COHEN & STEERS

Active Commodities

The commodities market had a 6.9% return in the first quarter (in U.S. dollars), as measured by the Bloomberg Commodity Index Total Return.

Investment Review

Commodities rallied as economies worked to open and U.S. employers hired more workers. Positive indicators included signs of continued economic growth, particularly in employment statistics, and the potential for additional fiscal stimulus from President Biden's new $2.4 trillion infrastructure plan. A strong expansion in manufacturing in March reinforced the sentiment that inflationary pressures are building, while continued reopenings and eased travel restrictions continued to point to strong economic activity in the second quarter.

Oil prices held firm even as the global economic picture turned mixed. The petroleum complex (22.8% total return[1]) benefited from rebounding global demand; however, a stronger dollar, the potential surge of Iran barrels (as a result of reentering the JCPOA), and fears that COVID-related lockdowns across Europe would significantly stall the global demand recovery in crude oil and products tempered sentiment toward the end of the quarter. Natural gas (3.0%) was up for the quarter, but a U.S. production rebound in March and weather factors clipped gains.

Precious metals fell amid a continued increase in real yields and the U.S. dollar. Gold (–9.8%) and silver (–7.3%), in particular, reacted to an increase in "real" (inflation-adjusted) bond yields. The yield on the 10-year U.S. Treasury note reached a 14-month high at the end of March. Higher real yields could reduce the attractiveness of precious metals as stores of value.

Index Performance (US$)

	Bloomberg Commodity Index Total Return
Q1 2021	6.92%
1 Year	35.04%
3 Year	-0.20%
5 Year	2.31%
10 Year	-6.28%

Data quoted represents past performance, which is no guarantee of future results.
This information is not representative of any Cohen & Steers account and no such account will seek to replicate an index. You cannot invest directly in an index and index performance does not reflect the deduction of fees, expenses or taxes.
Periods greater than 12 months are annualized.

Industrial metals remained solid despite tapering from a stronger dollar and rising real yields in March. Seasonal builds in Chinese inventories, against heightened expectations of stronger demand post the Lunar New Year, also contributed. The exception was nickel (–3.5%), which lost ground as a technological breakthrough from Chinese stainless steel producer Tsingshan eased concerns around battery-grade nickel shortages.

Livestock (10.4%) gained momentum, initially sparked by an Arctic blast in February and on reports that a new, less lethal strain of African swine fever (ASF) was detected in China. A counter-seasonal increase in U.S. wholesale pork prices, a sign of strong domestic demand, boosted hog futures (27.5%), which were also supported by a bullish USDA Hogs and Pigs inventory report in March and concerns over ASF in China. Cattle futures (2.3%) rose on optimism surrounding the vaccine rollout and the beginning stages of reopening of the food service industry in the U.S. A decline in cattle weights, resulting from adverse winter weather in February, also supported the cattle complex.

Grains sustained a rally that began in August 2020, with tightening conditions observed across the sector. However, on an individual basis, performance was mixed. Soybean oil (26.7%) led the broader sector higher, as rising renewable diesel demand and tightening global vegetable oil balances continued to drive upside surprises to demand. Corn (16.9%) rallied, supported by continued strength in U.S. export demand and USDA reports showing lower-than-expected March 1 stocks and 2021 farmer planting intentions. Wheat (–4.2%) fell as Russian wheat exporters rushed to ship their product ahead of the March 1 imposition of higher export tariffs.

Investment Outlook

We believe the pace of crude oil's rebalancing will continue to progress, with OECD inventories projected to fall below the five-year average in the second quarter. Strong global demand growth and OPEC's compliance with its remaining production cuts agreement are supportive. With significant deficits and greater deviation from the five-year average forecast to materialize in the second half of the year, we have maintained our overweight to the sector. Given our fundamental supply/demand outlook, which discounts the gradual return of OPEC and Iran barrels, we expect Brent

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crude prices to move into the mid- to high-$60s per barrel by year-end. Risks to a sustained price rally include a more aggressive return of OPEC barrels, increased U.S. rig activity translating into higher production, prolonged virus-related lockdowns globally, and the U.S. removing all Iran sanctions and reentering the Iran nuclear deal earlier than anticipated.

We remain cautious on industrial metals, as they have repriced to above pre-COVID levels on a recovery in demand from China and the rest of the world. Contrary to market expectations, there have been seasonal metal inventory builds on the Shanghai Futures exchange. We are more constructive on a medium-term basis, expecting demand to recover globally, helped by fiscal stimulus and lower production resulting from underinvestment during the pandemic. On a longer-term basis, the green energy transition could provide a tailwind for the sector for many years. Within the complex, we continue to prefer copper for its relative tighter forward balances and its demand linkage to the green energy revolution, while appreciating the positive impact decarbonization could have on aluminum in the medium term, especially as China looks to reduce carbon emissions by rationalizing supply.

We see limited upside for gold. U.S. fiscal stimulus prospects and improved vaccination uptake could push real yields higher, or may at the very least help them find a floor, which could cap any upside for gold. This same dynamic applies to silver, but to a lesser extent given its industrial metal features and leverage to a potential Biden green energy stimulus plan. We are underweight the sector, reflecting a silver overweight which is more than offset by our gold underweight.

Cattle prices could remain under pressure through the first half of the year. Placements of heavier animals onto feedlots and large placements during the fall of 2020 will keep the market well supplied into the second quarter of 2021. In the second half of the year, lower slaughter and beef production is likely due to poor cow-calf producer economics. A contraction in the cattle herd has historically supported cattle prices. An impressive rally in lean hog and pork prices and revisions to the USDA Hogs and Pigs report suggest the market has been overestimating the size of the U.S. hog herd and the backlog of animals resulting from the meat packing plant closures in 2020. Tighter supply and strong demand have pushed hog prices to levels we haven't seen since 2013–14, and well past the levels we saw in 2019 during the first ASF wave in China. Still, we think the fundamentals for the hog market in the U.S. are on solid footing, but valuations appear stretched.

We remain bullish on the grains and oilseeds sector due to above-target export demand in the U.S. In addition, deferred prices need to rise to induce U.S. farmers to plant more new-crop corn and soybean acreage than they reportedly intend. We continue to favor corn and the soybean complex, the two areas with the tightest U.S. and global balance sheets and the greatest exposure to continued weather risks in South America. We favor the price outlook for soybean oil over meal, as the demand outlook for renewable diesel and biodiesel remains rosier than that for U.S. and global protein feed demand. We remain less optimistic on the prospects for wheat, where U.S. and global balances remain more comfortable and inventories are drawing down less abruptly year over year.

Because of a potential crop disappointment in Brazil and the likely acceleration of vaccine-related demand from importing countries, we continue to favor coffee. We are bullish on the forward-looking prospects for cotton, with prices evidently not yet curtailing above-target demand for U.S. exports and deferred prices not high enough to adequately defend U.S. cotton acreage against surging soybean and corn values. We remain bearish on sugar prices, with summer and fall contracts still offering favorable returns for sugar production over ethanol, suggesting that at least the start of the 2021–2022 Brazilian crushing season will be tilted toward sugar.

(1) All sector returns are in U.S. dollars. Sector classification of securities in the index are determined by the investment advisor.

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As of 3/31/2021 Sources: Bloomberg, Cohen & Steers

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