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Vontobel Asset Management

Vontobel Fund - Commodity

Approved for institutional investors in: AT, CH, DE, ES, FI, GB, IT, LI, LU, NL, NO, PT, SE, SG (Professional Investors only)

Summary

- Strong recovery in commodities continues
- Base metals pickup on Chinese economic recovery and supply concerns
- Outperformance of fund since start of the year 8.1%

Market developments

The first half of 2020 was quite eventful. We saw the sharpest fall in equities since the financial crisis but also the fastest recovery since the Great Depression. June was another strong month for risk assets backed by a consistent improvement in business surveys (e.g. China PMIs) but also by the hard data that confirmed that economies are improving (e.g. US employment data, US housing data, EU credit growth). Improving economic data and continued reopening of many economies competed with concerning rising COVID-19 cases, particularly in the US where the reopening in certain regions (e.g. Florida, New York) was stopped. Despite fears of a second wave, stock markets (S&P index +1.8%, EStoxx index +6.0%) as well as commodity markets (BCOMTR index 2.28%) continued their upward trend that started in April. Further support came from the flood of central bank liquidity that calmed financial markets and pushed investors away from cash and government bonds into risk assets. The US-Fed signaled to leave interest rates unchanged until late 2022 and the ECB announced its intention to increase the Pandemic Emergency Program program by an additional 600 billion euros. Additionally, massive fiscal stimulus (direct tax and spending policies, loan guarantees, lending facilities), helps to ward off the economic contraction. The direct stimulus from fiscal policy is projected to add 3.5% to global GDP growth in 2020, much larger that stimulus provided in the full 2008-2009 period.

The energy sector (2.2%) was driven by an improved crude oil market balance, as supply shrinks quicker than previously expected and demand recovers faster. WTI posted another monthly gain (+8.7%), lifting the price up by 100% since the lows in April. US production shut-ins responded quickly as rig counts decreased from just under 683 mid-March to less 185 in June as well as production fell to 11 Mio. Barrel per day (mbpd). Brent gained 8.1% on high compliance of Opec+ output cuts, helping to reduce the supply/demand imbalance. Beginning of June, Opec and Russia announced that they would extend production cuts from May and June to July. Oil has certainly seen the biggest swings this year of all the assets after it went into negative territory in April, but seems to stabilize at around 40 US-Dollar now, making it the strongest quarterly performance since Q3 1990 when the Gulf War broke out. Also, products showed strong performance in June, with gasoline up 9.1%, gasoil up 16.8% and heating oil up 11.1.%. Despite this strong performance and improved fundamentals, concerns over a second coronavirus wave dampens hopes for a further oil price rise. Natural gas (-10.8%) was the only underperformer in the energy sector based on low demand as well as low exports due to weak economic activity and continued high US inventory levels.

The base metals complex was the best sector in June (6.9%) on recovery of demand and some mine disruptions, with copper (11.9%) outperforming the rest of the industrial metals. Copper regained its pre-corona-crisis-levels by the end of June. On the demand side, reopening optimism and a V-shaped recovery in China with decent growth in manufacturing and construction activities (Caixin and official manufacturing PMIs were above expectations for June at 51.2 and 50.9, respectively) drove prices. On the supply side, mine disruptions in Peru, where mines were closed due to the nationwide lockdown and continued virus spreading in Chile (28% of global copper supply) rose concerns of a potential supply deficit this year. Mine disruptions and accelerating credit growth in China provided also support for the other base metals (Nickel 3.7%, Zinc 2.6%, Lead 5.7%, Aluminium 4.0%). However, they could not keep up with coppers performance, as their inventory levels are still too high and supply seems sufficient.

Precious metals sector was up 2.2% in June, bringing year to date performance to 13.8%. Gold has held up better than expected during the recent risk-on rally and gained 2.8% last month, rising to the highest level in 8 years. As long as central bank easing keeps nominal yields at these low levels and rising inflation expectation decreases real rates even further, it should provide a tail-wind for gold. The US-Fed stressed more than once the willingness to do whatever it takes for as long as it takes to support the economy get through the recession, signaling unchanged interest rates until late 2022. At these elevated price levels, physical buying from India and China remain subdued. However, record ETF buying levels and bullish money managers positioning more than compensates that. The fear of a second wave was reflected in the US-Dollar, which fell vs all major currencies and provided further support for gold. Silver could not keep up with gold`s performance and ended almost flat (-0.3%). Palladium (-0.3%) and platinum (-3.4%) came under pressure due to sluggish auto sales in US and the EU. Some forecasts see a 20% decrease in global car production in 2020, which might drive a material decrease in PGM demand. However, losses were limited due to very positive Chinese car sales numbers as well as the trend towards individual car ownership.

Portfolio review

During the second quarter, the fund scaled up active positioning in the energy and metals sector, based on the view that the markets were too pessimistic on the economic recovery and the rebalancing process that helped to draw down excess oil and metals inventories. Oil rebounded strongly in line with our view that production shut-ins and shale drilling would lag the recovery in oil demand. Mobility trackers and energy consumptions data (gasoline demand, flight departures) all pointed to a direct rebound when the lockdown measures started to ease. At current price levels for oil (USD 40-45 range), the price recovery may pause for a while and wait for further indication on the speed of the inventories drawdown. We now repositioned active risk towards industrial metals and precious metals (platinum and palladium), since we see China directing enormous fiscal incentives and investments to construction and industrial production. This will strongly support the demand for copper, while copper supplies are lagging. Similarly, we expect that car production in China will rebound quicker than markets foresee. Subsidies and reduced taxes will improve Chinese car sales, whilst production of palladium and platinum remains hindered. Norilsk Nickel had an enormous oil spell that will make it harder for the biggest palladium producer in the world to expand production capacity. In South America, smelting and production capacity of precious metals remains constrained due to Covid-19.

Performance analysis

The Vontobel Fund – Commodity (I share class) gained +6.78%% in June versus a benchmark performance of 2.28%. The full quarter performance is +17.56% versus a benchmark performance of +5.08%, this results in an YTD outperformance of +8.1% The strong outperformance in June followed from underweighting and active curve trading in natural gas (+2.14%), petroleum trading (+0.5%), grains (0.4%) and livestock (+1.1%). Negative contributions followed from precious metals (-0.5%) and underweighting softs (-0.2%). The full quarter 2 outperformance of 11.67% had a similar breakdown: natural gas trading added +4.8%. Petrol trading added +3%, bearish positioning in grains added +1.8% and metals trading added +0.8%, whereas precious metals did not contribute to relative performance.

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Outlook

While market participants consider encouraging economic figures, some of which considerably exceeding expectations, as a sign of rapid economic recovery, uncertainties remain going forward. If cases were to flare up again, a return to potentially far-reaching restrictions on daily life would likely be unavoidable, prompting fears of further repercussions for the global economy. We have been more upbeat on the economic recovery than the market consensus, and this remains so. Though the number of cases continues to rise in predominantly Latin America and Southern states in the US, and is introducing a pause on the recovery, we do not see lockdowns returning to the levels of March and April.

We expect that the rally in oil prices has seen quick repricing of improving fundamentals and therefore attention will shift to commodities that are next to rebound. Base metals draw strong investor interest recently as copper rallied over 30% since the drawdown mid-March. Within the sector we see some further upside potential for copper as it is the most exposed commodity to the investment-driven Chinese recovery, which recently has led to low inventory levels in China. In the past, copper demand continued to grow 2-3 quarters after Chinese stimulus has been withdrawn, suggesting this current rally can continue well into 2021.On the supply side, there are looming risks of further mining disruptions as the largest portion of copper is produced in South America. Contrary to Peru, that suffered from a nationwide lockdown, Chile (world`s largest copper producer) has not yet reported any production cuts so far. However, the virus situation in Chile is far away from being under control and unions have been increasingly vocal about copper's occupational health risks from the virus. In Chile, the biggest mines started to defer projects to upgrade their aging mines in order to prevent virus spreading, as construction work and project development is more labor intense. This could lead to a prolonged period of structural undersupply. Turning to the 'green-focused' infrastructure plans in the US, China and Europe, copper prices should benefit most based on high demand over the next several years. Renewables are very copper intensive as renewable energy systems consume approximately five times more copper than conventional power generation systems.

Performance (in %)

Net returns			Rolling 12-month net returns			
USD	Fund	Index	Start date	End date	Fund	Index
MTD	6.8	2.3	01.07.2019	30.06.2020	-7.8	-17.4
YTD	-11.3	-19.4	01.07.2018	28.06.2019	-13.7	-6.8
2019	9.2	7.7	01.07.2017	29.06.2018	12.6	7.3
3 years p.a.	-3.6	-6.1	01.07.2016	30.06.2017	-5.7	-6.5
5 years p.a.	-4.6	-7.7	01.07.2015	30.06.2016	-6.5	-13.3
10 years p.a.	-4.6	-5.8	Index: Bloomberg Commodity Index TR			
Since launch p.a.	-3.5	-4.6				
Launch Date		07.01.2009	Share class: I			
			ISIN: LU0415415800			

Past performance is not a reliable indicator of current or future performance. Performance data does not take into account any commissions and costs charged when shares of the fund are issued and redeemed, if applicable. The return of the fund may go down as well as up due to changes in the rates of exchange between currencies.

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