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Market Commentary

Weekly perspective on current market sentiment **May 10, 2023**

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Last week's S&P 500 Index: -0.8%

With growth slowing, what about commodities?

Key takeaways

- Our analysis suggests the current commodity price pause is likely temporary, and we continue to believe this asset class is in the early stages of a bullish commodity super-cycle.
- Since 2020, commodity demand has far exceeded supply, and we believe producers will continue to need more time to increase their output to levels that will satisfy demand.

Historically, we have not covered commodities very often in this weekly piece. But clearly, as inflation continues to come in well above the Federal Reserve's (Fed's) average long-term target (2%), everything from oil to copper to grains like soybeans and corn has jumped in price over the last couple of years. Americans are particularly sensitive to commodity inflation as most of us fill up our gas tanks and go to the grocery store every week. As a result, we get a constant reminder that is frequently reinforced. Consumer sentiment is often tied to gasoline prices, especially when they are high and rising.

Over the last 40 years or so, as inflation and interest rates fell from the highs seen in the early 1980s, the Fed has tended to focus on "core" inflation, which excludes food and energy. The thinking has been that monetary policy has little effect on the price of food or energy. Grain prices often sway with the weather conditions in various growing regions around the world, so raising or lowering interest rates and tinkering with the money supply doesn't have much of an effect on Mother Nature. Oil historically has also frequently been a "weather market" where hurricanes or even the threat of hurricanes or tornados would shutter production for periods of time and move prices. Once again, Mother Nature is mostly immune from monetary-policy decisions.

Of course, the growth of oil and gasoline demand rises and falls with economic expansions and contractions, which are tied to the Fed's monetary-policy maneuvers and the market's perceived and realized impact on demand. For example, one key to the recent fall in the price of oil is the market anticipating a slowdown and eventual recession in much of the developed world. China's slower-than-expected recovery has also weighed on the price of oil and some other commodities.

But our analysis suggests that this commodity price pause is likely temporary, and we continue to believe this asset class is in the early stages of a bullish commodity super-cycle. A commodity super-cycle refers to an extended period of significant price gains (a bull super-cycle) or losses (a bear super-cycle) that exceed their long-term averages. A bull super-cycle typically evolves when supply is slow to respond to prolonged changes in demand. These cycles, looking at hundreds of years of history, tend to pause at some point before resuming their trend. This time, the pause occurred after an initial overshoot after the war in Ukraine began.

Since 2020, commodity demand has far exceeded supply, and we believe drillers, miners, and farmers will continue to need more time to increase their production to levels that will satisfy demand. In the meantime, we believe ongoing shortages and an eventual economic recovery in 2024 will likely push prices higher over time. As a result, we continue to carry a favorable rating on commodities and see pullbacks for the group as potential buying opportunities.

Risk considerations

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. The **commodities markets** are considered speculative, carry substantial risks, and have experienced periods of extreme volatility. Investing in a volatile and uncertain commodities market may cause a portfolio to rapidly increase or decrease in value which may result in greater share price volatility.

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