

A moment in markets – Are we in a commodity supercycle?

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The notion of a commodity supercycle is exciting for commodity investors. The term supercycle is used for a bull run that may extend for many years. What rouses investors is not only the prospect of making attractive returns on their commodity investments if there is indeed a supercycle, but also the knowledge that timing the market is not necessarily paramount given the trend might last for several years.

Commodity markets broadly have made significant gains after bottoming out in March last year. But can the bull run be classified as the early phase of a supercycle? The key thing is this: for a cyclical upswing to become a supercycle, there needs to be a structural driver of demand. In the previous so-called commodity supercycle, which took place largely over the first decade of this century, rapid industrialisation in BRIC countries¹ was the catalyst. The 2008 global financial crisis proved to be a decisive setback. Any subsequent recovery in commodities was thwarted initially by the European sovereign debt crisis and eventually by trade wars between China and the US. While there were still instances of strong performance in various commodities individually, gains made by the asset class overall in the first decade of the century were lost in the second.

Hitting rock bottom can introduce a relief rally but is not enough to initiate an entire supercycle. What might be the catalyst for another supercycle in this decade and, if it happens, what shape might it take?

The energy transition could be the key driving force going forward. This megatrend has been catalysed by the pandemic whereby policymakers have recognised the need for fiscal injections to induce growth, rather than relying just on monetary policy. Moreover, a large proportion of any infrastructure spend that gets introduced as part of any fiscal expansion is likely to go towards green initiatives. A third of President Biden's pledged \$2 trillion infrastructure spend² is earmarked for the transportation and electric vehicles sector. China has already introduced a new energy vehicle industry plan that has kicked off in 2021 and aims to make pure electric vehicles the mainstream option for automotive sales by 2035³. Many countries in Europe have already introduced bans on new internal combustion engine vehicles at various points over the next decade.

Policymakers are therefore paving the way for this industry to thrive. Most recently, the automaker Jaguar Land Rover declared its intentions to test hydrogen fuel cell technology this year in a bid to electrify its entire fleet by 2025. The uptake of electric vehicles from consumers is also on an exponential trajectory. According to Wood Mackenzie, there may be 300 million electric vehicles on roads worldwide by 2040 – up from around 5 million in 2019.

The energy transition bodes well for green metals like copper, nickel, silver, aluminium, and platinum, to name a few. For metals, there is a structural source of demand growth which is expected to accelerate over the coming years, if not decades. Demand is also likely to be global in nature rather than driven by a handful of countries. And weakness in the US dollar in the near term may provide just the added impetus for this megatrend to accelerate.

Commodity investors have numerous options ranging from individual commodities to targeted or broad baskets. The most profound observation when looking at global exchange traded product flows for commodities is how broad baskets have risen from obscurity last year to dominating flows this year. Flows into broad commodities have exceeded \$6 billion year to date while industrial metals stand at second place with just under \$800 million in net inflows⁴.

To conclude, are we in a bull run for commodities? It certainly appears to be the case. Is it a supercycle? Might be early to say but the question certainly warrants attention. Might a subset of the commodity universe like metals be in a supercycle? It is becoming easier by the day to make that case. Regardless of whether investors subscribe to the notion of a supercycle or not, it is indeed an exciting time for commodities.

1 BRIC countries refers to Brazil, Russia, India, and China

2 Source: The White House.

3 Source: Communist Party of China Central Committee

4 Source: Bloomberg as of 09 April 2021.

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