MAERKI BAUMANN & CO. AG

PRIVATBANK

The benefits of commodity investments

Market Comment, September 2022

This year is being shaped by inflation and interest rate hikes. Are there ways to benefit from this environment? At Maerki Baumann, we offer different modules for positioning yourself. Commodities as investments are unlikely to be only temporary in nature: As far back as the 1970s, it became apparent that commodity investments can play an important role during phases of marked interest rate hikes, serving to diversify a portfolio's overall make-up. In times of above-average rates of inflation by historical standards, commodity investments are important as part of a diversified portfolio. We offer a diversified commodity mandate as a complementary investment module, which has succeeded in generating a very good relative performance versus the benchmark both during 2022 and when viewed over several years.

Investing in commodities during times of heightened inflation makes particular sense. After all, it is important to counter the pressure that is weighing on both equities and bonds this year as a result of steadily rising consumer prices and interest rate hikes. The fact that this pays off can be seen from the performance posted by the various asset classes since the turn of the year: While the global Bloomberg Commodity Index is up around 15%, equities have fallen around 15% as measured by the world index, and bonds are also down by approximately 10% to 15%!

Indeed, the decade-long downtrend observed for commodities came to an end last year: A new upward cycle began on precisely 1 January 2021. This is true from both a chart and fundamental perspective. The fundamental analytical background to this development is that the global supply of available commodities has fallen below demand for the following reasons:

Firstly, the demand for energy commodities and industrial metals, in particular, was underestimated by the overall financial market consensus. While it is rare for the financial market consensus to be wrong, when it is, it can find itself a long way wide of the mark! In the case of an electric car for example, electrification leads to demand for copper that is around five times greater than in the case of a vehicle with a combustion engine.

Secondly, the digitisation of the global economy is gathering speed and requires rare earths and geostrategically important metals such as lithium or aluminium.

Thirdly (and particularly importantly), the supply of raw materials, and especially fossil energy, continues to be incorrectly assessed. Due to ESG-related concerns and pressure from institutional investors, investment activities in the area of global commodity production were curtailed for many years, with this being most notably the case for fossil energies, nuclear power and important industrial metals. The geopolitically required reduction of the West's dependence on commodities from Russia and China has only just begun and will necessitate enormous investments that will not be feasible without the large Western commodity firms. The world is only just waking up to the situation, especially with the spectre of a Northern Hemisphere winter looming...

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> Gérard Piasko, Chief Investment Officer

The four commodity sub-groups do not always perform in parallel. This year, for example, the rise of the US dollar to a 20-year high is temporarily weighing on the **precious metals sector, with gold being no exception**. The **industrial metals** sub-group rose too sharply during the first quarter, meaning that a healthy consolidation has been observed in recent times, partly in connection with weaker economic growth in China, which accounts for an important share of, albeit not all, global demand for various industrial metals. Following a sharp correction typical of this sub-group, **agricultural commodities** have benefited from the summer drought. Agricultural products are generally weather-dependent, however, and thus also especially volatile. In the **energy commodities** subgroup, many appear interesting over the long term following a cyclical consolidation phase, as the lack of production capacities is supporting the medium-term upward price trend. While, in addition to the known volatility of raw materials, commodity stocks are also exposed to the additional risk of company management, they nevertheless currently offer a substantially higher dividend yield than the rest of the equity market and are benefiting from very good revenues thanks to high commodity prices (as can be seen at the petrol pump). Furthermore, they do not have the frequent problem of rolling futures contracts that direct commodity investments sometimes exhibit.

One might think that commodities are more suitable for professional investors, as the large commodity traders often possess profound know-how. Even for the average investor, however, the inclusion of commodities in their overall investment portfolio is also beneficial. For example, we know from the experience of the 1970s that commodity investments are important in providing protection to portfolios as a whole during phases of above-average inflation, such as that observed this year, and serve as a means of diversification. With us, you have the option to invest in a well-diversified commodity mandate as a complementary investment module. Both during 2022 and when viewed over a period of several years, it has succeeded in posting a very good relative performance versus the benchmark.

Gérard Piasko

Gérard Piasko is Chief Investment Officer and head of the investment committee of private bank Maerki Baumann. Before he was for many years Chief Investment Officer of Julius Baer, Sal. Oppenheim and Deutsche Bank.

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