Insights
Multi-Asset Solutions

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A Bull Market for Commodities and Natural Resource Equities

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Commodities are experiencing the strongest rally in more than 30 years, with broad-based gains seen across the energy, metals, and agriculture sectors.

We anticipate that raw material prices will remain elevated throughout 2022, as the structural bull market in commodities is supported by limited spare capacity and supply-demand imbalances that are proving difficult to alleviate. This momentum has carried over to the global natural resource equities that focus on these three commodity sectors. Though many natural resource companies faced substantial pre-pandemic challenges, the recent surge in commodities prices, along with low relative valuations, continue to make them attractive to investors.

Energy

At the end of 2020, the Organization of the Petroleum Exporting Countries and its allies (OPEC+) began to push prices higher by reducing global crude oil inventories by approximately 750 million barrels, i.e., by returning total stocks to 2014 levels. Today, despite methodically increasing its contribution to global supply in an effort to meet the post-pandemic resurgence in demand, OPEC+ continues to struggle to deliver against its self-imposed production quota. Since the start of 2021, OPEC+ has effectively removed 1 million barrels per day from global inventory, which raises the specter of capacity constraints even before the Russia-Ukraine War, and resulting sanctions, curbed Russia's output (see Figure 1).

The war has validated Russia's global energy influence and highlighted the reality that the country's exports of crude oil and natural gas cannot be easily replaced — due to limited spare capacity. Further, about one-third of Europe's natural gas supplies originate in Russia, and any decision to pivot to other sources may lead to disruptions of an already tight market, i.e., prices will to continue to rise if alternative energy sources are not readily available.

This backdrop has set the stage for many of the integrated energy companies and their smaller brethren in exploration and production to excel; many have committed to a disciplined approach that is grounded in profitability rather than supply growth (which doomed the last rally).

Metals

Industrial metal inventories remain tight, especially copper and aluminum, and their balances reflect robust global demand. Covid lockdowns in China did cause some recent headwinds to metals demand (consumption was reduced in April), but these pressures should continue to abate as China eases mobility restrictions and industrial activity returns to normal levels.

As global manufacturers ceased trading with Russia, supply disruptions created further upside for metals (see Figure 1). Global miners had until recently cut back capital and expansion plans. However, governments' current desire to transition away from fossil fuels and toward alternative/ renewable energy sources has elevated demand for a wide range of metals, including aluminum, copper, nickel, zinc, cobalt, and lithium (the latter two are used in electric vehicle production).

Precious metals have more of a measured outlook, as gold has been supported as an inflation hedge and a safe-haven asset, but higher real yields and a strong US dollar may provide a headwind.

Agriculture

Surging global commodity demand coming out of the pandemic, adverse weather-related impacts, and the outbreak of war in Ukraine have driven an increase in agricultural prices and created a meaningful risk premium. Global crop inventories remain tight as the Northern Hemisphere growing season gets under way. We are also starting to see more trade protectionism related to agricultural exports.

Both Russia and Ukraine play a major role in supplying the world with wheat, corn, barley, and sunflower oil, as well as inputs to fertilizers that are used by farmers globally (see Figure 1). Grain and related commodities should see stickier price increases in the months to come as food inflation hits globally. This will buoy agribusiness companies involved in seeds, pesticides, and fertilizers, along with basic food products names.

Figure 1
Russia's and Ukraine's Production Share of Various Commodities
Recent Rankings

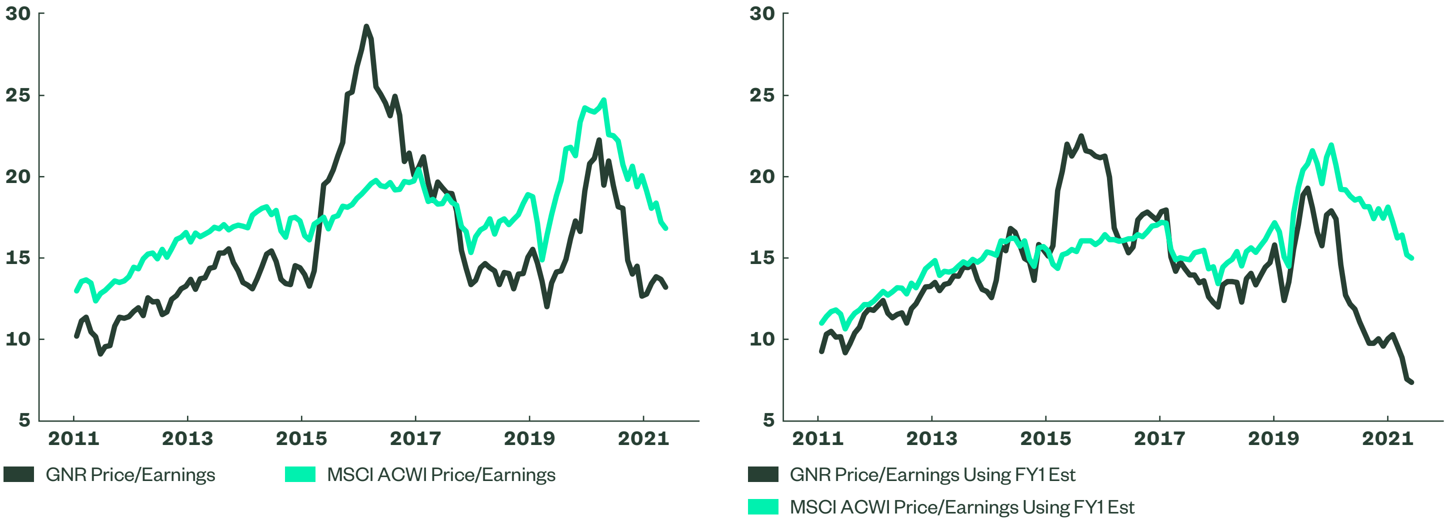
Energy		Metal & Mining			Precious Metal	Agriculture & Fertilizer		
Oil	**Natural Gas**	**Aluminium**	**Copper**	**Nickel**	**Gold**	**Wheat**	**Sunflower Oil**	**Potash**
United States	United States	China	Chile	Indonesia	China	European Union	Russia **30.6%**	Canada
Russia **13.1%**	Russia **17.9%**	India	Peru	Philipines	Australia	China	European Union	Russia **19.6%**
Saudi Arabia	Iran	Russia **5.4%**	China	Russia **9.3%**	Russia **10.0%**	India	Ukraine **23.7%**	Belarus
Canada	China	Canada	Congo	New Caledonia	United States	Russia **9.6%**	Argentina	China
Iraq	Qatar	United Arab Emirates	United States	Australia	Canada	United States	Turkey	Israel
China	Canada	Australia	Australia	Canada	Ghana	Australia	China	Germany
Iran	Australia	Bahrain	Zambia	China	Mexico	Pakistan	South Africa	Jordan
Unites Arab Emirates	Saudi Arabia	Norway	Russia **3.9%**	Brazil	South Africa	Ukraine **3.2%**	Kazakstan	Chile
Brazil	Norway	United States	Mexico	United States	Uzbekistan	Argentina	Serbia	United States
Kuwait	Algeria	Iceland	Canada			Canada	United States	Spain

Source: US Energy Information Administration (2021), World Mining Data, (2021), US Geological Survey, Minerals Commodity Summaries (2022), USDA Foreign Agricultural Service (June 2022).

Global Natural Resource Equities

Over the past five years and for much of the past decade, global natural resource stocks have traded at a discount to broad global equities across a number of valuation measures (see Figure 2). Looking at price to earnings, both reported and with one-year estimates, the natural resource asset group appears to be relatively cheap from a historical perspective. Further, relative valuations using price to book, cash flow, and sales ratios all tell a similar story.

Figure 2
Valuation of Global Natural Resource Equities and MSCI ACWI
2011–2021



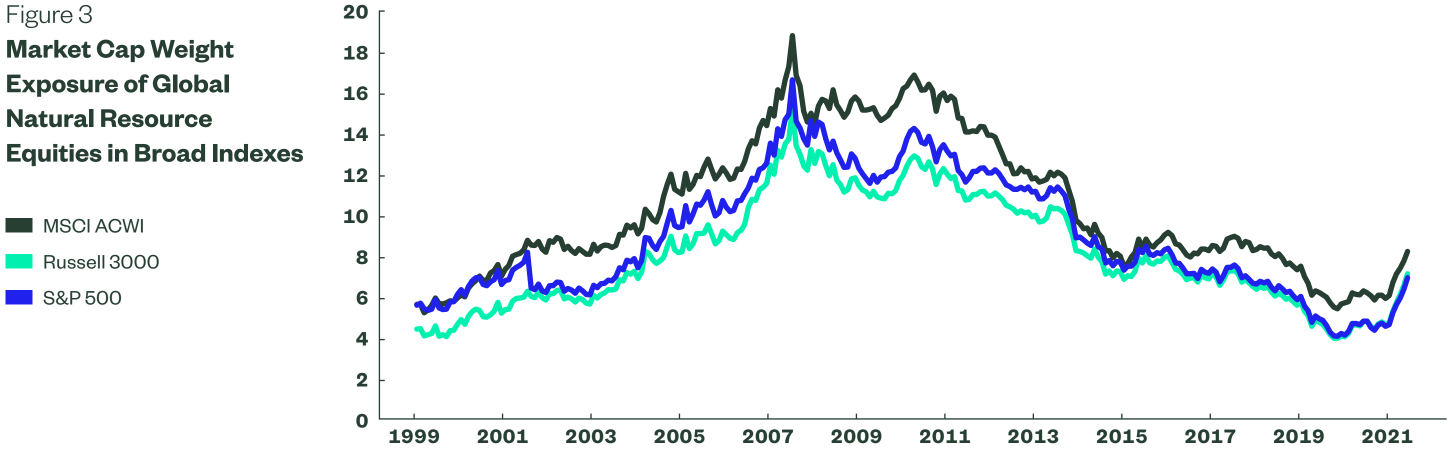
Source: State Street Global Advisors and FactSet. As of May, 2022. Global Natural Resource equities are represented by the S&P Global LargeMid Cap Commodity and Resources Index.

Global natural resource equities also provide a dividend yield that is nearly double that of broad global equities — it is currently nearly 4%. Lastly, it is important to note that, while the market capitalization of broad global equities has accelerated over the last decade, the market capitalization of natural resource equities has remained relatively flat — until this year.

Portfolio Exposure

Many investors' current allocations to global equity indexes leave them underexposed to global natural resource equities. Over the past ten years, the market cap weight exposure of natural resource equities in MSCI ACWI has declined significantly, hitting a low of just over 5% in October 2020 before rebounding to over 8% today. The market cap weight exposure of natural resource equities within the Russell 3000 and S&P 500 is about 7% (see Figure 3).

Figure 3
Market Cap Weight Exposure of Global Natural Resource Equities in Broad Indexes



Source: State Street Global Advisors and FactSet. As of May, 2022. Global Natural Resource equities are represented by the S&P Global LargeMid Cap Commodity and Resources Index.

Bottom Line

The current macroeconomic environment remains favorable for commodities and global natural resource equities, which both have historically performed well during periods of higher inflation. In the past they have provided superior protection from rising costs and have offered diversification benefits to traditional stocks and bonds.

With prices across the commodities complex at elevated levels, and a hawkish Fed potentially causing demand destruction, some investors are wondering if the rally can continue. We acknowledge that there may be bumps in the road. Geopolitical risk will contribute to heightened volatility — particularly for commodities directly or indirectly affected by the Russia-Ukraine War — but we expect prices to stay elevated throughout 2022 as the structural bull market within commodities remains intact.

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- Build from breadth
- Invest as stewards
- Invent the future

For four decades, these principles have helped us be the quiet power in a tumultuous investing world. Helping millions of people secure their financial futures. This takes each of our employees in 30 offices around the world, and a firm-wide conviction that we can always do it better. As a result, we are the world's fourth-largest asset manager* with US $4.02 trillion† under our care.

* Pensions & Investments Research Center, as of December 31, 2020.
† This figure is presented as of March 31, 2022 and includes approximately $73.35 billion USD of assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated.

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