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IN THIS ISSUE

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GLOBAL EQUITIES STILL THE PREFERRED ASSET CLASS

By Brian Butchart, CFP® and Managing Director of Brenthurst Wealth

If daily news headlines are to be believed, the world is entering another **COMMODITIES SUPERCYCLE** that promises to power certain sectors out of a COVID gloom. This narrative is always especially appealing for South African investors given the further boost this would give to local resources stocks.

The latest frenzy has sparked excited talk about a reoccurrence of the 2000s supercycle after the rise in key commodity prices this year.

The spike of some 20 years ago was driven at the time by China's rapid expansion. Its massive industrialisation and urbanisation programmes were gobbling up resources about as fast as they could be exported.

This seemingly insatiable demand for resources is the common denominator with previous supercycles.

Take the early 1900s supercycle that was driven by US industrialisation, while the 1930s boom came on the back of global rearmament. The same demand-driven growth fuelled the 1950s and 1960s supercycle as Europe and Japan underwent a period of reindustrialisation and reconstruction after the Second World War.

And now, as the global economy ticks up after the COVID lockdowns of 2020, we have seen prices for commodities from oil to corn to copper spike in response to new demand.

Domestically, this has played out in local resources stocks benefiting as the price of precious metals have also climbed inexorably upward.

Commodities in general have seen a significant price rise over the last year with copper, corn, oil, lumber, lean-hogs and iron-ore being amongst the star performers.



BUT WHAT ARE WE WITNESSING? | Refinitiv/CoreCommodity CRB Index



IS IT A MIRAGE?

Hear me out on this point: I do not believe that what we are seeing in 2021 is a repeat of the previous commodity supercycles. Given the rise in the prices this year my assessment seems churlish. But let us look at the facts to back up my contrarian view.

SUPERCYCLES ARE RARE OCCURRING EVERY 50 TO 60 YEARS AND RESULT FROM LONG TERM SUPPLY/ DEMAND IMBALANCES, THAT CAUSE PRICES TO PERSIST ABOVE THE TREND.

And what we are seeing today, I believe, is not an imbalance that can keep prices higher than usual for an extended period. On the demand side, for instance, the transition to a low-carbon economy is denting orders for certain metals. Governments across the world pledged to reduce net carbon emissions to zero by 2050 (Paris Agreement), which is creating demand for a host of new technologies such as electric vehicles and renewable energy such as solar and wind power.

While the transition to a low carbon economy is driving the demand of certain metals such as copper and cobalt, required for mass production as electric vehicles use 3-4 times the amount of copper vs traditional cars powered by an internal combustion engine, the demand for other commodities will decline.

But we must also consider the deflationary impact of China's inexorable slowdown – from an average annual real GDP growth rate of 11.41% between 2000 and 2010, to a much lower average growth rate of 6.82% over the last decade. Furthermore, China has been rebalancing its economy towards the consumer and services and away from capital investment; urbanization and industrialization are not proceeding at anywhere near the same pace as they did during the last cycle. This growth slowdown was one of the major contributors to the decline in commodity prices from 2011 and is a trend unlikely to change in the foreseeable future.

And on the supply side, while the effects of coronavirus should pass, the period of low investment in new production will take much longer to reverse.

Importantly, the primary driver of the previous supercycle – China's seemingly insatiable appetite for resources – is not what it once was. Especially since the country's economy is rebalancing towards consumers and away from capital investment.

Yes, the country is still investing heavily in urbanisation and industrialisation, but not at anywhere near the same pace as before.

We therefore think it is too early to describe this as a commodity supercycle. However, this does not mean we are not selectively bullish on demand for certain commodities. In this regard we have been increasing our exposure to the Counterpoint value fund run by esteemed fund manager Piet Viljoen.

THE NEW GLOBAL ECONOMY

One of the consequences of the COVID pandemic is that we are witnessing the acceleration of some global Megatrends. The growth pattern of these global Megatrends has been compressed into months rather than years. We expect these Megatrends to continue and still prefer quality growth stocks, particularly the long runway for the technology, healthcare and consumer services sectors where innovation in a post-pandemic world continues to drive demand and revenue.

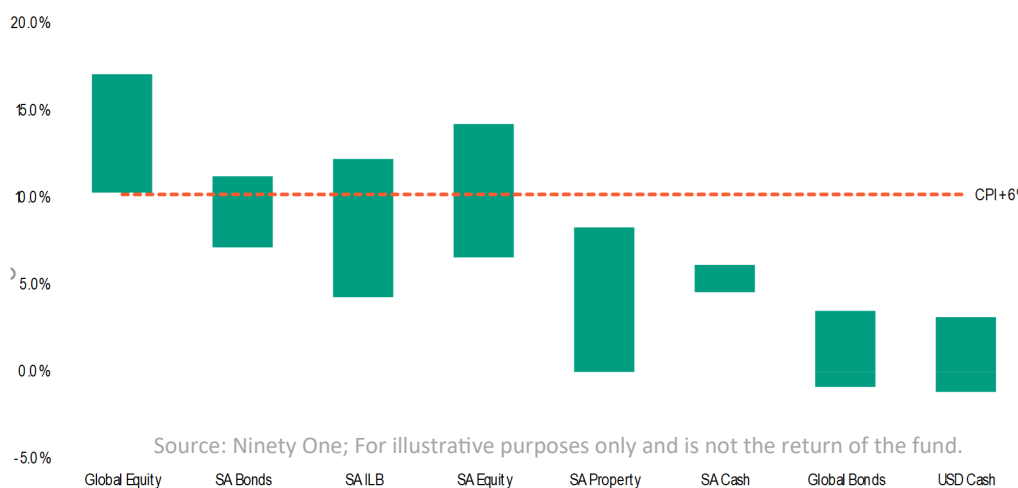
What is significant for domestic stocks is that these sectors feature multiple sub-sectors that are dependent on local resources.

Take the tech sector that spans everything from 5G technology, semiconductors and chip manufacturers, cloud technology, renewable energy, robotics, artificial intelligence, cybersecurity, blockchain technology, electric vehicles, genetic editing and many more. They represent the future economy, not only in terms of technological development but also the switch to environmentally sensitive operations that play into the ESG theme most of which are only accessible across international markets.

Externalising assets and gaining accessibility to offshore investment opportunities is a strategy Brenthurst has used for more than a decade, delivering exceptional returns to clients. More recently Duane Cable, co-manager of the R17 billion Ninety One Cautious Managed fund expressed Ninety One's views that they expect global equities to be the top performing asset class over the next five years and Brenthurst agrees.

RANGE OF EXPECTED FIVE YEAR RETURNS

Views from asset selection within Ninety One Opportunity Fund | May 2021



INVESTORS CONSIDERING OFFSHORE DIVERSIFICATION AT CURRENT EXCHANGE RATES WILL BENEFIT FROM BUYING DOLLARS AT AN ATTRACTIVE ENTRY LEVEL, AND SELLING SA EQUITIES TO DO SO, WILL HAVE BENEFITED FROM THE RECENT RALLY.

MICRO SUPERCYCLES

Given the dominant role the tech sector will continue to play, we believe it's plausible to have 'supercycles' in specific commodities that encounter above-trend demand growth conditions.

We also see significant investment demand in commodities in response to inflation fears because of continued monetary and fiscal policies around the world to stimulate local economies.

These tailwinds, combined with accelerated decarbonisation, are expected to drive supply deficits in commodities such as copper, lithium, PGMs and, perhaps ironically, oil. The extent and persistence of these deficits will depend on government commitment, speed of adoption and continued decarbonisation policy initiatives.

If investors are still excited about commodities and the prospect of a supercycle, they might want to curb their enthusiasm for the broad commodities basket. However, cherry-picking the commodities that will be fuelling technological growth and decarbonisation are unquestionably worth considering as part of well diversified global portfolio.

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