December 2023, the World Bank tracked 27 food export bans and 17 additional export-limiting measures around the globe. Protectionist policies have become more frequent since the COVID-19 pandemic and raise food costs outside the target country. Key markets to watch that are subject to restrictions include onions, sugar, rice, wheat and beef, among others. In considering risks to the sector, severe weather remains a leading concern. The US endured a record number of climate disasters (causing $1 billion or more in damage) in 2023, a worrying trend that has accelerated in the past decade.[3] With severe weather comes lower crop yields and greater prevalence of disease.

Industrial Metals | One of the most common predictions at the onset of 2023 was the call for an imminent US recession. So far, that outcome has been avoided; however, a recession of sorts did manifest in the price of materials like copper, nickel and zinc (see Figure B). Since then, most industrial metals have stagnated in a holding pattern at or just above the marginal cost of production. The implications are severalfold. First, at such high prevailing interest rates, most visible inventories have been exhausted. This leaves markets like copper and aluminum subject to supply-side shocks given little-to-no buffer. Second, at such low prices, suppliers have started to shut down the more expensive mines, smelters and refineries within their operations. In December alone, roughly 3% of copper mine supply was taken offline indefinitely.[4] For a market that trades on the margin, 3% is a significant shift in the supply/demand balance. Producer economics have struggled as mining assets age, ore quality degrades, labor disputes increase and bureaucracy stifles the onboarding of prospective projects. The latest copper mines that entered operation between 2019 and 2022 had an astonishing average lead time of 23 years from discovery to commercial production.[5] Above all else, the amount of capital needed to sufficiently supply the market hasn't surfaced. A tally of the world's top 30 miners indicates capital expenditures are still 25% below the 2013 peak, a major shortfall given accelerated demand forecasts.[6]

Figure B: Recession Probability Pricing Across Different Asset Classes



Source: J.P. Morgan, as of 11/22/2023

Considering the slump in prices and various struggles facing the global mining community, we are positive on the sector. We acknowledge a sustained rally may be limited in the near-term until construction and industrial activity recovers, particularly among developed economies, but it is our view that the outlook improves meaningfully over longer timeframes. The Chinese economy is not out of the woods just yet, but the latest fiscal stimulus measures indicate the Chinese Communist Party will do what is necessary to achieve growth targets. Raising the fiscal deficit ratio and potentially issuing 1 trillion yuan in ultra-long sovereign debt together represent an aggressive commitment to economic stability.

We are particularly bullish on those metals with high "green" penetration given the transition to an electrified energy system is fully underway. Thanks to the COP28 summit in Dubai, over 100 governments have pledged to triple renewable energy capacity by 2030. China has led the transition, having commissioned as much solar PV in 2023 as the entire world did in 2022.[7] Amid lower global growth, these green sources have proven capable of keeping demand for base metals climbing at a healthy pace.

[3] *Source: NOAA, "Annual 2023 US Climate Report", as of Jan 2024*

[4] *Source: MiningWeekly, "The world's copper supply is suddenly looking scarce", Dec 2023*

[5] *Source: S&P Global Market Intelligence, as of Feb 2023*

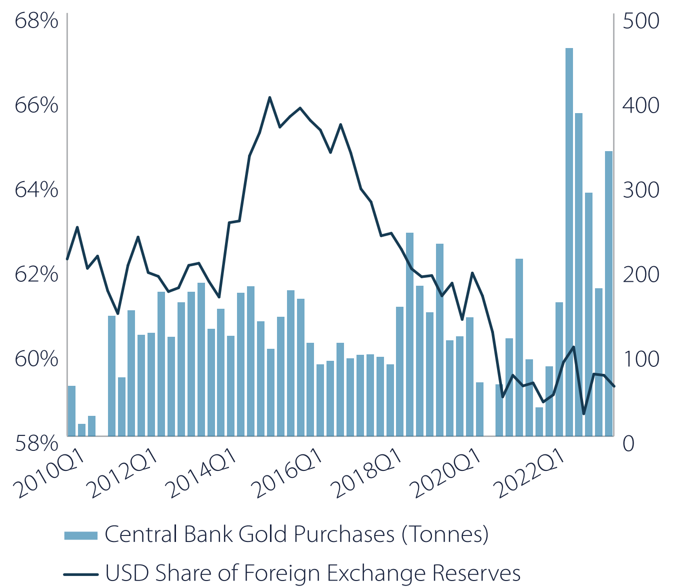
[6] *Source: S&P Global Market Intelligence, as of Oct 2023*

[7] *Source: IEA, "Renewables 2023", Jan 2024*

Precious Metals | Historically, a decline in the level of real interest rates has coincided with a higher price for precious metals like gold and silver. Lower carrying costs as well as ancillary effects on the US dollar typically bode well for the sector and for that we are generally bullish. However, we also acknowledge the rally into year-end 2023, triggered by dovish Fed projections, may have taken some of the upside out of the market in the short-term. Commentary from the FOMC has continued to push a "higher-for-longer" narrative, and we have little reason to question that trajectory until there is proof of labor market deterioration and sustained disinflation near the established target.

Beyond the influence of rates, retail and wholesale demand for gold is improving in China and India with a near-term boost from certain seasonal forces. October through March generally represents peak-demand season in Asia, coinciding with Golden Week, Diwali and Chinese New Year. Regional premia commanded by Asian buyers suggests physical demand is strong; but, given near-record prices, retail demand for gold bars, coins and jewelry may wane after the holiday rush. On a structural basis, a surge in central bank buying appears to be a more lasting tailwind for the sector. Reserve diversification, especially since the latest barrage of Russian sanctions, has intensified among emerging and developing economies (see Figure C). Rising militarization and geopolitical division points to greater gold reserves ahead, replacing, in part, US currency and Treasuries.

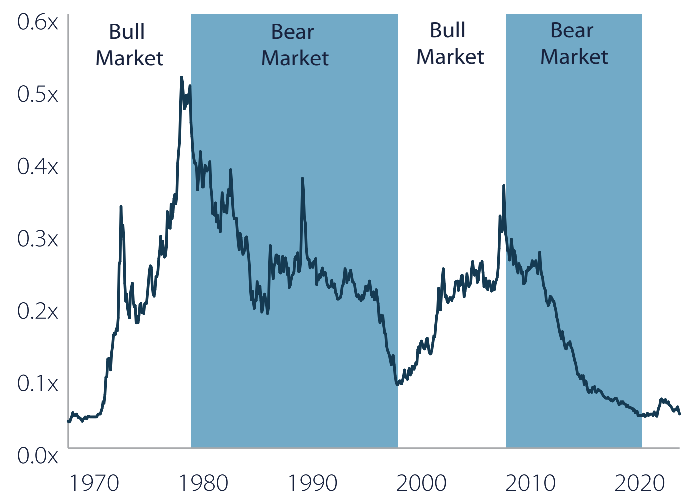
Figure C: Reserve Diversification Sacrifices Dollars for Gold



Source: World Gold Council, IMF, Jan 2010 – Sep 2023. Quarterly frequency

Closing Comments | In general, there are many outside forces that can and will have a material effect on the price of commodities this year. The fundamental balance for most markets is still favorable as inventories are low based on historical standards and producers are battling a wave of challenges. The latest economic readings indicate a "hard landing" for the global economy is less of a threat than previously feared, and investor positioning in traditional equity and fixed income markets certainly reflects a rosier outlook. If economic activity were to suffer well beyond expectations, commodity prices are not immune to weakness; however, the depressed price level at which we currently reside implies much of the downside may already be embedded (see Figure D).

Figure D: Ratio of Commodities to Equities



Source: Bloomberg, CoreCommodity, Jan 1970 – Dec 2023. Commodities are represented by the Bloomberg Commodity Index Total Return. Equities are represented by the S&P 500 Index.

In addition to rhetoric from the FOMC, we remain attuned to the growing list of conflict zones around the map. On the political front, 2024 is slated to be an incredibly important year with more than 60 different elections taking place around the globe. Now more than ever, food and energy security are top of mind for our politicians and legislators. If the political winds keep blowing in the direction of onshoring, deglobalization, and isolationism experienced in recent years, commodity supply chains may endure greater disruption.

The possibility of a more protracted slowdown in China poses a risk to our outlook and must be monitored closely; nonetheless, imports of industrial metals, energy and agriculture products have increased through this period of uncertainty. China has been the predominant exporter of deflation since joining the World Trade Organization in 2001 via low-cost labor and an industrial complex more than 2.5 times the size of the American manufacturing sector.[8] Foreign direct investment in the country has cratered and Western nations have increasingly distanced themselves from Chinese reach. The paradigm shift is being felt in freight costs, material/processing shortages and wage gains. This, among other trends identified here, is likely to lift the general price of goods and natural resources for some time, bolstering the case for real assets.

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[8] *Source: United Nations, as of 2023*

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Bear Market: a condition where a market experiences prolonged price declines, usually when securities prices fall 20% or more from recent highs amid widespread pessimism and negative investor sentiment.

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Bull Market: a financial market in which prices are trending upward or are expected to trend upward.

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