Copper back on the charge

Published 16 June 2020

Mobeen Tahir
Director, Research

An opportunity hiding in plain sight

The global economy is gradually emerging from an acute shock earlier in the year. As the world's economic engines are reignited, markets too will breathe a sigh of relief. But some investors may take the view that the cyclical recovery has already been priced into certain assets. Take US equities as an example - the S&P500 Index is swiftly approaching its previous all-time highs recorded in February this year. The question that arises therefore, is: what asset class would benefit from an economic upswing but hasn't moved to price it in yet? We believe, this is industrial metals. And to pick a candidate from within the pack, we choose copper.

Moving slowly, but moving nonetheless

Not all cyclical assets move in tandem. US equities have surged since the current switched its direction in April. This, however, was more a symptom of tech sector strength rather than improving economic fundamentals. Copper, in contrast, aligns more closely with emerging market equities (Figure 01). This makes sense – China accounts for around half of world copper demand1 and holds a weight of nearly 40% in the MSCI Emerging Markets Index2. Copper's fate, and that of emerging market equities for that matter, is therefore inextricably intertwined with China's economic outlook.

Figure 01: Copper's correlation with emerging market equity

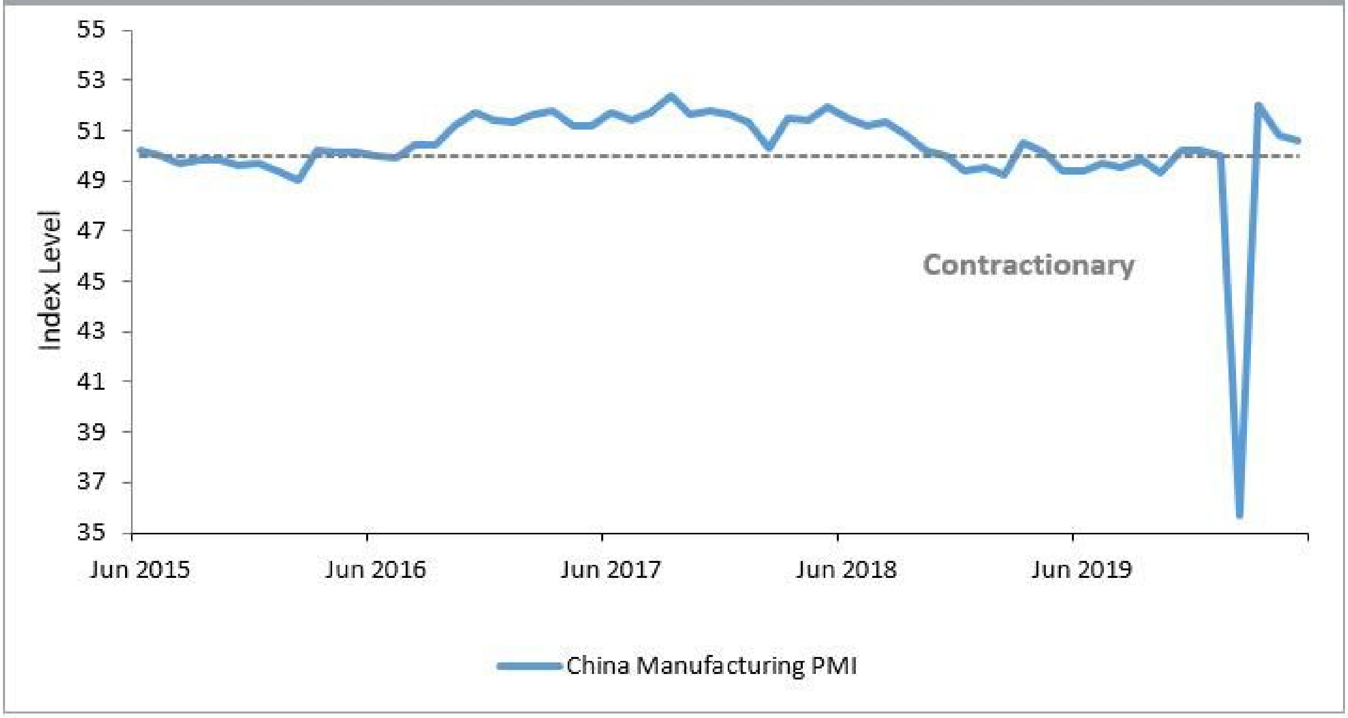
Source: WisdomTree, Bloomberg. Data as at 02 June 2020.

Historical performance is not an indication of future performance and any investments may go down in value.

China gradually returns to normalcy

China was the first to endure the pandemic and the first to emerge from it. As strict lockdowns were lifted in April, economic activity gathered steam. Now, we completely endorse the view that 2020 will be a painful year for economic growth. Indeed, Chinese policymakers have acknowledged this too, setting aside their cherished 6% GDP growth target for this year. But manufacturing Purchasing Managers' Indices (PMIs) for May paint a promising picture of a budding economic recovery (Figure 02). As the outlook for manufacturing improves, copper demand will be boosted.

Figure 02: China Manufacturing PMI has bounced back strongly



Source: WisdomTree, Bloomberg. Data as at 02 June 2020. PMI refers to Purchasing Managers' Index.

Historical performance is not an indication of future performance and any investments may go down in value.

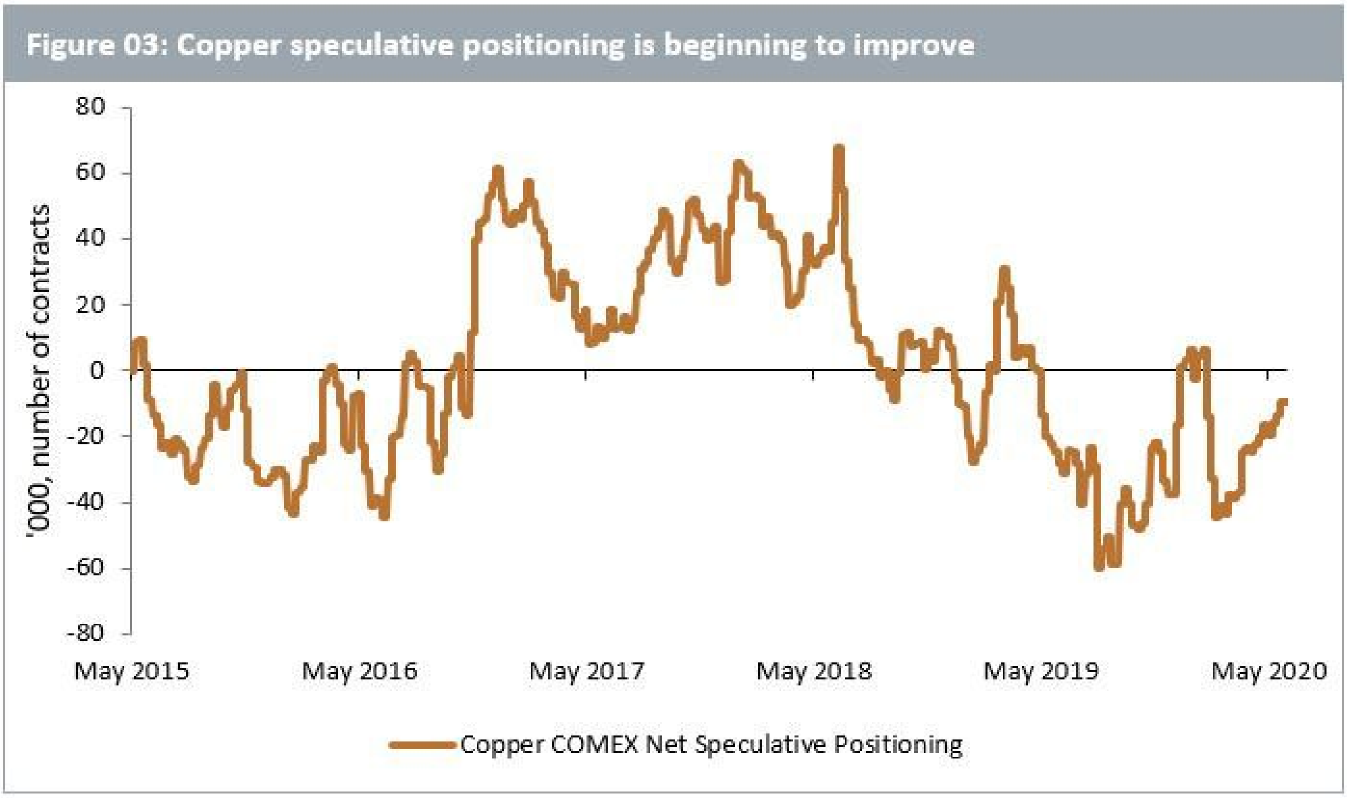
Chinese policy relief has arrived

At the recently concluded National People's Congress in May, Chinese Premier Li Keqiang unveiled a Rmb6.1tn ($853bn) fiscal package. This economic inducement will include an allocation to new infrastructure spend – with a focus on 5G and electric vehicle projects. Copper is integral to both. Copper's durability, high conductivity and efficiency make it a core component of electric vehicles, charging stations, and the entire supporting infrastructure3. Similarly, the deployment of 5G technology requires both fibre and copper cable across the network. An investment in these technologies can electrify the demand for copper.

There are always risks

Copper's demand and supply was broadly in balance4 in January before the pandemic accelerated. As a result, some of the demand weakness was offset by mining supply disruptions in key producers, notably Chile and Peru. Unlike some other metals which were in a supply surplus, copper's inventories on exchanges experienced a quicker drawdown through April and May. This also explains the quicker recovery in copper prices relative to other industrial metals so far. As mining activity resumes, support for copper prices from tight supply will wane. Copper will thus rely on a pick-up in demand to propel the charge forward.

A second wave of the pandemic is a risk that applies to all cyclical assets. Copper is no exception. If governments are forced to tighten lockdowns yet again, economic activity will be jolted. Nevertheless, we draw comfort in not hearing any alarm bells yet.



Source: WisdomTree, Bloomberg. Data as at 02 June 2020. COMEX is the Commodity Exchange – a division of the New York Mercantile Exchange.

Historical performance is not an indication of future performance and any investments may go down in value.

Markets are placing their bets

We believe markets are beginning to recognise the potential energy in the base metal. Net long speculative positioning in copper futures started to rise in May (Figure 03). If the cyclical wave of economic recovery materialises, copper will stand to benefit, and with copper being a key component of future technology – 5G and electric vehicles – we envisage a sustainable outlook for the metal's demand.

1 Statista https://www.statista.com/statistics/693466/distribution-of-global-refined-copper-consumption-by-region/

2 MSCI Emerging Markets Index factsheet https://www.msci.com/documents/10199/c0db0a48-01f2-4ba9-ad01-226fd5678111

3 Copper Development Association Inc. report https://www.copper.org/publications/pub_list/pdf/A6191-ElectricVehicles-Factsheet.pdf

4 International Copper Study Group https://www.icsg.org/index.php/component/jdownloads/finish/165/871

Related blogs

+ Short term recovery due for platinum and palladium

+ Copper’s fundamentals displaced by the Coronavirus

Related products

+ WisdomTree Copper

Important Risks Related to this Article

Important Information

Marketing communications issued in the European Economic Area (“EEA”): This document has been issued and approved by WisdomTree Ireland Limited, which is authorised and regulated by the Central Bank of Ireland.

Marketing communications issued in jurisdictions outside of the EEA: This document has been issued and approved by WisdomTree UK Limited, which is authorised and regulated by the United Kingdom Financial Conduct Authority.

WisdomTree Ireland Limited and WisdomTree UK Limited are each referred to as “WisdomTree” (as applicable). Our Conflicts of Interest Policy and Inventory are available on request.

For professional clients only. The information contained in this document is for your general information only and is neither an oer for sale nor a solicitation of an oer to buy securities or shares. This document should not be used as the basis for any investment decision. Investments may go up or down in value and you may lose some or all of the amount invested. Past performance is not necessarily a guide to future performance. Any decision to invest should be based on the information contained in the appropriate prospectus and aer seeking independent investment, tax and legal advice.

The application of regulations and tax laws can oen lead to a number of dierent interpretations. Any views or opinions expressed in this communication represent the views of WisdomTree and should not be construed as regulatory, tax or legal advice. WisdomTree makes no warranty or representation as to the accuracy of any of the views or opinions expressed in this communication. Any decision to invest should be based on the information contained in the appropriate prospectus and aer seeking independent investment, tax and legal advice.

This document is not, and under no circumstances is to be construed as, an advertisement or any other step in furtherance of a public oering of shares or securities in the United States or any province or territory thereof. Neither this document nor any copy hereof should be taken, transmitted or distributed (directly or indirectly) into the United States.

Although WisdomTree endeavours to ensure the accuracy of the content in this document, WisdomTree does not warrant or guarantee its accuracy or correctness. Where WisdomTree has expressed its own opinions related to product or market activity, these views may change. Neither WisdomTree, nor any ailiate, nor any of their respective oicers, directors, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any use of this document or its contents.