A fistful of commodities

Given current volatility, is it the opportune time to look beyond equities and bonds?

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Analysts:
Jo Groves
jo@keplerpartners.com

The world of investing has evolved considerably since the 1950s, when Harry Markowitz introduced his theory of portfolio allocation and investors had all of 200 funds to choose from (compared to a staggering 170,000 today).

Despite this transformation, the traditional 60/40 equity-to-bond portfolio allocation has survived largely unchallenged, relying on uncorrelated or negatively-correlated assets to mitigate risk for investors.

In fairness, bonds have mostly provided an effective cushion against equity downturns but this relationship imploded in 2022 when both bonds and equities posted negative returns for the first time in over 40 years. This may prove an anomaly but there's been a notable weakening in their inverse correlation over the last decade.

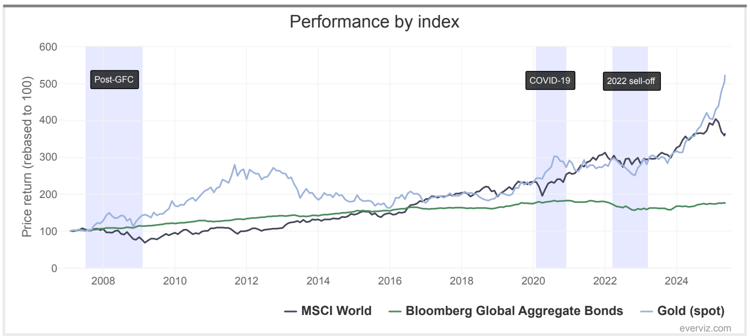
Time to look beyond equities and bonds?

For investors subscribing to Warren Buffett's view that the best way to make money is not to lose it, a multi-asset portfolio is arguably most needed during times of market stress as we saw in 2022.

Commodities are perceived as a high risk, high reward option, but gold, in particular, has been resilient during periods of market volatility, proving its value as a 'safe haven' asset.

As the graph below shows, gold performed strongly during 2008, posting a 40%-plus total return compared to a near-20% fall in the MSCI World Index, and a similar trend was evident during the early part of the pandemic in 2020.

Fig.1: Gold Has Shown Resilience During Market Downturns



Source: Bloomberg (as at 06/05/2025)

However, the effectiveness of gold as a diversifier was seen most clearly in 2022, when interest rate hikes sent both bonds and equities tumbling, while gold rose by more than 10% in the last two months of the year. To put this in context, the 30% fall in global bonds was the worst in more than a century, according to the Financial Times.

While gold has often provided a hedge during equity market downturns, the broader commodities sector also exhibits a low correlation to bonds and equities. Prices are a function of global demand and supply, which can be shaped as much by geopolitical events, production disruptions and weather patterns as the economic cycle.

Why it pays to be active

While commodities can provide a useful source of diversification, it can be challenging for investors to navigate the diverse universe. However, an active approach enables investors to piggyback on the fund manager's expertise in identifying the best opportunities and adjusting allocations to manage volatility.

BlackRock World Mining (BRWM) provides diversified exposure to global mining and metal assets, primarily through investments in publicly traded companies, alongside smaller holdings in physical metals and unquoted investments.

Investing in the equities of mining companies, rather than directly in the underlying commodities, offers a diversified approach that captures both commodity price movements and operational efficiencies while also providing an income stream.

Managers Evy Hambro and Olivia Markham tailor the portfolio to harness the potential upside from higher-returning commodities while managing downside risk for investors. The portfolio currently has significant exposure to copper and gold, together with a smaller exposure to iron ore.

Gold and copper have performed particularly strongly in recent years, achieving annualised returns of 12% and 14% respectively over the last five years (as at 09/05/2025). However, gold has a very weak correlation to both copper and iron ore and this low correlation between commodities supports an active strategy, allowing portfolio managers to dynamically adjust allocations in pursuit of alpha.

Harnessing the growth drivers

BRWM is well-positioned to benefit from strong structural growth drivers underpinning demand across the commodities sector.

Buy not build

Mining companies have focused on repaying debt in recent years and, as a result, have strong balance sheets, with low net debt/EBITDA ratios relative to historic averages and other sectors.

As a result, current supply constraints are expected to persist due to a lack of shovel-ready projects, long lead times and a substantial rise in the cost of new projects. The sector has seen a notable uptick in M&A activity as mining companies look to acquire assets trading below replacement costs, which should be a tailwind for returns.

Closing the gold-to-equity gap

Gold prices have continued to climb ever higher, breaking out of the $3,000 barrier to hit a record high in April. Central banks, particularly in China, have been major buyers of gold to reduce their reliance on US dollar reserves.

Despite strong fundamentals, gold miners have been trading at a discount relative to underlying gold prices. This has prompted Evy and Olivia to increase their allocation to high-quality gold producers with low operating costs, positioning the portfolio for a potential re-rating if elevated gold prices translate into higher free cash flows.

Soaring demand for copper

BRWM has a notable overweight to copper due to its long-term structural growth drivers. Copper is a critical raw material for large-scale infrastructure projects from global power system electrification to hyperscale data centres, with the International Energy Agency forecasting a 50% increase in demand by 2040 (under its net-zero emissions scenario).

On the supply side, a decade of structural underinvestment has led to a shortage of new copper deposits, creating a supply-demand imbalance that is expected to support the long-term investment case for copper.

Nuclear power and the AI revolution

The rapid adoption of AI technology has led to a surge in demand for hyperscale data centres, particularly in the US, where power needs are forecast to grow to three times higher than current capacity by the end of the decade according to McKinsey.

In response, some of the Magnificent Seven have turned to nuclear energy, with Amazon acquiring a nuclear-powered data centre in Pennsylvania and Alphabet purchasing small nuclear reactors to power data centres.

As a result, BRWM has a small position in uranium miners to tap into the growing, non-cyclical demand for alternative low-emission energy sources.

Final thoughts

As the traditional 60/40 portfolio faces increasing challenges, investors may look to commodities as a diversification tool, with an active approach helping to capture potential alpha while managing the higher volatility inherent in the sector.

BRWM has demonstrated a strong track record of outperformance against its index (the MSCI ACWI Metals & Mining 30% Buffer 10/40), achieving a five-year share price total return of 131% compared to 108% for the index (as at 31/03/2025).

Dividends also form a major part of the investment case for commodities and BRWM offers the highest dividend yield in the AIC Commodities & Natural Resources sector by some margin, with a current dividend yield of just under 5% (as at 09/05/2025).

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