Dear reader,

The era of electric mobility is gaining momentum, to employ this somewhat overused analogy. However, the focus lies not primarily on Europe, but rather on China. According to the International Energy Agency (IEA), in 2022, 60 percent of electric vehicles sold worldwide found their way into the hands of consumers in China. The market share of electric cars in China has now reached an impressive 30 percent.

This boom shows no signs of abating, as global sales of electric vehicles with anticipated electric propulsion are expected to increase by 35 percent this year. Considering the rapid pace at which the industry in China is transforming, it is unlikely that this trend will subside anytime soon. The effect of this development on future demand for petroleum has been a subject of debate between the IEA and OPEC, and one that can be further contested. However, what remains clear is the significant surge in demand for all the raw materials required for batteries, as well as the electrification and digitalization of the economy.

Rare earth elements, not only crucial for the energy transition and decarbonization but also indispensable in a wide range of modern technologies, including electric vehicles, smartphones, and televisions. Strategic metals such as cobalt and titanium play a vital role as well. Furthermore, the demand for lithium, essential for battery cells, continues to grow steadily.

Mining Companies in Focus

For years, investments in companies focusing on the extraction and processing of rare earth elements and strategic metals have attracted the attention of many investors. However, speculation plays a significant role, and the equation "rising demand equals high stock profits" has rarely proven true. There are several reasons for this.

One of them is that mining companies also struggle with increasing costs, such as energy expenses. As a result, higher revenue often does not easily translate into higher profits. Currently, the fear of a recession and short-term declining demand is weighing on the prices of many commodities, including copper and lithium, which also burdens the stocks of corresponding producers. From our perspective, this is a temporary effect that opens up long-term investment opportunities.

Nevertheless, there are also structural factors that increase the risk of investments in this sector. Metals like lithium, cobalt, and others, as well as rare earth elements, are rightly considered strategic. They play a central role in the transformation of the economy, and the countries that have access to these resources at favorable prices have a competitive advantage.

Consequently, there is already considerable political influence in this market, including export controls, and this influence is likely to grow in the coming years. The recent announcement by Chile, the world's second-largest lithium producer, to strengthen control over the metal's extraction through a national strategy, has made a significant impact. The fear of nationalization is spreading. As a result, the stocks of lithium producers have temporarily come under significant pressure, as demonstrated by the example of the US company Albemarle (chart is in USD):

However, the share price of Albemarle and other lithium producer stocks had already fallen prior to this, primarily due to the prolonged decline in the lithium price.

An ETF for rare earth elements and strategic metals

The weakness in lithium stocks also affected the performance of the VanEck Rare Earth and Strategic Metals ETF. While stocks such as Albemarle and lithium producer SQM are not included in this ETF, among the top 10 weighted stocks, there are six lithium producers and miners, namely Liontown Resources, Pilbara Minerals, Livent, Allkem, Sigma Lithium, and Gangfeng Lithium, accounting for a combined 35 percent. The remaining 25 stocks in the ETF also include additional lithium producers.

The Australian company Liontown Resources explicitly focuses on the production of metals for batteries, with lithium being a significant emphasis. Recent takeover rumors propelled the company's stock price upward, catapulting Liontown to the top of the ETF.

To be included in the underlying MVIS Global Rare Earth/Strategic Metals Index, companies must generate at least 50 percent of their revenue from rare earth elements or strategic metals or pursue mining projects with similar potential. The maximum weight of a single position is limited to 8 percent, reducing the risk of concentration.

In contrast to many other thematic ETFs, the U.S. representation is relatively low at 14.5 percent. Instead, companies from Australia (38.6 percent) and China (30.3 percent) dominate the index, as these minerals are frequently mined in these countries. China, in particular, has a significant advantage in rare earth elements.

Taking second place in the ETF is China Northern Rare Earth, a manufacturer of rare earth products. With a market capitalization of approximately $12 billion and revenue of about $5 billion, it is a heavyweight in the industry. The expected dividend yield for 2023 stands at 1.8 percent. While many other companies are already profitable, most do not currently pay dividends.

A new ETF with a different approach

It is not entirely clear why companies like Albemarle are not included in the VanEck ETF, considering that in 2022, Albemarle derived 68 percent of its revenue from lithium. However, the Global X Disruptive Materials UCITS ETF (ISIN: IE000FP52WM7), which was established only in September 2022 and is still relatively small, follows a different and more diversified approach.

This ETF includes companies like Albemarle, as well as other major and more diversified resource companies such as First Quantum, Freeport McMoran, and Anglo American. It encompasses not only rare earth elements and strategic metals but also commodities like copper, platinum, palladium, zinc, nickel, and more.

Our conclusion

The political influence on the markets for strategic metals and rare earth elements is likely to increase in the future, primarily because excessive prices for these crucial resources would endanger the economic transformation. Nonetheless, the world market prices of these respective commodities are expected to rise in the long term.

However, investing in individual stocks in this sector remains highly speculative, and it's important to be aware of this. Political decisions and even events at individual mines can significantly impact stock prices. The risk is lower with large resource companies that operate across multiple commodities and markets. Diversification is even stronger with commodity ETFs.

Nevertheless, the VanEck Rare Earth and Strategic Metals ETF has not lived up to expectations thus far. The high proportion of Chinese stocks in the ETF further increases the risk. This also applies to the Global X Disruptive Materials ETF, which includes Chinese stocks to the extent of 29 percent.

In both the long-term and actively managed medium-term portfolios of our Premium Investment Letter, we prefer to invest in individual stocks from the resource sector. This approach allows for the potential of outperforming the market. However, for those who are unable or unwilling to do so, the two ETFs can be a viable alternative. However, it is crucial to be aware of the risk of significant price fluctuations.