Natural Resource Equities

Undervalued, Under-Owned and Underestimated | August 2024

Current Market Dynamics

Currently, the S&P 500 Index is more top-heavy than it has been in a generation, with the top 10 holdings capturing more than a third of the total market share, substantially more than that experienced during the Dot-Com Bubble (Figure A).[1] In light of such narrow positioning, investors may be far less diversified within their equity portfolios, as well as from an overall asset allocation standpoint.

While timing is rarely precise, extreme consolidation of the past has often led to mean reversion.[2] Either higher-beta outperformers retrace to more reasonable valuations, or the rally broadens to incorporate other industry groups. Both scenarios warrant a search for overlooked market segments and, at present, few sectors boast as strong a case as natural resources in our opinion. From both a quality and risk-mitigation standpoint, we believe natural resource equities are well-positioned and may benefit from a host of secular demand drivers.

Figure A: Weight of Largest 10 Stocks, % of S&P 500 Index[1]

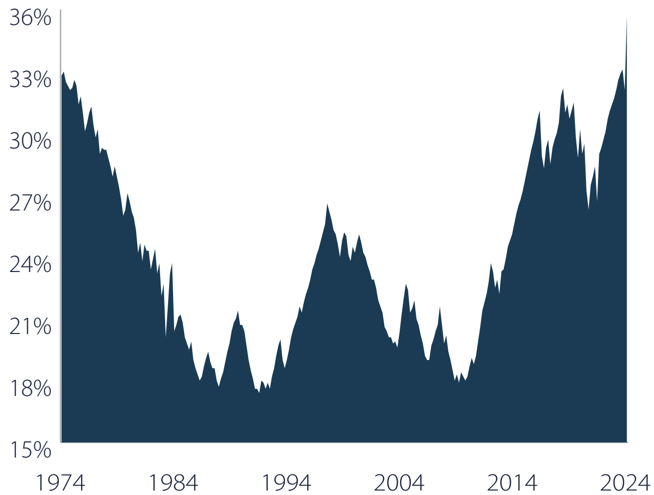
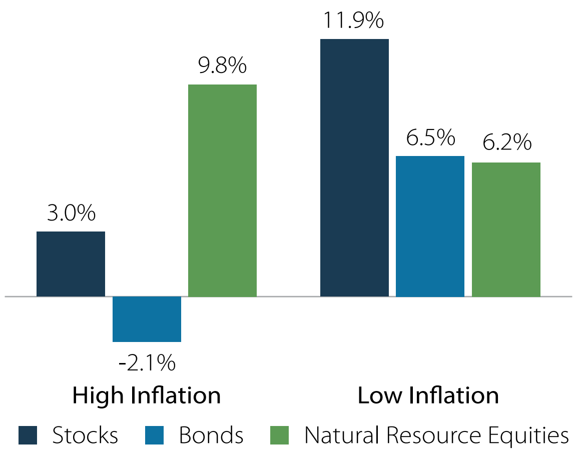


Figure B: Average Annual Total Return Since 1961, Inflation-Adjusted[3]



Traditional Benefits

Natural resources, primarily within the energy, materials and industrials sectors, have historically filled three critical roles in a diversified portfolio: inflation hedge, diversifier and performance driver. Compared to other asset classes associated with high inflation sensitivity, such as real estate and infrastructure, natural resource equities have exhibited a higher beta and correlation to the Consumer Price Index (CPI). In a study going back to the 1960s, they significantly outperformed both stocks and bonds during periods of above-average inflation (Figure B).[3]

As diversifiers, they have exhibited low correlation with other asset classes, with the energy sector now having the lowest beta (0.4) to the S&P 500 among all primary sectors.[4] For reference, the beta of the technology sector is currently 1.5. As performance drivers, natural resource equities have delivered strong returns over time, with the S&P Global Natural Resources Index achieving an average annualized return of 8.1% since its inception in 2002.[5]

[1] Source (Figure A): JP Morgan, Bloomberg, 1/1/1974 – 6/30/2024

[2] Source: S&P Dow Jones Indices, "Concentration within Sectors and Its Implications for Equal Weighting", February 2022

[3] Source (Figure B): Bloomberg, Robert J. Shiller and CoreCommodity, 1/31/1961 – 6/30/2024. Stocks represented by the S&P 500 Index; Bonds represented by 10-Year US Treasuries; Inflation is the US Consumer Price Index (CPI) and "high" or "low" is relative to the trailing 10-year average.

[4] Source: S&P Dow Jones Indices, as of 6/30/2024. Represents the trailing 1-year beta of daily returns to the S&P 500 Index.

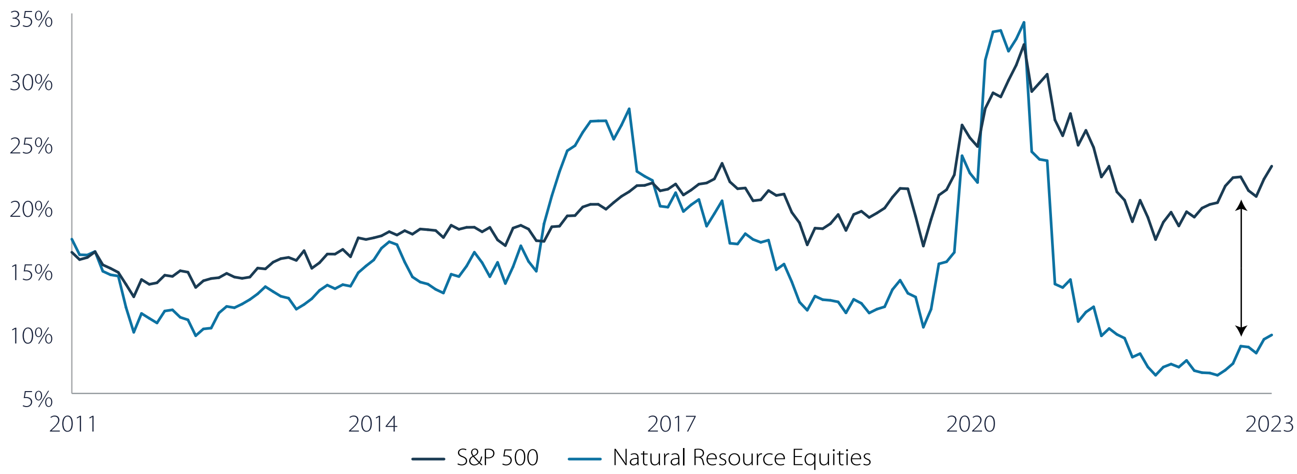
[5] Source: Bloomberg, 11/30/2022 – 6/30/2024

Undervalued

By most measures, energy, mining and agricultural companies represent high-quality names at low relative cost. Currently, natural resources are attractively priced versus the S&P 500 and their historical range, with a trailing 12-month price-to-earnings ratio of 12.2, compared to 25.6 for the broader index (Figure C).[6] The very same phenomenon exists for other multiples such as price-to-book, price-to-sales, and enterprise value-to-earnings.

Management teams are increasingly paying down debt, issuing dividends and repurchasing shares. Without adequate compensation from the market, more cash flow is being channeled toward shareholder returns and away from new production capacity. Consequently, the dividend yield for natural resources is among the highest across all sectors, nearly triple that of the S&P 500, 3.9% versus 1.3%.[7] Attractive valuations have also driven inorganic growth through acquisitions, with insiders recognizing value where others have grown complacent.

Figure C: Current P/E Ratio[6]



Under-owned

Despite attractive valuations and rising free cash flow, representation among major equity indices has plummeted to record lows. Companies like Microsoft, Nvidia and Apple each hold a larger share of the S&P 500 than the entire energy (3.6%) and materials (2.2%) sectors combined.[7] A key factor contributing to low representation is the weighting scheme of major equity indices. Allocation by market cap has favored long-duration sectors like technology and pharmaceuticals, which derive most of their value from long-dated revenue projections. Once near-zero interest rate policies of the 2010s were enacted, "new economy" industries experienced aggressive multiple expansion, leaving behind "old economy" industries like exploration, mining and agriculture. Today, with a lower average market cap, natural resources are positioned advantageously, as smaller stocks typically have greater potential for price appreciation and may benefit more from a potential sector rotation.

6 *Source (Figure C): Bloomberg, 1/31/2011 – 12/31/2023. Natural Resource Equities represented by the S&P Global Natural Resources Index.*

7 *Source: Bloomberg, as of 6/30/2024*

Underestimated

The final component of the value proposition for natural resources is the supportive macro environment. Numerous trends suggest a bullish outlook for the sector, with significant potential to boost natural resource prices and the profitability of natural resource companies. Here, we will briefly highlight three of the more prominent themes we believe are most relevant over the coming years:

Decarbonization
Eradicating carbon emissions from the global economy is projected to be the most costly and coordinated endeavor in human history. According to BloombergNEF, $1.8 trillion was invested in energy transition technologies in 2023, marking a new all-time high and a 17% year-over-year gain. Despite this effort, the report culminated with a sobering conclusion: to align with the net zero goals established in the 2016 Paris Agreement, global investment must triple to an average of $4.9 trillion per year between 2024 and 2030. This figure needs to rise to $6.6 trillion annually in the 2030s and $7.6 trillion in the 2040s.[8] Staggering projections underscore the immense scale of the transition and highlight the resource-intensive nature of such an endeavor. Collectively, renewable energy, hydrogen, battery technology, electrified transport, grid expansion and many other low-carbon technologies have already begun to trigger a paradigm shift in resource consumption (Figure D).[9]

Figure D: Projected Demand Growth from Clean Technology, 2023 - 2040[9]

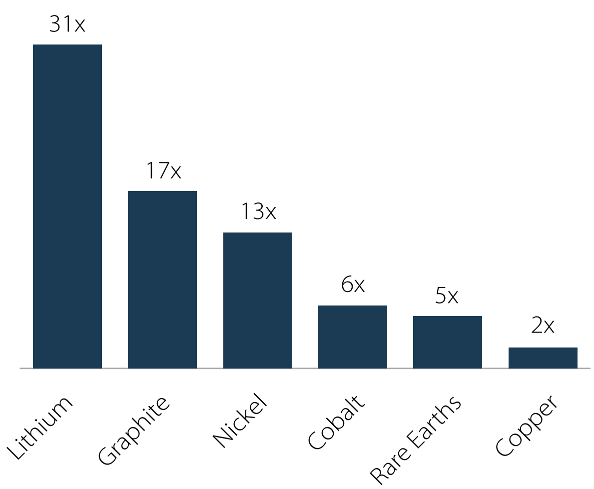
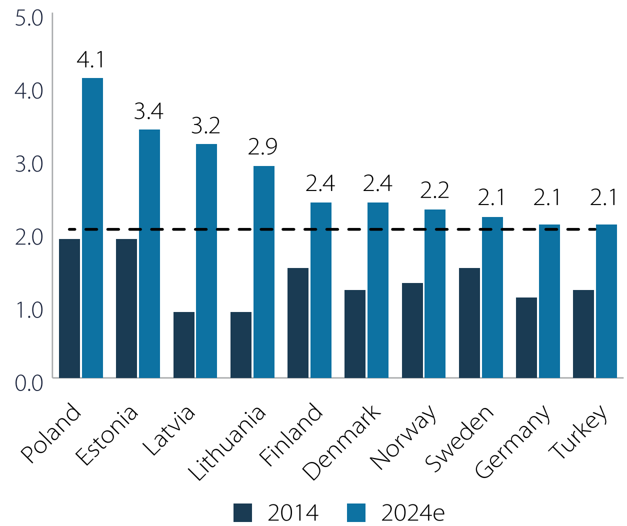


Figure E: Russia Fuels Global War Machine Defense Spending, % of GDP[10]



Deglobalization
As the global energy mix evolves, the geopolitical landscape is also undergoing significant shifts. Historically, competition for finite resources has always been a factor, but the race to develop advanced technologies like artificial intelligence has strained trade relations to the point of fracture. For many sectors within financial markets, this presents substantial risks. However, companies involved in upstream production and those with high-quality deposits may stand to gain immensely. The major conflicts between Russia-Ukraine and Israel-Hamas might be early indicators of larger issues. These regional wars are already prompting an international response through increased military spending and rearmament (Figure E).[10]

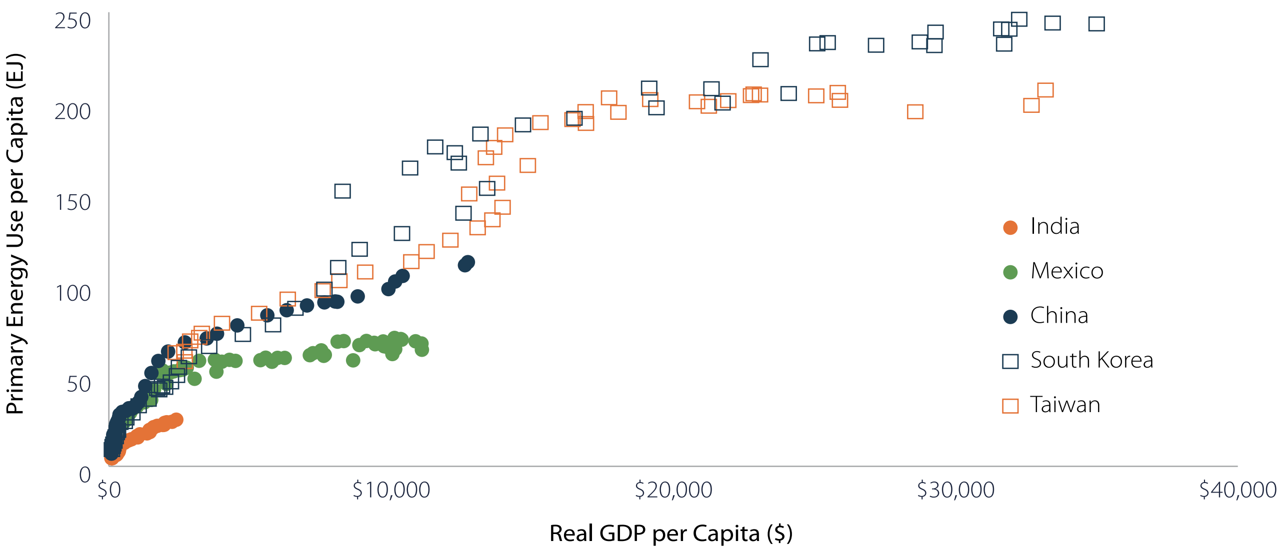
Beyond physical conflicts, cold war tactics such as export restrictions and sanctions also underscore the need for countries to reindustrialize. Since the initial Russian incursion, total construction spending in the US has doubled. Moreover, since the first US-China Trade War in 2018, total spending has more than tripled.[11] A more polarized world could benefit natural resource equities through two distinct channels: rising demand for strategic materials and supply-led price shocks. Overall, recent geopolitical trends may justify a premium for energy, mining and agriculture suppliers over the course of the next decade.

[8] *Source: BloombergNEF, "Energy Transition Investment Trends 2024", January 2024*
[9] *Source (Figure D): IEA, "Global Critical Minerals Outlook 2024", May 2024*
[10] *Source (Figure E): NATO, 2014 – 2024, defense expenditures based on 2015 prices and exchange rates. 2024 represents latest estimate.*
[11] *Source: United States Census Bureau, February 2022 – June 2024 (Russian incursion) and December 2018 – June 2024 (US-China Trade War)*

Demographics

Lastly, perhaps the most underappreciated driver may be the slow, yet critical change in demographics. The world's middle class is already the largest spending group and the driving force behind increased consumption of goods and materials. But as developing countries, particularly in Asia, industrialize and acquire wealth, this cohort is expected to add another 700 million people by 2030.[12] With greater spending power comes greater consumption of raw materials (Figure F).[13] Bikes become automobiles, grains become proteins and power-hungry amenities are added like air conditioning, lighting and grid connectivity.

Figure F: Greater Wealth Equals Greater Energy Use, per Capita[12]



Final Comments

Currently, many equity investors lack exposure to the natural resources sector, but the structural growth opportunity it presents is significant. The world is transitioning from an era of commodity abundance to one of undersupply, which may result in substantial returns for resource producers over the next decade. In our view, natural resource equities offer a unique asset class that combines the benefits of real assets and equities, providing alternative exposure with ample liquidity. Given the current market dynamics and the potential for sector rotation, we believe natural resource equities represent a compelling opportunity for traditional equity investors looking to diversify and participate in today's most exciting investment themes.

Nicholas Schwartz, CFA
CoreCommodity Management, LLC

[12] Source (Figure F): Brookings Institution, 2021
[13] Source: Energy Institute, World Bank 1965 – 2022

Important Disclosures & Definitions

An investor should consider the investment objectives, risks, charges and expenses carefully before investing. To obtain a prospectus containing this and other information, call 1-866-759-5679 or visit www.alpsfunds.com. Read the prospectus carefully before investing.

Shares of ETFs are bought and sold at market price (not NAV) and are not individually redeemable.

All investments are subject to risks, including the loss of money and the possible loss of the entire principal amount invested. Additional information regarding the risks of this investment is available in the prospectus.

The ALPS | CoreCommodity Natural Resources ETF is new and has limited operating history.

Diversification does not eliminate the risk of experiencing investment losses.

ALPS | CoreCommodity Management CompleteCommodities Strategy Fund Risks: the commodities markets and the prices of various commodities may fluctuate widely based on a variety of factors. Because the Fund's performance is linked to the performance of highly volatile commodities, investors should consider purchasing shares of the Fund only as part of an overall diversified portfolio and should be willing to assume the risks of potentially significant fluctuations in the value of the Fund. The Fund invests in commodity futures related investments, which are derivative instruments that allow access to a diversified portfolio of commodities without committing substantial amounts of capital. Additional risks of commodity futures related investments include liquidity risk and counterparty credit risk. Liquidity risk is the risk stemming from the lack of marketability of an investment that cannot be bought or sold quickly enough to prevent or minimize a loss. Counterparty risk is the risk that a party to a transaction will fail to fulfill its obligations. The term is often applied specifically to swap agreements in which no clearinghouse guarantees the performance of the contract. Another principal risk of investing in the Fund is equity risk, which is the risk that the value of the securities held by the Fund will fall due to general market and economic conditions, perceptions regarding the industries in which the issuers of securities held by the Fund participate or factors relating to specific companies in which the Fund invests. The Fund's investments in non-US issuers may be even more volatile and may present more risks than investments in US issuers. Equity investments in commodity-related companies may not move in the same direction and to the same extent as the underlying commodities.

ALPS | CoreCommodity Natural Resources ETF Risks: the Fund's investments in securities of natural resource companies involve risks. The market value of securities of natural resource companies may be affected by numerous factors, including changes in overall market movements; economic, geographical or financial events; events occurring in nature; inflationary pressures; and domestic and international politics. Because the Fund invests significantly in natural resource companies, there is the risk that the Fund will perform poorly during a downturn in the natural resource sector. Certain natural resources may be produced in a limited number of countries and may be controlled by a small number of producers. As a result, political, economic and supply related events in such countries could have a disproportionate impact on the prices of such natural resources and the value of securities of companies involved in such natural resource. Another principal risk of investing in the Fund is equity risk, which is the risk that the value of the securities held by the Fund will fall due to general market and economic conditions, perceptions regarding the industries in which the issuers of securities held by the Fund participate or factors relating to specific companies in which the Fund invests. The Fund's investments in non-US issuers may be even more volatile and may present more risks than investments in US issuers. Equity investments in natural resources-related companies may not move in the same direction and to the same extent as the underlying natural resources.

Beta: a measure of the volatility, or systematic risk, of a security or a portfolio in comparison to the market or a benchmark. The beta of the market or benchmark is 1.00 by definition. An investment with a beta above 1 is more volatile than the overall market, while an investment with a beta below 1 is less volatile.

Consumer Price Index (CPI): a measure of the average change over time in the prices paid by urban consumers for a representative basket of consumer goods and services.

Dividend Yield: a financial ratio that shows how much a Fund pays out in dividends each year relative to its share price.

Mean Reversion: a theory used in finance that suggests that asset price volatility and historical returns eventually will revert to the long-run mean or average level of the entire dataset.

Price/Book (P/B) Ratio: the weighted average of the price/book ratios of all the stocks in a portfolio. The P/B ratio of a company is calculated by dividing the market price of its stock by the company's per-share book value.

Price/Earnings (P/E) Ratio: a valuation ratio of a company's current share price compared to its per-share earnings.

Price/Sales (P/S) Ratio: represents the weighted average of the price/sales ratios of the stocks in a portfolio. Price/sales represent the amount an investor is willing to pay for a dollar generated from a particular company's operations.

S&P 500 Index: consists of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500 is designed to be a leading indicator of US equities and is meant to reflect the risk/return characteristics of the large cap universe.

S&P Global Natural Resources Index: includes 90 of the largest publicly-traded companies in natural resources and commodities businesses that meet specific investability requirements, offering investors diversified and investable equity exposure across 3 primary commodity-related sectors: agribusiness, energy and metals & mining.

One may not invest directly in an index.

ALPS | CoreCommodity Management CompleteCommodities Strategy Fund Advisers and Affiliation: ALPS Advisors, Inc. and CoreCommodity Management, LLC are registered with the CFTC as the Commodity Pool Operator and, respectively, as the Commodity Trading Advisor. Both ALPS Advisors, Inc. and CoreCommodity Management, LLC are NFA members. ALPS Advisors, Inc. and CoreCommodity Management, LLC, registered investment advisers with the SEC, are the investment adviser and sub-adviser to the Fund, respectively. ALPS Advisors, Inc., ALPS Distributors, Inc. and ALPS Portfolio Solutions Distributor, Inc., affiliated entities, are unaffiliated with CoreCommodity Management, LLC. CoreCommodity Management, LLC serves as investment adviser to the Fund's Cayman Islands subsidiary. "CompleteCommodities" is a service mark of CoreCommodity Management, LLC.

ALPS | CoreCommodity Natural Resources ETF Advisers and Affiliation: ALPS Advisors, Inc. and CoreCommodity Management, LLC, registered investment advisers with the SEC, are the investment adviser and sub-adviser to the Fund, respectively. ALPS Advisors, Inc. and ALPS Portfolio Solutions Distributor, Inc., affiliated entities, are unaffiliated with CoreCommodity Management, LLC.

ALPS Portfolio Solutions Distributor, Inc. is the distributor for the Funds.

Not FDIC Insured • No Bank Guarantee • May Lose Value

JCN000115 2/28/2025