Commodity stocks are currently experiencing low demand – however, this situation could undergo a transformation...

Dear reader,

The robust condition of the stock markets may overshadow the fear of a stronger downturn in the global economy, which has not dissipated. In the United States and Europe, it is predominantly the service sector that sustains economic growth, while the industrial sector exhibits weakness. Disappointing economic data has also emerged from China in recent times.

Consequently, this has exerted significant pressure on the stock prices of commodity companies in recent months, as most commodities are essential for industrial production. The prospect of weaker demand also adversely affects commodity prices. Decreased demand and lower commodity prices, in turn, deteriorate the financial performance of commodity firms.

Long-term growth in commodity demand

However, the medium-term outlook indicates a global increase in the demand for commodities such as copper and iron ore. This is driven by the accelerated restructuring of energy infrastructure, digitalization, electrification, and rising investments in defense, all of which are resource-intensive. Supply, on the other hand, will often struggle to keep pace with the long-term rising demand, especially considering the currently relatively low prices that diminish incentives for investments in new mining projects. Additionally, escalating costs due to increasing environmental regulations further contribute to this challenge.

For instance, the closure of one of the smelters operated by the state-owned copper producer in Chile, the country with the highest copper production and reserves worldwide, reflects the immense irreversible environmental damage caused by production. Similar situations are prevalent in various other regions and mines.

This situation needs to change because it is more than paradoxical that materials essential for the sustainable transformation of the economy contribute to irreversible environmental damage during their production. The pressure from governments, consumers, and environmental advocates will intensify in this regard, ultimately leading to increased costs. As many projects become less viable, the supply will grow at a slower pace than anticipated. Consequently, resources like copper are expected to become scarcer and more expensive.

Resources are predominantly extracted, produced, and processed by large internationally operating corporations, as this industry requires substantial investments and long-term commitment. Companies such as Rio Tinto, BHP Billiton, Anglo American, Glencore, and others would benefit from increased commodity demand and higher selling prices. While these corporations produce a wide range of commodities, their specific focuses may vary.

In our opinion, commodity stocks offer significant medium-term opportunities for investors. Those seeking exposure to the entire sector could consider utilizing exchange-traded funds (ETFs), although it is worth noting that available index funds have both strengths and weaknesses.

Significant concentration in the STOXX Europe 600 Basic Resources ETF

ETFs often exhibit a regional focus, such as the Lyxor STOXX Europe 600 Basic Resources (ISIN: LU1834983550). However, due to historical reasons, three of the largest commodity companies, namely Rio Tinto, Glencore, and Anglo American, are headquartered in Europe. Therefore, the ETF still provides relatively good sector coverage.

The top 10 holdings in the Lyxor STOXX Europe 600 Basic Resources ETF are as follows:

	Stock (Country)	Weight in %
1	Rio Tinto (GBR)	28,73
2	Glencore (CHE)	16,38
3	Anglo American (GBR)	14,97
4	UPM Kymmene (FIN)	6,77
5	Arcelor Mittal (LUX)	5,25
6	Norsk Hydro (NOR)	3,67
7	Boliden (SWE)	3,26
8	Stora Enso (FIN)	3,19
9	Antofagasta plc (CHL)	3,05
10	Svenska Cellulosa (SWE)	3,02
	Sum	**88,3**

The STOXX Europe 600 Basic Resources Index, consisting of 18 stocks, exhibits significant concentration, with the mentioned three global commodity giants alone accounting for 60% of the index's weighting. Also prominently represented in the index are wood-processing companies such as UPM Kymmene, Stora Enso, and Svenska Cellulosa. While BHP Group was the second-heaviest weighted stock in the STOXX Europe 600 Basic Resources in 2021, it is now considered an Australian corporation and is no longer included in the index.

VanEck Vectors Global Mining ETF: Includes gold mining as well

An alternative option is the VanEck Vectors Global Mining ETF (ISIN: IE00BDFBTQ78). The underlying EMIX Global Mining Constrained Weights Index is truly global in its orientation, including stocks such as BHP Group, Vale, and copper producer Freeport-McMoRan.

Furthermore, the weight of individual index members is limited, preventing excessive concentration. No stock is allowed to exceed 9% of the index, and the sum of stocks with a weight of 4.5% or higher cannot exceed 36% in total.

A potential drawback, if considered so, is that the index also includes stocks of gold producers. Among the top 20 stocks with the highest index weighting, there are six with a combined weight of 18.0% that are primarily involved in the gold market. This dilutes the focus on commodity stocks benefiting from an economic recovery. However, companies like Newmont Mining and Barrick Gold not only mine gold but also produce industrial metals. Additionally, we assess the long-term outlook for precious metals to be positive.

The top 10 holdings in the VanEck Vectors Global Mining ETF are as follows:

	Stock (Country)	Weight in %
1	BHP Group (AUS)	9,07
2	Rio Tinto (GBR)	8,62
3	Glencore (CHE)	5,73
4	Freeport McMoran (USA)	5,25
5	Vale (BRA)	4,86
6	Anglo American (GBR)	3,87
7	Newmont (USA)	3,55
8	Barrick Gold (CAN)	2,99
9	Franco Nevada (CAN)	2,83
10	Agnico Eagle Mines (USA)	2,56
	Sum	**49,3**

The four commodity giants, BHP Group, Rio Tinto, Glencore, and Vale, collectively hold the highest weighting in the index, accounting for 28.3%. Freeport-McMoRan, the copper producer, falls in between, followed by Anglo American and the gold stocks Newmont Mining and Barrick Gold. With 164 stocks, the ETF offers broad diversification; however, the 100 stocks with the lowest weighting make up only around 12% of the total.

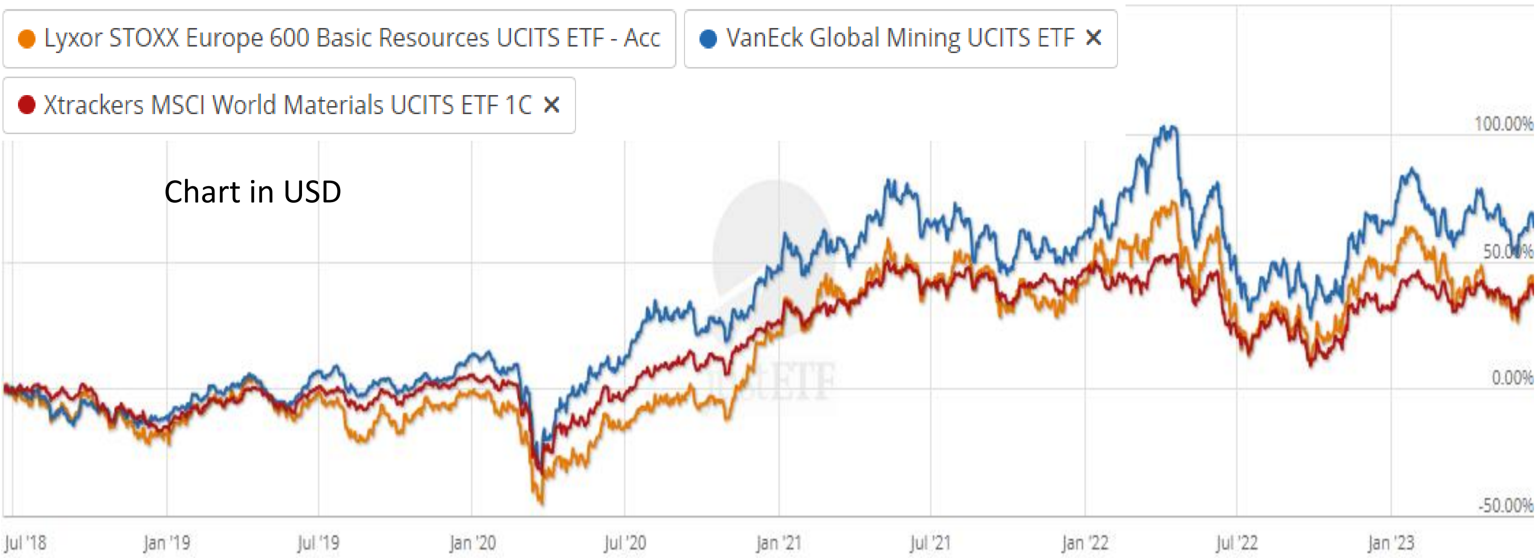
The "Materials" sector

Furthermore, there are many ETFs, such as the globally-oriented Xtrackers MSCI World Materials (ISIN: IE00BM67HS53), which focus on the "Materials" sector. In addition to commodity producers, this sector also includes basic materials producers, often comprising companies from the chemical industry.

Among the top 10 holdings in the MSCI World Materials Index, you can find companies like Linde, headquartered in Ireland, Air Liquide from France, and BASF from Germany. While they also benefit from an economic recovery, they may not necessarily experience a direct benefit from rising commodity prices as they may face increased costs themselves.

The top 10 holdings in the Xtrackers MSCI World Materials ETF are as follows:

	Stock (Country)	Weight in %
1	Linde (IRL)	8,56
2	BHP Group (AUS)	8,38
3	Air Liquide (FRA)	5,47
4	Rio Tinto (GBR)	5,16
5	Air Products & Chemicals (USA)	4,84
6	Shinb-Etsu Chem (JPN)	3,77
7	Sherwin Williams (USA)	3,59
8	Glencore (CHE)	3,25
9	Freeport McMoran (USA)	3,02
10	BASF (DEU)	2,74
	Sum	**48,8**



The three commodity ETFs have exhibited similar fluctuations over the past 5 years, but their overall performance has been quite different. After a strong rally until April 2022, all three ETFs experienced a significant correction. The Lyxor Basic Resources ETF has been most affected by concerns about the economy and the current weakness in many commodity prices.

Our Conclusion

Over the past 5 years, the VanEck Vectors Global Mining ETF has outperformed the other two sector-specific ETFs and even outperformed an ETF tracking the MSCI World. This does not guarantee future performance, but it highlights the strength of the ETF's diversified exposure to the metals sector.

In our opinion, this ETF is the best choice for investors looking to gain exposure to the overall metals sector, from copper to gold. While the companies in the Lyxor Basic Resources ETF produce a wider range of commodities, the high concentration within the ETF raises concerns. The Xtrackers Basic Materials ETF, on the other hand, focuses on basic materials and cannot be seen as a pure investment in the commodity sector. Among the three sector-specific ETFs, it exhibits the lowest level of volatility.