MACQUARIE

Investment Strategy Update #36

Commodities compendium: in the eye of the beholder

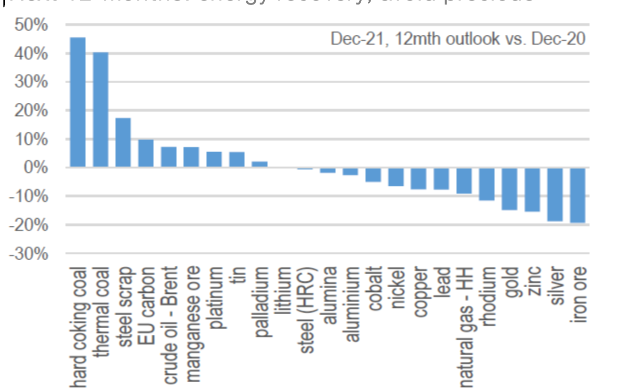
- Macquarie's Commodities team (Team) recently released their 2021 outlook; upgrading forecasts for base metals, iron ore and crude oil while downgrading price forecasts for precious metals.

- Strong demand driven by the continued recovery in economic growth coupled with low inventory will provide support into 1H21 for base metals, steel and raw materials. This will likely taper off however, as vaccine rollouts drive a switch in consumption from goods to services.

- In the near term, energy commodities are expected to remain supported by the recovery in demand however, production overhangs are likely to act as a headwind to crude oil price increases. Long term, demand for thermal coal will be challenged by the increase in renewable energy production.

- Precious metal prices have likely peaked, as investor safe-haven demand subsides. However, prices are expected to sustain high real prices given structurally low real interest rates.

Next 12-months: energy recovery; avoid precious



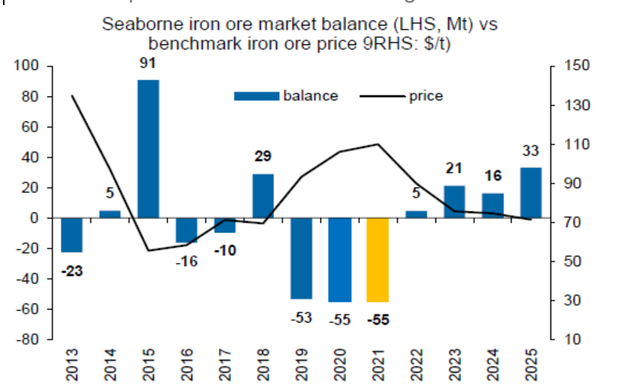
Source: Macquarie Commodity Strategy, December 2020

Base metals: approaching a cyclical demand peak

Base metals have posted a year-to-date price gain in the order of 10-50% driven largely by a rapid and full recovery in global industrial production – at ~2.5% above its pre-COVID peak. Prices outperformed expectations benefitting from China's investment-led rebound and inventory stocking, an increase in goods demand outside China as well as strong positive investor sentiment.

The team expects demand to remain strong into 1Q21, tapering off however as China dials back its stimulus support. The rollout of the vaccine and the expected increase in demand for services (at the expense of goods) should also act to as a headwind to continued growth in demand.

Iron ore to post another deficit through 2021



Source: Macquarie Commodity Strategy, December 2020

Steel and raw materials: prices to hold high

Steel production outside China slumped 14% in 1H20 preventing a build up in inventories while demand was dormant during lockdowns. Demand has surged globally, leaving production to catch-up. The team forecasts global steel output to rise 6.9% in 2021 (taking production to just above 2019 levels) as ex-

China producers continue to recover and China sustains current output. **Prices and margins should hold high** until inventory balances are restocked and/or demand softens.

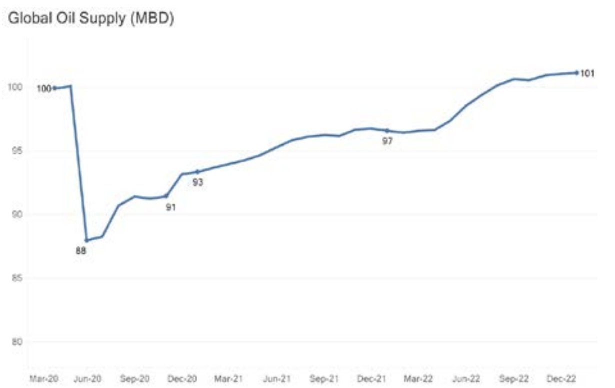
Strong Chinese demand coupled with Vale's production guidance cut will keep **iron ore** supply constrained – with **prices likely to move higher** to encourage marginal supply. Iron ore inventories remain relatively low providing a positive backdrop for prices to remain elevated in the months ahead.

The team is outright bullish Coking coal spot prices for 2021 driven by the increase in manufacturing which is expected to extend into 1H21. Further support is expected from significant pent up demand from the auto-sector.

Energy commodities: challenges remain

Fundamentals in the near-term for **crude oil** remain challenged by the resurgence in COVID-19 in the northern hemisphere winter and the subsequent restrictions on mobility. However, vaccines offer a path to normalisation in demand with the team forecasting a drawdown in oil stocks in 5 of the next 8 quarters. The team remains **constructive on the price** outlook but to turn bullish, remaining latent productive capacity needs to be absorbed (5-8m barrels per day). Brent crude is expected to average $50-60 per barrel through 2021-24.

Supply expected to chase demand in recovery scenario



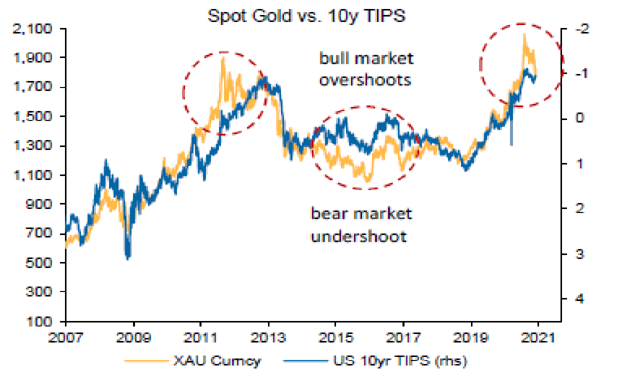
Source: Macquarie Commodity Strategy, December 2020

The long-term outlook for **thermal coal** is challenged by the growth of renewables generation. However, 2021 should see a temporary shortfall in supply (broad economic recovery increases power demand plus a slight easing in China's current import restrictions) which paves the way for price normalisation.

Precious metals: past the peak

The team forecasts that 2020 will mark the peak for **gold** and **silver** prices – safe-haven demand is expected to ease through 2021 and even modest increases in real interest rates raises the opportunity cost of holding zero yield assets.

Growth recovery points to lower gold prices



Source: Macquarie Commodity Strategy, December 2020

In the near term, silver is expected to outperform gold – benefitting from its industrial uses as strong global IP growth continues – but on a relative basis **both metals are expected to decline** as the investor-driven rally unwinds. However, given the low real yield environment, precious metal prices are likely to sustain at relatively high historical real prices.

Macquarie's commodity price forecasts

	2020	2021	2022	2023	2024
Copper ($/t)	6,191	7,050	6,050	5,575	5,675
Nickel ($/t)	13,666	14,750	15,000	15,250	16,000
Gold ($/oz)	1,763	1,669	1,550	1,500	1,550
Iron ore ($/t)	106	110	90	76	75
Met coal ($/t)	125	155	178	163	165
Thermal coal ($/t)	57	74	68	70	68
Brent oil ($/bbl)	44	50	54	58	59
Lithium ($/t)	6,688	6,000	5,625	6,250	8,500

Source: Macquarie, December 2020

Jason and the Investment Strategy Team

The report was finalised on 14 December 2020.

Recommendation definitions (Macquarie Australia/New Zealand)

Outperform – return >3% in excess of benchmark return

Neutral – return within 3% of benchmark return

Underperform – return >3% below benchmark return