



A GENERATIONAL MOMENT FOR COMMODITY TRADING STRATEGIES

May 2024

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A Generational Moment for Commodity Trading Strategies

An unprecedented scramble for commodities collides with a decade-long capex depression

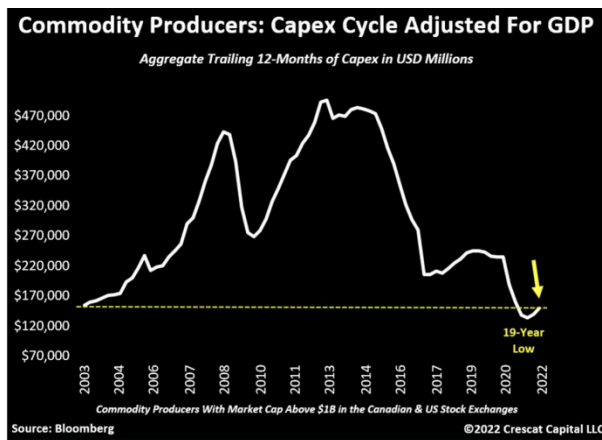
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A long-term favorable supply/demand dynamic is unfolding in commodities markets that we believe promises to support their value and attract sizable fund flows. After multiple decades of under-investment by both the capital markets and the industry itself, we think a convergence of cyclical and secular shifts is shoring up markets for materials and various hard assets. It is still the early innings for fund managers focused on this space to capitalize on data-driven opportunities and demonstrate their ability to capture alpha.

Titan Advisors' thesis on the opportunity set for commodity trading strategies is predicated on three core tenets:

Under-Investment

Sparked by the 2014 dislocation of the high yield market and exacerbated by corporate and governmental policies, the cost of capital for companies that extract materials has risen substantially. Even at higher cost, there has been a broad contraction in the availability of capital for oil and gas, metals, and mining. Regulations inflict an additional latticework of administrative costs that hike the hurdle rate for new projects, further diminishing capital expenditures and constraining capacity. Capital expenditures by commodity producers are in a depression.



Source: Crescat Capital LLC

Re-Shoring and Energy Transition

Supply chain vulnerabilities laid bare by Covid-19 and by the behavior of China and Russia are forcing a reshoring of manufacturing to the United States and Europe. What have been global commodities markets are fragmenting into costlier, local pools of inventory needed to accommodate new supply chain dynamics. This change layers on additional shipping expense and reduces the reliability of available supply. Reversing a 50-year trend of sourcing manufacturing to Asia and China in particular, the broader de-coupling from China is driving a multi-fold increase in construction spending on industrial manufacturing capacity and the infrastructure that supports it.

Much of the developing infrastructure underpins a steep ramping up of energy production and distribution, some of which supports environmentally driven efforts to decarbonize. As an

example, electric vehicle batteries require lithium, nickel, and graphite. To manufacture batteries and other finished products, new natural gas-fueled plant capacity can meet much of the additional demand for power, but there is increasing interest in reviving a neglected and often reviled sector of the power industry – nuclear energy, which most frequently requires uranium.

Both natural gas and nuclear power are making large claims on the commodities markets, just as most industries are starting to adopt artificial intelligence capabilities fed by datacenters that demand an abundance of copper as a raw material and incrementally draw on energy resources.

Exhibit 1: Electricity inflation is the highest in 40 years, just as data center & AI demand surge
US electricity CPI component, 3-year annualized change



Source: BofA Research Investment Committee, Haver

BofA GLOBAL RESEARCH

Source: BofA Global Research

Currency Debasement and Inflation

For years, unprecedented peacetime deficit spending and expansionary monetary policy have elicited warnings of monetary debasement from the precious metals and Bitcoin corners of the investment ecosystem. Now coming into the mainstream, worries about the currency are shaping a view that higher-than-targeted levels of inflation will be long-lasting and destined to be a mechanism to monetize the \$34.7 trillion (about \$267,000 per taxpayer) U.S. sovereign debt. When the money supply persistently grows faster than goods and services, it results in price inflation for scarce assets, including gold, which investors and central banks are purchasing to hedge inflation risk.



Source: USDebtClock.org

Structural supply/demand imbalances across the commodity sector combine with global macro and geopolitical factors to create an asymmetric risk/return dynamic with long-term visibility. This convergence of fundamental factors comes to the commodities market at a time when institutional capital is substantially under-weight these sectors. The resulting funds flow overlay presents a propitious opportunity for liquid strategies. Capital committed now to commodities strategies comes at a moment when the drivers of the thesis are no longer speculative. They are underway with granular visibility, yet markets remain inefficient in pricing in the information.

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Since the commodity cycle lows of 2020, commodity trading funds have on average produced a compound annual return of 10.8% with a 6.4% standard deviation, as measured by the HFRI Macro Commodity Index. Today's unique circumstances we believe complement characteristics that historically have drawn investors to the commodity sector: high liquidity, diversification of risks found in other assets, and low correlation to the S&P 500.

HFRI Macro Commodity Index (Jan 2008 – March 2020)

Ann. Return	1.9%
Std. Dev.	5.3%
% Positive Months	51.7%
Max Drawdown	-13.0%

HFRI Macro Commodity Index (April 2020 – Jan 2024)

Ann. Return	10.8%
Std. Dev.	6.4%
% Positive Months	67.4%
Max Drawdown	-4.2%

This is the first in an ongoing series of reports from Titan Advisors that analyze the opportunity set in the commodity sector.

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