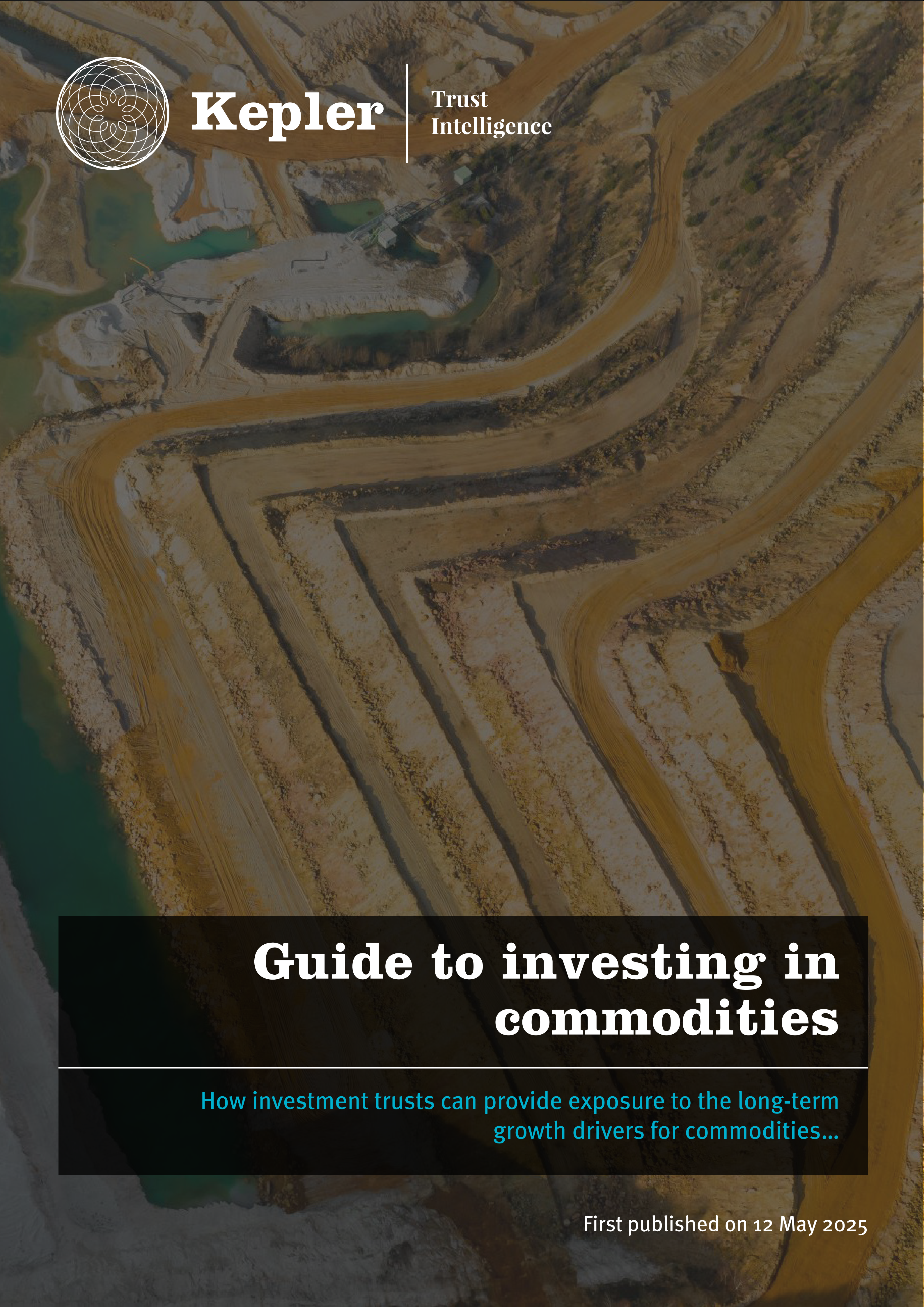

Kepler | Trust Intelligence

Guide to investing in commodities

How investment trusts can provide exposure to the long-term growth drivers for commodities...

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It may be more than 6,000 years since commodities were first traded but they still sit at the heart of the global economy, with Statista reporting that an estimated $140 trillion in interests will change hands this year alone.

Commodities remain an indispensable part of our daily lives, from the oil and gas heating our homes to the lithium-ion batteries powering our smartphones and electric cars. More recently, geopolitical tensions have heightened concerns around national energy security, while the rapid adoption of energy-intensive AI technologies is driving a significant increase in demand.

Looking ahead, commodities are poised to play a pivotal role in the clean energy transition, with the International Energy Agency (IEA) forecasting that demand for critical minerals could triple by 2040. Minerals such as lithium, nickel and cobalt are critical components in battery production, while electricity grids, which form the backbone of the renewable energy transition, will require substantial quantities of copper and aluminium.

Beyond their practical applications, commodities provide investors with valuable diversification beyond traditional equities and bonds, as well as protection during periods of rising inflation. Despite these benefits, commodities are often under-represented in investors' portfolios.

What drives the price of commodities?

Commodities are broadly categorised into two groups:

- **'Hard' commodities:** extracted or mined resources including energy (oil, natural gas and coal), precious metals (gold, silver and platinum), and industrial metals (copper, iron ore and lithium).

- **'Soft' commodities:** agricultural or livestock products such as corn, coffee, soybeans, wheat, meat and cotton.

Rakesh Jhunjhunwala, often hailed as the Warren Buffett of India, is quoted as saying, "In commodities, when prices go up, demand goes down. In stocks, when prices go up, demand goes up." While commodity prices are largely a function of demand and supply, the dynamics can vary significantly by the type of commodity.

Energy commodities are strongly influenced by economic cycles and geopolitical factors, with OPEC actively managing oil production. Precious metals command high valuations due to their finite supply and sustained demand across both industrial uses and consumer applications, while industrial metals are closely linked to manufacturing cycles, as well as the global transition toward clean energy. Agricultural commodities face unique supply and demand dynamics, including adverse weather such as floods or drought, technological advances and government support.

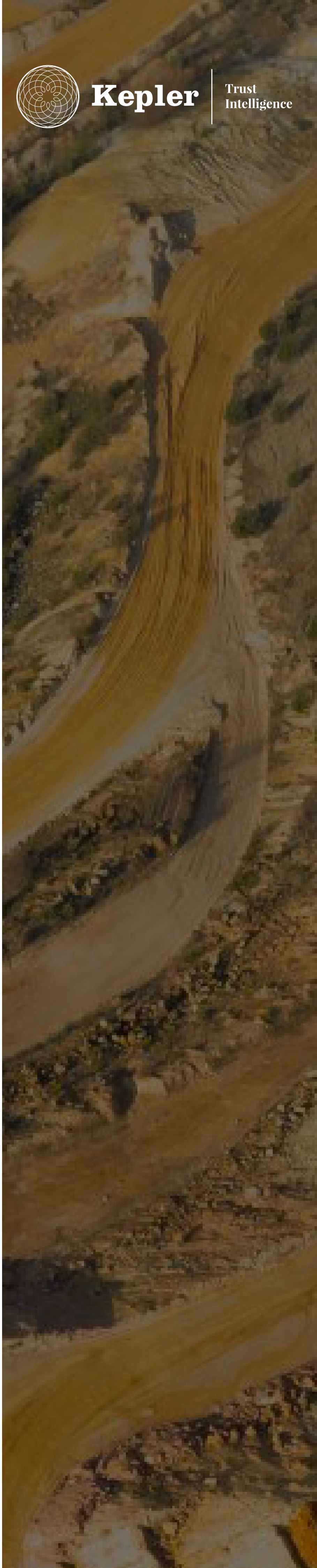
Why invest in commodities?

There are a number of reasons to invest in the commodities sector, which we explore in more detail below.

1. Strong drivers of demand

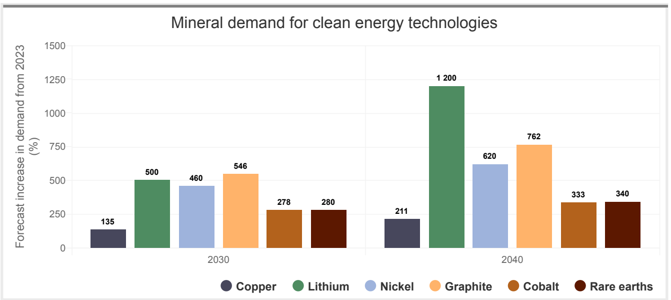
Commodities are forecast to enjoy strong secular growth drivers as the critical building blocks in the clean energy transition.

As illustrated in the graph below, the IEA is projecting a five-fold increase in demand for lithium from clean energy technologies by 2030 (and a 12-fold increase by 2040),



with electric vehicles and battery storage accounting for 90% of total demand. This is accompanied by robust growth in other battery minerals such as nickel, cobalt, manganese and graphite.

Fig.1: Soaring Demand For Critical Minerals In The Transition To Net Zero



Source: Global Critical Minerals Outlook 2024, the IEA. Forecast increase in demand from 2023 to 2030 and 2040 under the Net Zero Emissions (NZE) scenario

Another key driver of growth is the pressing need to upgrade global energy infrastructure. Copper plays a critical role in power transmission networks and clean energy technologies such as solar panels and wind turbines, with the IEA forecasting that copper demand will double by 2030. In addition, rare earth elements are essential for the magnets used in wind turbines and electric motors.

As a result, governments have earmarked substantial funds for investment in low-carbon technologies, including almost $400 billion under the US Inflation Reduction Act (IRA) and €270 billion by the EU.

The rapid expansion of energy-intensive data centres is also expected to drive substantial demand for commodities. On average, processing a ChatGPT query consumes ten times more electricity than a Google search and a recent study warned that the AI industry could consume as much energy as a country the size of the Netherlands by 2027.

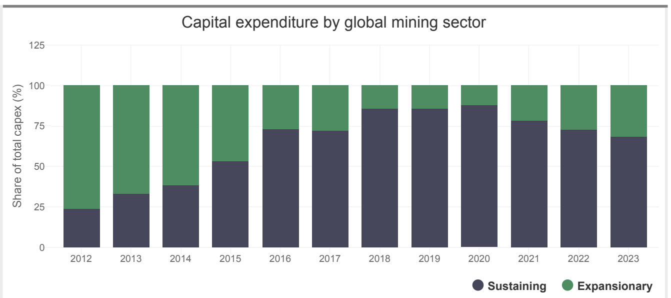
This trend has led major technology firms such as Amazon, Alphabet and Microsoft to explore nuclear power solutions, which could boost demand for uranium.

2. Persistent supply constraints

Supply constraints remain a challenge across the commodities sector, with production limited by factors such as declining ore grades, ageing infrastructure, long lead times for new mines, geopolitical issues and a lack of investment in new capacity.

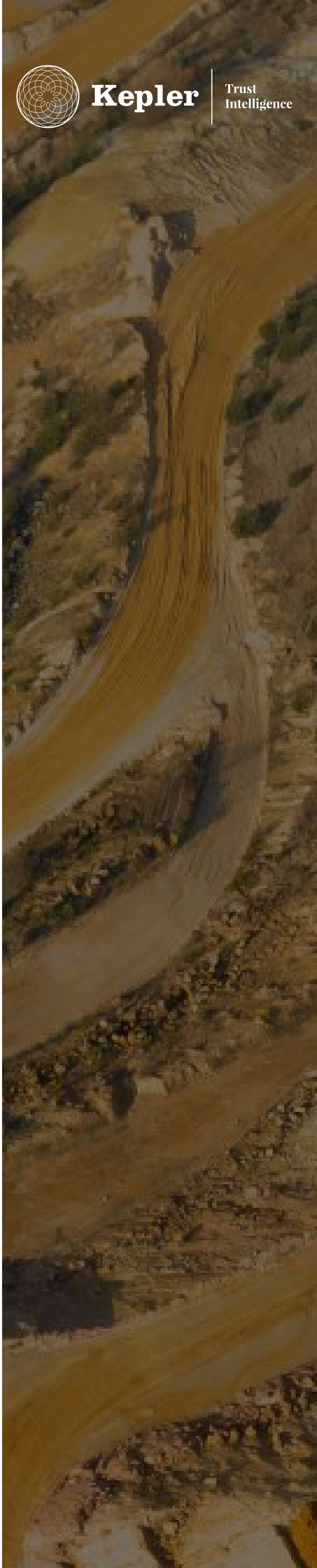
As illustrated in the following chart, expansionary capital expenditure has significantly fallen over the last decade as mining companies have prioritised debt repayment over new investment, resulting in strong balance sheets and lower leverage compared to historical averages and other sectors.

Fig.2: Significant Fall In Expansionary Capex Over Last Decade



Source: RBC, 31/03/2024

A lack of shovel-ready projects and a substantial rise in the cost of new projects mean that current supply constraints are likely to persist, which should be supportive of commodity prices going forward. There has also



been a notable uptick in M&A activity as mining companies look to acquire assets trading below replacement costs, which may provide a further tailwind for returns.

3. Portfolio diversification

Commodities provide the opportunity to diversify into a different asset class to equities, bonds and property. Historically, commodities have had a low correlation to equities, meaning that commodities have generally outperformed when equities have underperformed.

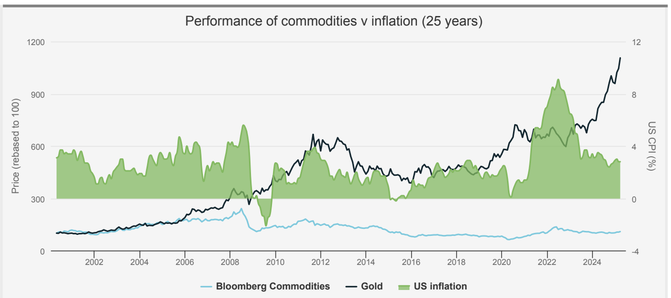
This low correlation was particularly valuable when bonds and equities fell sharply in 2022. By way of example, investors in **BlackRock World Mining (BRWM)** would have enjoyed a share price total return of 26% in 2022, compared to a negative return of 38% and 19% in the UK index-linked gilt market (using an iShares ETF as a proxy) and S&P 500 indices respectively.

However, while the share prices of mining companies have often displayed a low correlation to broader equity indices, it should be noted that they can be highly correlated at other times.

Commodities can also act as a hedge against inflation as prices generally rise during times of inflation, with commodity prices often included in inflation calculations.

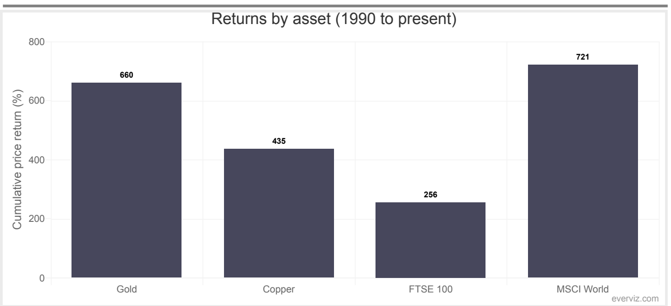
The following chart shows that the broad-based Bloomberg Commodity Index rose when US inflation exceeded 4% in 2008 and 2022. Gold has also often performed strongly in times of rising inflation, as seen in the period following the global financial crisis. Given the potential inflationary impact of US tariffs, this could provide a useful protection mechanism for investors.

Fig.3: Performance Vs Inflation



Source: Bloomberg (26/03/2025), based on the Bloomberg Commodities Index, spot price of gold and year-on-year US CPI
Past performance is not a reliable indicator of future results

Fig.4: Gold Has Delivered Attractive Long-Term Returns



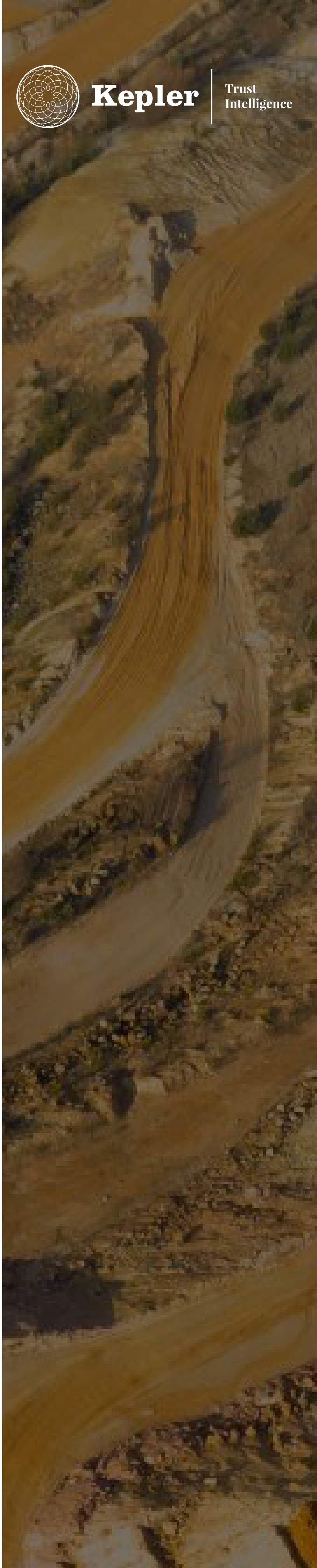
Source: Bloomberg, as at 26/03/2025
Past performance is not a reliable indicator of future results

4. Track record of attractive returns

Commodities have historically delivered strong returns over the long term, although they can be volatile over shorter time periods.

The following chart shows the price returns from a selection of commodities and indices. Gold and copper have delivered returns of 660% and 435% respectively, significantly outperforming the returns from the FTSE 100 Index.

Gold has delivered a particularly strong performance in recent years, reaching record



highs amid macroeconomic uncertainty and escalating geopolitical tensions. A key driver has been increased purchasing by central banks, particularly in China, as they seek to reduce their reliance on US dollar reserves.

Why invest in commodities via investment trusts?

It's worth saying at the outset that it's difficult to invest directly in physical commodities other than precious metals. However, the latter incurs a cost in terms of secure storage and insurance and jewellery typically has a high markup on the underlying value of the metal. Another option is futures contracts but, due to their volatility, these are suitable only for professional traders. Investment trusts offer a practical solution by providing exposure to a diversified portfolio of commodities managed by experienced professionals. An active approach enables trusts to research the best opportunities in a broad and complex universe rather than investing indiscriminately across the sector.

Trusts will generally invest principally in the equities of mining and exploration companies rather than directly in the underlying commodities. While the share prices of mining companies are typically less volatile than the underlying commodities, returns from mining equities can diverge from commodity prices.

There are currently seven trusts specialising in the AIC Commodities and Natural Resources sector on the London Stock Exchange. The scope varies by trust, with some trusts investing in specific areas and others across commodities more broadly.

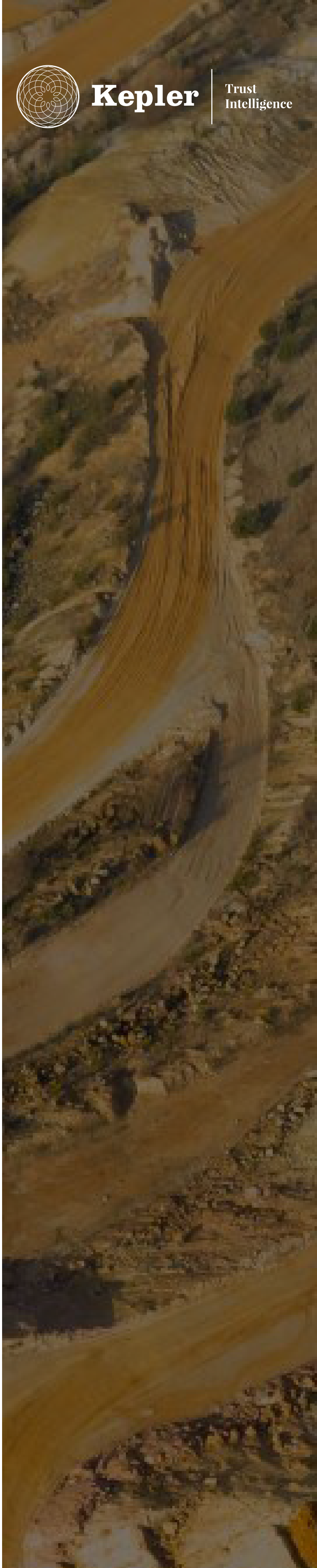
Investment trusts v open-ended funds

It's fair to say that some of the benefits mentioned above, whether a diversified portfolio or manager expertise, also apply to open-ended funds but investment trusts have some unique attributes, which may help them deliver superior returns compared to their open-ended peers.

Firstly, open-ended funds are not publicly traded (unlike investment trusts), meaning that the size of the investable fund will rise and shrink with the purchase and sale of units in the fund. As a result, open-ended funds typically hold a significant proportion of cash in reserve to meet redemption requests, which can create a drag on returns.

As publicly traded companies, investment trusts do not have this problem, as the buying and selling of shares in the investment trust does not affect the size of the investable fund. Trusts are not required to retain cash for redemptions, which can boost returns for investors and allow longer-term investment in less liquid and private investments, including pre-IPO companies and private market royalty investments. On the other hand, trusts may trade at a discount to net asset value, meaning that the share price may underperform relative to the underlying net asset value of the portfolio.

Trusts can also deploy gearing, which has the potential to enhance returns (although it can also augment losses on the downside), as well as using capital reserves to pay dividends.



Case Study

BlackRock World Mining Trust

Launched: 1993

Manager: BlackRock Fund Managers

Ongoing charges: 0.95%

Investment policy: The trust aims to deliver long-term capital growth by investing in a portfolio of global mining and metal companies. While the policy is to invest principally in quoted securities, the company's investment policy includes investing in unquoted investments, royalties derived from the production of metals and minerals as well as physical metals.

Comparative Index: MSCI ACWI Metals & Mining 30% Buffer 10/40 Index (net return)

BlackRock World Mining (BRWM) aims to provide a diversified investment in mining and metal assets worldwide, actively managed with the objective of maximising total returns.

Managers Evy Hambro and Olivia Markham have a conviction-led approach to adding value by carrying out in-depth analysis of the best companies in the mining sector, rather than betting on the short-term movement of commodity prices.

The managers look for companies exposed to long-term secular themes (such as decarbonisation and renewable energy) across a range of market caps, subsectors and regions. These are balanced with more traditional investments in precious metals (such as gold) to provide a diversified income stream and long-term capital growth.

The trust is supported by BlackRock's extensive Thematics and Sectors team, providing the resources to undertake extensive 'on the ground' research. This provides a first-hand insight into the capability of management teams and the ESG credentials of companies.

BRWM has delivered a total share price return of 131% over the past five years (as at 31/03/2025) and is currently trading on a dividend yield of 4.8% (as at 08/05/2025), the highest in the AIC Commodity and Natural Resources sector.

There are no guarantees that this will be repeated in the future, however the managers believe that the secular growth trends of the transition to net zero should support the commodities sector moving forward.

1. What is the investment trust's goal?

BRWM's goal is to provide an actively managed and diversified investment portfolio of global mining and metal assets, with the objective of maximising total returns.

2. What kind of stocks do the managers like?

The managers are a blend of top-down and bottom-up stock pickers, combining the demand outlook for individual commodities with company-specific factors such as growth prospects, corporate and capital allocation strategy and the opportunity for value creation.

The managers look for companies with strong balance sheets, attractive dividend streams, sound capital discipline and good ESG characteristics. Many mining companies are highly cash-generative with low debt and disciplined spending on capital investment has freed up cash for share buybacks and dividends. They also ensure that companies are making the necessary investment in decarbonisation to future-proof against tighter regulations.

3. Are investment decisions driven by a particular investment style?

The team has an unconstrained and high-conviction investment style, with the top ten holdings typically accounting for more than half of the portfolio.

The managers combine their bottom-up research of individual companies with a top-down macro-overlay based on geographic and commodity-specific factors. They look for 'best in breed' assets to fit their desired commodity exposure, with strong capital discipline to protect shareholder returns and a focus on both income and growth.

As a result, the portfolio encompasses commodities with diverse economic drivers, from cyclical commodities (such as iron ore) to those benefiting from secular growth trends (such as lithium and the platinum group metals), as well as gold which is driven by macroeconomic uncertainty and geopolitical risk. Interestingly, the vital role of commodities such as copper and iron ore in the clean energy transition has reduced the cyclicality of their demand.

While BRWM invests principally in quoted securities, it also invests in royalties derived from the production of commodities as well as physical metals. Up to 10% of gross assets may be held in physical metals and up to 20% in unquoted investments, which have been a strong driver of returns.

4. How many investments does the investment trust typically hold?

The managers do not have a rigid number of investments that they hold but target a portfolio of 50 to 70 investments.

5. What is the investment trust's dividend policy?

BRWM aims to pay a dividend linked strongly to portfolio income each year, rather than having a progressive dividend policy, and dividends are paid quarterly.

6. What are the investment trust's ongoing charges?

The investment trust's ongoing charges are 0.95%.

7. Does the investment trust have performance fees?

BRWM charges an annual management fee of 0.8% of net assets. If NAV per share increases on a quarter-on-quarter basis, the fee will be paid on gross assets for the quarter.

8. How much attention do the managers pay to the index, and to what extent are absolute returns important?

BRWM's managers are highly active and use the MSCI ACWI Metals & Mining 30% Buffer 10/40 Index (net return) as the reference index.

9. Does the investment trust use gearing and, if so, is it structural or opportunity led?

The managers can use gearing up to 25% of NAV although, in practice, gearing rarely exceeds 10-15%. Gearing is deployed tactically, with the managers aiming to utilise it when they anticipate a period of enhanced returns. However, the managers consider effective gearing to be lower than the headline number due to the unquoted exposures and debt positions accounting for a significant proportion of gearing.

View the latest research note here
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