



FOUNDED IN

1988

EMPLOYEES

80+

LOCATED IN

10+
COUNTRIES

ASSETS DIRECTLY
UNDER MANAGEMENT

US\$1.9
BILLION

ASSETS INDIRECTLY
UNDER MANAGEMENT

US\$24.5
BILLION



ICM Monthly Outlook

JUNE 2024

Market Review

US short-term interest rates, measured by US three-month treasuries, yielded 5.40% at the end of May. Since July 2023, short-term rates have remained range-bound between 5.33% and 5.46%. At the end of May, US one-year treasuries yielded 5.18%, implying that the market now expects circa one rate cut over the coming twelve months. Expectations of interest rate cuts have repeatedly been pushed out as economic data has positively surprised, and the final steps to return inflation to 2% have proven increasingly difficult.

According to the US Department of Labor Bureau of Labor Statistics, the US economy created 272,000 new jobs in May, while average hourly earnings increased by 4.1% from a year previously, up from 4.0% in the prior month.

Personal Consumption Expenditures (PCE) inflation remained steady at 2.7% in April, having accelerated to 2.7% in March from 2.5% in February. Core PCE inflation remained at 2.8% for the third consecutive month. While inflation remains above 2.0% and the labour market remains strong, the chances of an interest rate cut by the US Federal Reserve remain low.

Long-end, US interest rates decreased by about 20bps in May. This was a welcome respite after the rapid increase early in 2024. For instance, US 10-year treasuries finished May at 4.50%, having risen to 4.68% at the end of April, up from 3.88% at the beginning of the year.

As measured by the Barclays US Aggregate Government Index, US Treasury bonds increased by 1.5% during the month but remained down 1.9% year-to-date.

In Europe, short-term rates declined as the market priced in a rate cut from the European Central Bank (ECB). In early June, the ECB delivered that first rate cut, it's first in almost five years, cutting base rates to 3.75% from 4.00%. ECB president Christine Lagarde said that while there was a "strong likelihood" the decision marked the beginning of declining base rates, future reductions would depend on inflation easing further.

Despite a decrease in short-term rates, European Government bonds, as measured by the Barclays Euro Aggregate Government Index, fell by 0.1% in May as the yield on longer-dated German government bonds increased. European Government bonds are down 2.2% in 2024.

The divergence between US and European longer-term yields meant that the Euro strengthened against the US Dollar for the first time this year, increasing by 1.7%. The British Pound strengthened against the US dollar, as did the Japanese Yen, as Japanese interest rates surged higher during May. The yield on Japanese thirty-year bonds reached 2.22% in May, breaking 2% for the first time since the early 2010s. The 0.3% gain for the Japanese Yen against the US Dollar marked the end of a four-month losing streak for the Yen. The Yen has lost one-third of its value against the US Dollar since the end of 2020.

Market Review continued

In May, the S&P 500 increased by 4.8%, with considerable gains in interest rate sensitive sectors such as Tech, up 10% and Utilities. The Nasdaq showed even stronger performance, rising by 6.9% in the month. With almost all S&P 500 companies having reported earnings for Q1 2024, 79% reported earnings above estimates, with aggregate reported earnings 7.4% above estimates. For the twelve months to the end of Q1 2024, earnings for the S&P 500 grew by 5.9%, the highest annual growth rate since Q1 2022. Based on current analyst estimates, earnings are expected to increase by 11.2% for the S&P 500 in 2024. The S&P 500 is currently trading on a forward Price Earnings ("PE") ratio of 20.7, above its five-year average of 19.2 and its ten-year average of 17.8. It's no surprise to see the S&P 500 trade at a premium, given the colossal earnings growth of 14.0%, priced for 2025.¹

Interestingly, the number of companies citing recession on S&P 500 earnings calls fell again in Q1 2024, marking the seventh consecutive quarterly decline. Citations of recession peaked in Q2 2022 at 235. In Q1 2024, the recession was mentioned on only 29 calls.

In May, European Equities, as measured by the Eurostoxx, fell by 1.3% (2.4% after accounting for dividends). Year to date, European Equities have increased by 10.2% versus 10.6% for the S&P 500. Year to date, the strongest equity market in the developed world has been Japan, with the Japanese TOPIX increasing by 18.4%. Japanese Equities are undoubtedly benefitting from a weaker Yen, which will lead to an increase in overseas sales and a higher sales number in Yen when foreign sales are converted to local currency.

In May, UK Equities, as measured by the FTSE 100 Index, increased by 1.6% (2.0% after accounting for dividends). Emerging Market Equities, as measured by the MSCI Emerging Market Equity Index, increased by 2.0%. Chinese equities, as measured by the Hong Kong Hang Seng Index, were up 1.8%. Commodities, as measured by the Bloomberg Commodity Index, increased by 1.3%, despite oil declining by 7.1% during the month. Natural Gas increased by 29.9% during the month, coal increased by 3.0%, copper increased by 0.8%, and gold increased by 1.8%.

In May, spreads in US investment-grade corporate bonds tightened from 91bps to 88bps. The spread on US investment-grade corporate bonds was 104bps at the beginning of the year. Despite spreads remaining reasonably steady during the month, US Investment Grade Corporate Bonds, as measured by the ICE Bank of America US Corporate Index, rallied by 1.9%. Interest rate moves are currently having a significantly greater impact on investment-grade corporate credit than changes in spreads.

Spreads in US high yield bonds widened from 318bps to 320bps during the month. In April, US high yield bonds, as measured by the ICE Bank of America High Yield Index, increased by 1.1%. Similar to investment grade bonds, US high yield bonds benefitted from declining interest rates during the month.

Market Outlook

In the absence of blockbuster economic data and just for some variety, we're taking a slightly different approach to the outlook section this month by examining the copper and oil markets more closely. Even by our standards, there are only so many consecutive monthly commentaries in which we can debate GDP growth forecasts and the like.

Fear not; next month, we'll be back with more CPI data and the dot plot and can revert to discussing the general market's direction. Just quickly, lest you think we've lost focus, the latest economic data continues the confusing narrative on economic growth. In May, the US economy took two steps forward and one step back from that elusive pivot. Jobless claims and the Institute of Supply Management suggested weakness in the US, but nonfarm payrolls were much stronger than expected. The US 10 year yield was four basis points lower on June 10th than on May 10th.

Our outlook synopsis remains that the disinflation trend is still intact, at least for now. We expect core PCE to drop to 2.5% from 2.8% as lower shelter costs and declining wage costs feed into the year-over-year measure. We expect the jobs market to continue to slow and rebalance. The recent JOLTs report points to this loosening in the jobs market. However, getting inflation much lower than 2.5% could be a struggle as the economy and business cycle still looks resilient.

We think the Federal Reserve will likely start cutting rates even if core PCE inflation does not push lower all the way to 2%, provided it believes inflation is on a sustainable path lower, with few signs of it reaccelerating. The Federal Reserve believes that rates of 5.5% are probably too restrictive and will inevitably pressure certain areas of the economy, which would cause contraction and send the unemployment rate needlessly higher.

Hence, the Federal Reserve will start to cut rates, most likely towards the end of this year, with a view to slowly bringing rates back to a more neutral level of around 4-4.5%. An easing of the monetary cycle will boost liquidity and suggests the business cycle will expand for at least the next 12-15 months. As the business cycle expands, this will be positive for corporate earnings.

What is Doctor Copper?

Doctor Copper is a concept, not a person. It is a market argot for the diagnostic powers of copper, believed to be a harbinger of turning points in the global economy, whether expansionary or contractionary. Year to date, the copper price has increased by 15.33% to its highest level in two years, at \$10,000 per ton.

Copper is ubiquitous in society, with wide-ranging applications from equipment\electricity, construction, transport, and others. Copper is an essential component in renewable energy technologies, including solar panels, electric vehicles, and electrical grids.

Because of its widespread applications, copper demand is often viewed as a reliable leading indicator of economic health. Rising copper prices generally suggest strong copper demand and, hence, a growing global economy. At the start of this month's outlook section, we touched on the positive outlook for the business cycle. In our opinion, the copper price trend reiterates this point.

Outlook for copper prices

Generally, commodity analysts are very bullish on the copper price for years to come based on surging demand for electric cars, data centres, renewable power infrastructure, together with a supply deficit. Copper is expected to be a big winner in the energy transition from fossil fuels to electrification.

Citigroup forecasts that the copper price will increase to \$12k per ton in the coming 12 months. Energy Pathways Chief Strategy Officer predicts \$12 - \$15k per ton, and a well-known commodity hedge fund manager expects the copper price to reach \$40,000 a ton in the next few years, according to the Financial Times.

As far back as 2020, Goldman Sachs predicted a commodity supercycle, including copper, which has yet to transpire. However, the thesis for the upswing in commodity prices is as valid today as four years ago, with potentially less time to wait.

The thesis for copper demand growth has been unchanged in recent years:

- Growing consumption from the lower and middle classes bulwarks demand for energy, transport, and appliances. More people are using copper and oil. That demand looks set to persist, given the globe is near full employment.
- The necessity for environmental change and energy transmission remains intact, especially for copper, as the globe strives for Net Zero carbon emissions.
- China's increased spending on environmentally friendly capex and green energy. Green capex, as it's called, grew by over 100% year on year versus 30% in the previous year. Green capex continues to stimulate demand for commodities.
- Deglobalisation and militarisation are real drivers of commodity prices, though less palatable. Recent large-scale reshoring projects are driving demand for copper in particular.

The decline in the price of copper in the past few years was linked to reduced demand from China due to reduced construction activity. China's policy is shifting toward green capex now, for which copper is an essential component.

Copper's supply-side constraints

The new supercycle incorporates structural supply constraints. Goldman Sachs coined structural supply constraints as "the revenge of the old economy". Capital has been flowing into technology and growth stocks at a rapid rate over the past few years to the detriment of other sectors, including commodities and copper companies. Poor comparative returns from commodity companies, combined with ESG considerations, starved the 'old economy' of the investment it needed to grow its supply base. Structural undersupply is hence a very real risk.

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Recently, supply shortages were exacerbated when the giant Cobre Panama mine was shuttered in late 2023, a decision welcomed by environmentalists after the mine threatened water supplies. Cobre Panama, which began producing in 2019, accounted for 1% of the world's copper output before it was closed.²

There remains a shortage of new supply coming on stream. It takes years to bring a new copper mine onstream, potentially resulting in a long term shortage of the metal. Today, the lead time to bring a new mine on stream is probably longer than ever, given the increase in environmental regulations and local opposition.

On April 25th, BHP made a bid for Anglo American, which analysts believe is a cheaper way for BHP to access copper reserves than to develop greenfield sites. BHP bid nearly \$40 billion for its UK rival, in what would be the largest mining deal on record. If completed, the acquisition would increase BHP's access to copper reserves. BHP is the world's second-biggest producer of mined copper; Anglo America is eighth.³

This attempted takeover tells us we're not yet at the point where companies are willing to make greenfield investments because they can buy other companies more cheaply and with less development risk. Copper prices must go higher, and management teams' convictions will need to be greater before we see a substantial rise in greenfield investment.

If these companies do start to invest, we will see cost inflation, which could drive prices to the next level. We experienced this effect in the oil market about ten years ago. The cost of new production from less hospitable global locations drove up consumer prices. It's just a matter of time before supply constraints bite hard.

Oil demand and supply

The disinflation story of the past nine months occurred against a backdrop of record oil demand (and commodity demand), as illustrated by the oil demand table, consistent with strong GDP growth, especially in the US.

Global oil demand by region (mb/d), 2019-2028

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2022-28	
											Rate	Growth
North America	25.0	22.1	23.9	24.6	24.7	24.5	24.3	24.0	23.8	23.5	-0.8%	-1.1
S&C America	6.7	5.8	6.4	6.6	6.7	6.8	6.9	7.0	7.1	7.2	1.5%	0.6
Europe	15.7	13.7	14.5	14.9	14.9	14.8	14.7	14.6	14.5	14.3	-0.6%	-0.5
Africa	4.1	3.8	4.0	4.2	4.3	4.4	4.5	4.6	4.7	4.8	2.0%	0.5
Middle East	8.8	8.1	8.5	9.0	9.2	9.3	9.4	9.6	9.7	9.8	1.3%	0.7
Eurasia	4.3	4.2	4.5	4.6	4.6	4.6	4.6	4.7	4.7	4.7	0.5%	0.1
Asia Pacific	35.9	34.0	35.7	35.8	37.8	38.8	39.7	40.3	40.9	41.3	2.4%	5.5
World	100.7	91.7	97.5	99.8	102.3	103.1	104.1	104.8	105.3	105.7	1.0%	5.9
Annual change	0.6	-9.0	5.8	2.3	2.4	0.9	1.0	0.7	0.5	0.4		

Source: International Energy Agency, Oil 2023, Analysis and forecast to 2028

For the past few years, we have proffered the investment thesis that structural supply shortages would cause the oil price to increase. Instead, the oil price has remained range-bound between \$75 and \$95, averaging \$83.50 in the past year. So why has the price not increased as we expected?

The answer is lax enforcement of the sanctions because it suited political leaders. Last year, sanctioned oil flowed freely in large quantities, even increasing in many instances, keeping oil prices lower than would have been expected.

Oil supply has increased from sources that we did not expect, sources that are either unstable or unsustainable. For example, sanctioned oil flowed more freely than expected from Russia, Venezuela, and Iran. Russia's so-called Dark Fleet contains up to 600 vessels, evading sanctions.⁴ Despite its war with Russia, the US discourages Ukraine from attacking Russian oil refineries. Lower oil prices in the run-up to the election suit President Biden (and the US). Depending on who the next president is, the US is expected to reinforce sanctions after the election.

Non-Opec supply has also kept oil prices from rallying hard, much to the surprise of many investors. In 2023, the US increased production by c.900k barrels per day, nearly c.400k barrels more than expected. It remains to be seen if the US can repeat that level of production increases year after year. Iran reportedly increased supply by 850k barrels per day in 2023 despite sanctions. Venezuela increased supply by 150,000 barrels per day, emboldening it to start a war with neighbouring Guyana to access oil reserves.

In theory, electric vehicles should cut into oil demand. So far, global governments have used subsidies to entice consumers away from internal combustion engine cars. If governments really wanted to get oil demand down, they would increase carbon/sulphur taxes, but this would have a big impact on economic activity and growth. Demand for fossil fuels will remain in the absence of the political fortitude to bring in unpopular legislation asking voters to live with less. When the cost of decarbonisation becomes very expensive, politicians acquiesce to lesser ideals.

Conclusion

We believe there will be significant long-term demand for copper due to the planned capital spending on electrification in order to power EVs and Artificial Intelligence platforms. Copper will be needed to decarbonise the energy system, yet ESG-minded citizens are likely to continue to rally against new and existing mines, curtailing supply. Higher copper prices seem inevitable. Despite a move toward decarbonisation, this process is likely to remain slow, in the meantime absolute demand for oil is likely to increase. The investment thesis for the commodity supercycle remains intact.

Conor Spencer

12 June, 2024

Source Data: ICM, Bloomberg as of 31 May, 2024.

[1] <https://www.ft.com/content/2b16f721-007d-4148-b4b7-bca15d054bed>

[2] <https://www.ft.com/content/6e5c5657-b50c-4da2-a82c-20e991b87b5f>

[3] ["The recent data lead me to believe this will take more time than previously thought," Collins said in a speech at the Sloan School of Management at the Massachusetts Institute of Technology. "There is no pre-set path for policy."](#)

[4] [Kashkari said at the Milken Institute conference in Los Angeles.](#)

Risk Warning

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