Portfolio Advisory Service Insights

April 2021

The what, why and how of a super cycle.

Commodity prices have moved higher recently. There has been a lot of discussion that the global economy is at the start of a commodity super cycle. Whether it is or not, and what that means for investors, has gathered a lot of attention. We think it is important to focus on the underlying drivers of a super cycle when considering how your portfolio can access this theme.

What is a super cycle?

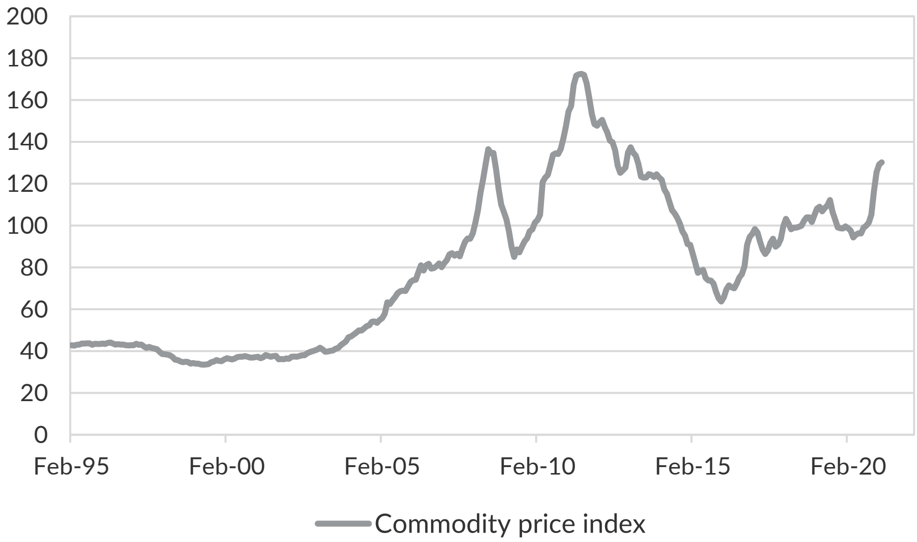
A commodity super cycle is a sustained spell of particularly strong demand growth for commodities, that is not matched by production from suppliers. This imbalance can support a rally in commodity prices that can persist over the medium-term, and in some cases the longer-term.

Why might this be a super cycle?

Right now, the driver of a super cycle could be the surge in fiscal support and liquidity that has been provided by global governments and central banks. This pandemic response has boosted economic demand.

The previous super cycle took place from early 2002. It was a function of the phenomenal growth experienced by China. China built cities and infrastructure on an unprecedented scale. China's demand for raw materials pressured suppliers and helped sustain prices for iron ore, copper and oil pushed prices to record highs.

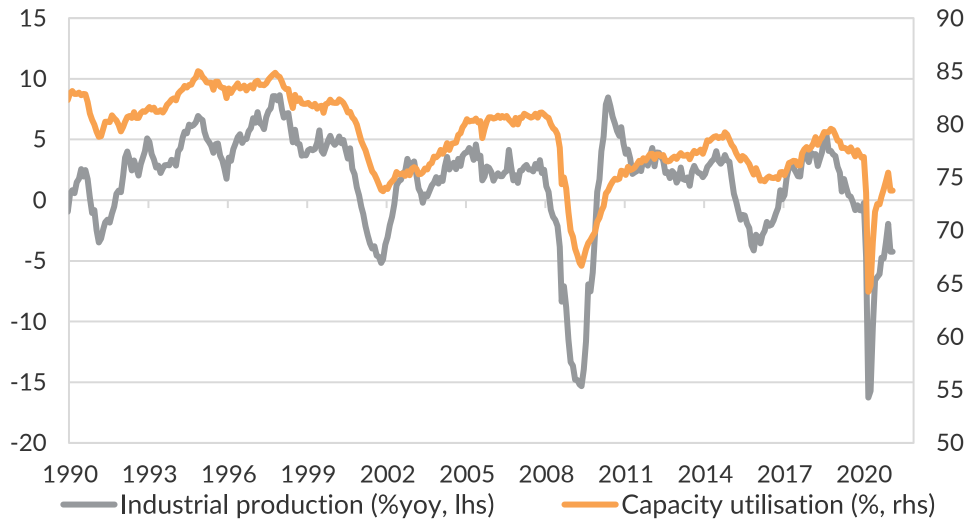
Fig 1: Commodity prices surged in the decade from early 2002.



India and other parts of the emerging world are now using the opportunity to fund economic growth and infrastructure spending. This is a potentially large source of demand that could drive a new super cycle.

Another point to note is ongoing weakness in private investment, industrial production and capacity utilisation. Prior to the pandemic, private investment was already weak. Public investment was doing much of the heavy lifting for economic growth. This has persisted through the pandemic. And very low government funding rates has allowed global governments the opportunity to push ahead with much needed infrastructure spending, after a period of low public investment into productive capacity. This points to potential for a supply-demand imbalance to persist for some time.

Fig 2: Industrial production and capacity utilisation has been weak for some time in the US.



Why might this not be a super cycle?

The recent rise in commodity prices could partly reflect rising inflation expectations. Higher inflation expectations have been reflected in term premia reasserting itself in sovereign bond yield curves. This is noticeable both in the US and Australia. Hard commodities include some inflation hedging properties so the higher prices recently could reflect inflation hedging from some investors, rather than excess demand.

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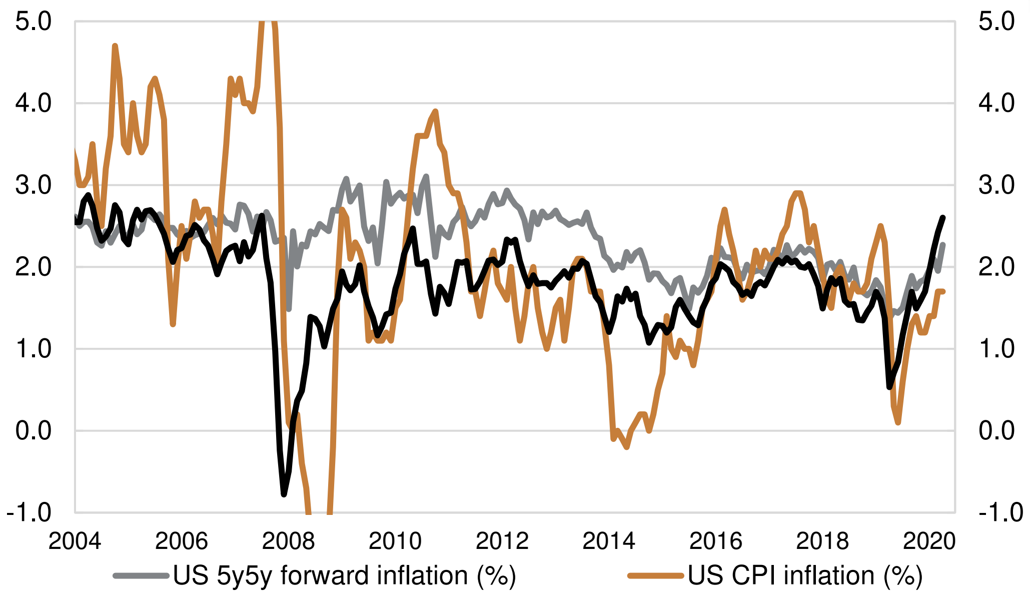
Fig 3: Inflation expectations have increased post-pandemic.



Does it matter?

The global economy is at the start of a durable, self-sustaining economic recovery. We expect that to persist for the medium-term. That solid growth will keep demand growth at above-trend levels. These are economic characteristics that have historically been supportive of commodity demand and commodity prices. We are cautious about calling this a super cycle. But we do expect commodity prices to trend higher and remain elevated over the medium-term as strong economic demand persists.

How can I access this theme?

The underlying macroeconomic driver of strong commodity demand is above trend economic growth. This is a feature of our Medium-Term Global Outlook. We expect that will provide tailwinds to global equities. We project returns for developed market equities that are elevated relative to history. Our portfolios have moved to be overweight developed market equities, reflecting this theme.

This macroeconomic driver is also a positive tailwind for emerging markets. We think this will play out particularly in Emerging Asia, including China and India but also through other economies linked to these regions. EM equities and EM credit can provide access to this macroeconomic theme.

Reach out to our Portfolio Advisory Service to find out how we can assist you with managing your investment challenges.