



Leaning Into Real Assets

August 2023



KEY INSIGHTS

- Although equities have rallied so far in 2023—supported by falling inflation and improving economic growth expectations in the U.S.—commodity prices have lagged.
- Our Asset Allocation Committee recently added to real assets equities, given attractive valuations for commodity-related assets and improving fundamentals.



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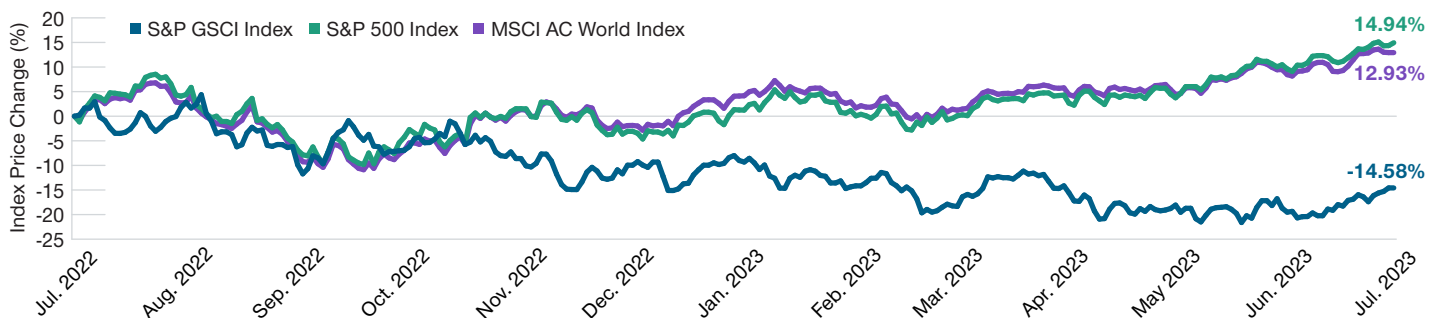
Since the beginning of this year, equity markets have advanced as inflation and economic growth expectations improved in the U.S. However, despite this uptick, commodity prices have been moving in the opposite direction (Figure 1).

Commodities, which are highly sensitive to global economic growth, have been

weighed down by elevated recession risks, especially outside the U.S. Demand has also been muted due to considerable weakness in the Chinese property market and a surprisingly mild winter, particularly in Europe, which reduced the need for natural gas and oil. Meanwhile, the supply impact of Russia's invasion of Ukraine has been more moderate than expected.

Commodities Left Behind

(Fig. 1) Stocks versus commodities.



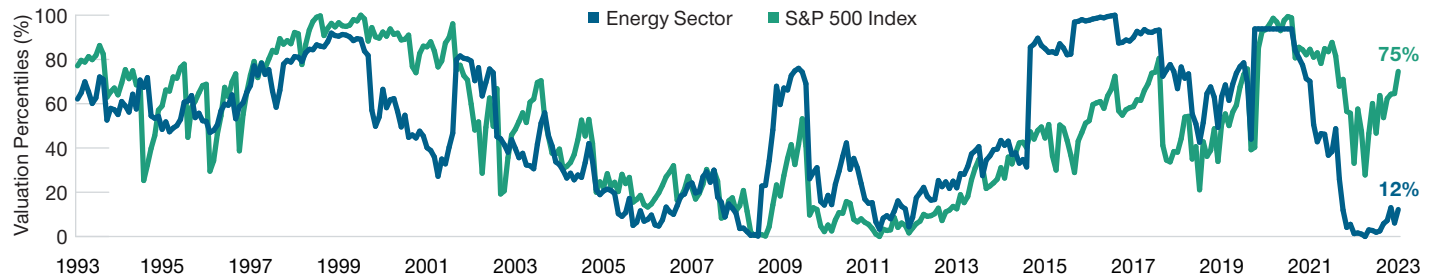
July 25, 2022, through July 24, 2023.

Past performance is not a reliable indicator of future performance.

Sources: Bloomberg Finance L.P., S&P, and MSCI. See Additional Disclosures.

Energy Stock Valuations Are Attractive

(Fig. 2) Monthly valuation percentiles over the past 30 years.



July 30, 1993, through June 30, 2023.

Actual outcomes may differ materially from estimates. Valuation is calculated as next 12 months price-to-earnings (P/E) ratios.

Sources: Bloomberg Finance L.P. and S&P. See Additional Disclosures.

But these headwinds may be fading as energy sector fundamentals improve. China has recently signaled its intention to provide more support to its property market, and Russia's decision to prevent grain exports through the Black Sea could be disruptive to some global economies. Valuations for commodity-related equities have therefore become attractive (Figure 2).

Further, the number of active oil and gas rigs—a useful predictor of energy supply trends—has been decreasing at an accelerated pace since February, an indication that energy supply levels

may be peaking. With this backdrop, the commodities sector is likely to benefit amid strong demand and limited supply.

Inflation could also boost commodity-related equities. Although inflation seems to be moderating in the near term, there are concerns that prices could rebound and surge higher, as they did during the early 1980s when the Federal Reserve eased restrictive monetary policy prematurely. As a result, our Asset Allocation Committee recently increased its allocation to real assets, which include a large allocation to commodity-related equities.

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