Daily Macro Insights: Diversifying within commodities

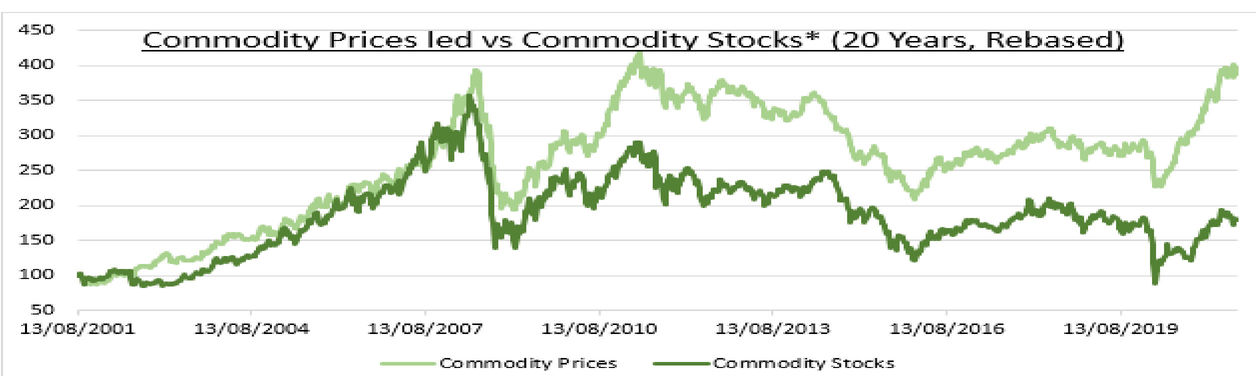
20/08/2021

PHYSICAL OR EQUITY: Commodities have performed well this year, after a poor decade. We see a 'sweet spot' of recovering demand, tight supply, demand for inflation 'hedges' and eventual help from a weaker USD. Our [retail investor survey]() shows commodities as the most popular asset class to increase allocations. A key decision is whether to own the physical commodity or the equities exposed to it. Commodity stocks have underperformed the physical in the long term (see chart) but may still be more suitable for many. They can offer more choices (to specific commodities or diversified producers), whilst giving dividend income, and with operating leverage to higher prices (as profits rise faster than revenues).

PROS AND CONS: Investing in physical commodities gives direct and pure-play exposure but can be very volatile, has its own complexities (rolling futures contracts in contango or [backwardated]() markets), and some commodities are not widely traded. Commodity equities offer a broader range (from hard to access specific commodities like diamonds or uranium to widely diversified producers), often pay big dividends, and have operating leverage. But they may not move in line with the underlying commodity, if they hedged their production or produce many commodities, or have other more important issues, like debt problems.

EXPOSURE: Industrial metals is our favoured segment, boosted by fast-growing 'green transition' [demand]() and still strong China demand: copper (with leading equity producers like FCX, ANTO.L), lithium (ALB, SQM), nickel (VALE, MNODL.L), aluminium (AA, NHY.OL), and uranium (CCJ). Broader exposure is possible with @OilWorldwide and @GoldWorldWide.

TODAY: US equities again showed 'buy the dip' resilience, with a broader investor base (new retail buyers to returning share buybacks), few alternatives (10-yr bond yields 1.3% and money market accounts at 0.1%), and strong fundamentals (Q2 EPS beat by over 25%).



Source: Bloomberg Commodity Price Index and MSCI ACWI Commodity Producers Index

Ben Laidler, Global Markets Strategist. Email: benla@etoro.com