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A WORD ON METALS AND THE ENERGY TRANSITION

METALS ARE THE BEDROCK OF THE ENERGY TRANSITION

Benjamin Louvet, Head of Commodities at Ofi Invest Asset Management, tells us how metals are likely to play a key role in the energy transition.

We have been told for years that to move on from oil, we need to switch to alternative energies. How is this affecting metals?

We don't generate electricity with wind or sun. The energy they produce must be converted into electricity, and for that we need transformers. And what do we need to make these transformers? Metals!
To cite two examples, building a wind turbine requires between 950 kilos and 5 tonnes of copper, and an electric car needs four times more copper than an ICE (internal combustion engine) car.
Another example: silver is the best-conducting metal. Five grammes of silver are needed for each solar panel to move electrons around. Now, multiply that by the number of solar panels, for which demand is booming worldwide. The solar sector was negligible 10 years ago but now accounts for almost 18% of global silver demand, and even 25% when including electric vehicle batteries.
To make batteries, lithium, cobalt, manganese and other metals are also needed.
Platinum and palladium are needed for making catalytic converters. Platinum is used more in catalytic converters in diesel vehicles, while palladium is used more in gasoline vehicles. From 2015 to 2020, the palladium price rose by 500%, while platinum took a hit from Dieselgate. These two metals are likely to benefit soon from the toughening of standards on ICE vehicles. During the transition to electric vehicles, these metals will continue to play a key role in making catalytic converters for rechargeable hybrid vehicles, something that we expect to support demand in the medium term. In the longer term, green hydrogen is expected to require a large quantity of platinoids (for electrodes and fuel cells).
Platinum is currently a 250 annual tonne market. Anglo American Platinum recently estimated that demand from the hydrogen sector could alone account for 100 tonnes annually by 2030, or 40% of current global demand.
Demand for metals is thus taking over from demand for oil, and the metals market does not yet look ready to make this transition, particularly in terms of production capacities.

What makes gold a special case among precious metals?

Gold has performed very well on the year to date, and we expect it continuing doing so for several reasons.

First of all, Western central banks' monetary policies appears to be reaching the end of their tightening cycle. Historically, there is a close connection between real (i.e., inflation-adjusted) interest rates and gold prices. As gold generates no yield, its value to investors derives from the yields of other asset classes. So, if interest rates come back down, gold will become relatively more attractive. There is a negative correlation between gold prices and real interest rates.

Meanwhile, central banks are buying more and more gold. To cite one example, in 2022, central banks bought 1136 tonnes of gold, the most since 1967 – even before the end of the Bretton Woods system. This year, in the first quarter alone they bought 228 tonnes of gold, the biggest start to a year since the early 2000s.

The latest survey of central banks, in July 2022[1], found that 25% of them planned to expand their gold allocations in the following 12 months, and none of them reported wanting to reduce their allocations. The recent 2023 update found that 24% of them still planned to expand.

(1) Annual survey of central banks on gold, 2022:
www.gold.org/goldhub/data/2022-central-bank-gold-reserve-survey
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Gold has no counterparty risk, as it is not a debt owed to anyone. That's why it is regarded as a safe haven, even by major central banks, which, incidentally, expect real interest rates to remain low for a long period of time.

We believe that gold could very well hit an all-time high, at over 2100 dollars per ounce.

As for silver, central banks are not specifically active on this market. However, as I explained earlier, silver prices are supported by low-carbon technologies, solar panels and batteries.

How can we invest on the metals market?

The commodities market is subject to the law of supply and demand. When supply is lacking and demand is robust, prices naturally rise.

It happens that demand for metals is intrinsic to transforming our economic system as part of energy transition measures. So higher prices will not cool off demand. The solution therefore lies in investing to expand production, in order to address this structural expansion in demand.

Take the example of copper. In a recent report(2), the International Energy Agency estimated at 220 the number of copper mines worldwide. Eighty more will be needed to meet our energy-transition needs. And it takes an average of 16 years for a mine to become operational, and there are currently almost no announced copper mining projects.

The International Monetary Fund (IMF) has researched the outlook for various metal markets(3) such as lithium, cobalt, nickel and copper. Prices of lithium, cobalt, nickel are expected to rise by "several hundred percent" by 2040 but with most of the movement coming by 2030, while copper prices are expected to rise by 60%, according to the IMF, which added that these are "conservative" estimates.

So, the challenges are huge in this area. It's hard to say how fast the energy transition will happen, as it's subject to economic constraints and unpredictable geopolitical developments, but in the long term structural demand is inevitable.

In investment terms, the metals that we overweighting in our allocations include silver, which is essential to solar energy; copper, the jack-of-all-trades of the energy transition and which is needed everywhere; platinum, which is essential to clean hydrogen, which is helping address intermittence issues in renewable energies; and nickel, which is needed for electric batteries.

There are two ways to invest in these trends:

1 – Shares in mining companies, but we don't feel that is the best way right now, given that, in a phase of transition, they will have huge investments to make, which will drag down their profitability, although in the long term, they could be the big winners of the transition.

It is also possible to invest in companies that are active in the energy transition (e.g., wind power, solar panels, etc.), but their business models must be looked into carefully, as some of them don't yet look mature enough (remember those bankruptcies in solar power with the arrival of competition from China).

2 – Direct exposure to the performance of metals via specialised funds. We believe that commodities provide diversification and a possible decorrelation from other asset classes in an environment of heavy economic and geopolitical uncertainty.

Within a diversified asset allocation, always keep in mind that metal prices are highly volatile. We therefore believe that a conservative allocation should not have more than 2% to 3% in this type of strategy. A balanced allocation can go as high as 5% and a dynamic allocation, 7%. Metals remain a diversification instrument.

When dealing with this type of investment, also keep an eye on exchange rates, given that all these commodities are traded in dollars. Ask therefore if the funds are hedged against exchange rates.

What is your management speciality in this area?

Ofi Invest Asset Management has developed expertise on the market for metals and precious metals, based on in-depth knowledge of the fundamentals that can drive these markets, including regulation, macroeconomic, financial, geopolitical and meteorological trends, and trends in production, storage, etc.

(2) IEA: Energy Technology Perspectives, 2023
https://iea.blob.core.windows.net/assets/a86b480e-2b03-4e25-bae1-da1395e0b620/EnergyTechnologyPerspectives2023.pdf
(3) www.imf.org/en/Publications/WP/Issues/2021/10/12/Energy-Transition-Metals-465899

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Our team is well-regarded on the metals and commodities markets and has more than 20 years of expertise in managing commodities, with 1.4 billion euros in assets under management as of the end of January 2023.

Ofi Invest Energy Strategic Metals is a SICAV subfund meant for both professional and individual clients. It provides exposure to the performance of metals, which we expect to be positive amidst an acceleration of demand, driven by the need to transform our energy system towards a more environmentally friendly model.

This fund offers exposure to the performance of strategic metals without investing in the equities markets. It thereby targets a decorrelation with financial markets in exchange for the risks incurred by this type of investment (loss of capital in particular). Exposure to the commodities markets is achieved through commodity index swaps.

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