

June 10, 2021

Dear Clients and Colleagues:

Inflation has been at the centre of attention recently. The most recent core personal consumption expenditure data release, which excludes food and energy, was at a level not seen in decades¹. Despite this, the Fed has not acted yet, believing that it is transitory due to a combination of low base level and a challenged supply chain. With the economy transitioning from recovery to stability, and no tapering just yet, commodity prices look set to remain at current high levels. Therefore, the question is: are these current commodity prices also transitory, or are we going to enter a commodity supercycle?

A supercycle is hard to define, but can be generalized as a long-term period, usually greater than 10 years, where commodity prices are above their long-term trend. Supercycles are caused by an event that causes a significant increase in global demand. In natural resources, bringing a significant new supply, such as building a large mine or developing a new oilfield to the market (i.e., not just restarting idle mines or oilfields), can take years.

In the last century, there have been three commonly identified supercycles. The most recent was caused by the rapid industrialization of China that consumed raw materials at a pace that oil producers and miners could not keep up with. Before that, there was the oil crisis of the 1970s, which caused an increase in production costs for other commodities, hence lifting their prices. The third was related to rebuilding infrastructure after the Second World War.

Those who believe we are entering a supercycle point to governments needing to focus on job creation and stimulus post-Covid-19, rather than fiscal responsibility in the wake of the great financial crisis. They point to commodity-heavy infrastructure spending and green projects, such as the \$2.3 trillion American Jobs Plan and Europe's Green New Deal as evidence of this. Another reason why we could be heading for a supercycle is the lack of new or expansion projects that could respond to an increase in demand. Each supercycle is followed by an equally long period of low prices as demand wanes and new supply emerges. Recent years of low commodity prices have meant producers have spent less on exploration and production.

¹ <https://www.bea.gov/news/2021/personal-income-and-outlays-april-2021>

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A contrasting opinion is that these commodity prices are more of a spike than entering into a new supercycle, with the recovery and fiscal response being the cause for the increase in commodity prices; this opinion is shared by the Fed. They believe this is not the structural change in demand needed for a supercycle and any increase in demand from the green energy transformation will be offset by slowing growth coming from China. Rather, they foresee sustained rallies in certain commodities more highly correlated to energy transition or electric vehicles and a limited new supply, such as copper, cobalt, nickel, lithium, and some rare earth metals.

Whether this is a short-term spike for commodity prices, or the start of another supercycle, Global Alpha has a diversified commodity exposure across its portfolios.

Westgold (WGX:AU) owns and operates three mining centres in Western Australia, a very favourable mining jurisdiction. These three operations have a throughput capacity of over 4 million tonnes per annum production capacity. The potential upside to throughput will come from the Big Bell mining operations, where production is set to go from 250,000 oz per annum to a long life 300,000 oz per annum average. Westgold has a solid balance sheet and will generate strong free cash flow as the company moves from an intensive capital spending phase.

Alumina (AWC:AU) is a leading Australian resource company with a specific focus on alumina, the feedstock for aluminum smelting. Alumina owns 40% of the world's largest alumina business, Alcoa World Alumina and Chemicals (AWAC) JV with Alcoa. AWAC assets include bauxite mines and alumina refineries in Australia, Brazil, and other countries. AWAC also owns a 55% interest in an aluminum smelter in Australia. AWAC is the world's largest producer of alumina and has a low position on the bauxite and alumina cost curves.

Aurubis (NDA:GY) is a leading integrated copper group and the largest copper recycler worldwide. The company produces over 1 million tons of copper cathodes per year, and from them a variety of copper products. Aurubis also produces precious metals, lead, nickel, tin, and zinc among other metals, as well as additional products, such as sulfuric acid. Aurubis has production sites in Europe and the United States.

Rayonier (RYN:US) is the second-largest timber REIT, with approximately 2.7 million acres located in strong softwood timber growing regions throughout the United States, primarily in the south with some operations in the Pacific Northwest, and New Zealand. What differentiates Rayonier is that they are a pure timber play – they do not own any pulp, paper or wood manufacturing operations.

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Osisko Gold Royalties (OR:CN) is the fourth-largest precious metal royalty company in the world, with a North American focused portfolio of over 140 royalties, streams, and precious metal offtakes. Their main asset is a 5% net smelter return royalty on the Canadian Malartic mine, the largest gold mine in Canada. Osisko enjoys a diversified cash flow from 17 producing assets in low geopolitical risk jurisdictions.

Limoneira (LMNR:US) is one of the largest growers of lemons and avocados in the United States. In addition, the company grows oranges and a variety of specialty citrus and other crops. Demand for fresh citrus continues to grow steadily, driven by a growing middle class with disposable income and changing consumer preferences. Limoneira is vertically integrated due to its packing facilities, and its real estate portfolio could be another source of realizing value for shareholders.

Eagle Materials (EXP:US) is a leading supplier of heavy construction materials, such as cement, concrete and aggregates, and light building materials, such as gypsum wallboard in the United States. The company is a low cost producer, with between 30 and 50 years of raw material reserves. The majority of Eagle's revenues are generated in markets where population growth, highly correlated to construction activity, is expected to be greater than the United States as a whole.

ARC Resources (ARX:CN) is a leading Canadian oil and gas company with high quality assets in the Montney region. After a merger with Seven Generations Energy, ARC is the Montney leader in production, land base, and condensate output.

Have a great day.

The Global Alpha team

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