

## Hot Commodities

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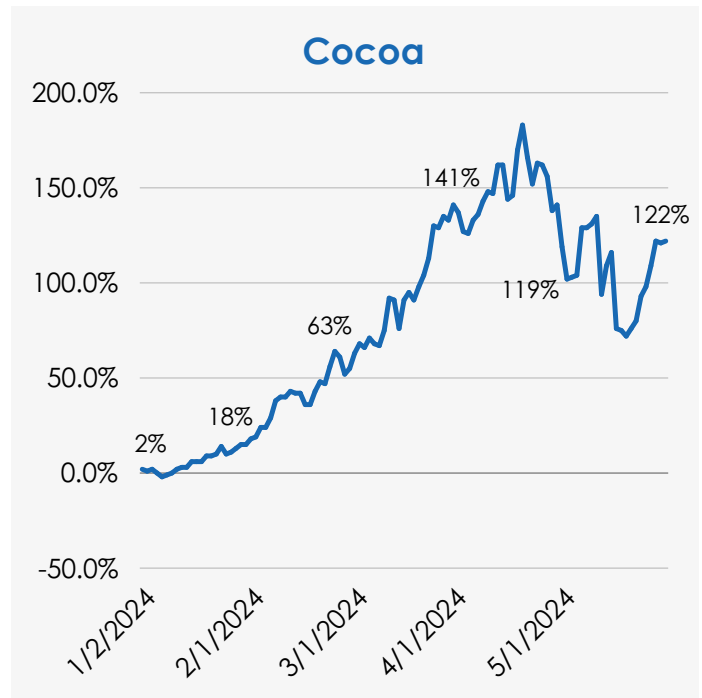
### SUMMARY

- Thus far in 2024, **commodities have experienced significant volatility**. This is exemplified by a tripling of cocoa prices that occurred between January and April. In addition, the price of gold has risen by 13% driven by strong demand from China.
- Within fixed income markets, bond yields have been on the rise as investor expectations adjusted to reflect fewer interest rate cuts by the Federal Reserve. As a result, **investors are able to generate more income on their bonds, creating what we view as a favorable range of potential outcomes**.
- Given this evolution, **we see an opportunity to capitalize on favorable conditions by reducing exposure to gold and commodities and reallocating toward assets with more attractive risk profiles such as bonds**.

Markets in 2024 have been far from mundane. As we entered 2024, investor expectations were that the Federal Reserve would cut interest rates six times. However, higher inflation has backed those projections down to roughly two rate cuts. We've seen the *Magnificent Seven*<sup>1</sup> continue to drive outsized gains within the equity market. More recently, speculative behavior has returned to the fray, with the 'Meme Stock' trade making a comeback in some of the old favorites of 2021. Volatility and even speculative behavior have not just been relegated to traditional stocks and bonds.

Segments of what we consider liquid alternatives, such as gold and commodities, have experienced unique conditions. For example, among commodities, the price of cocoa tripled between January and April.

Figure 1 - Year-to-Date Price of Cocoa

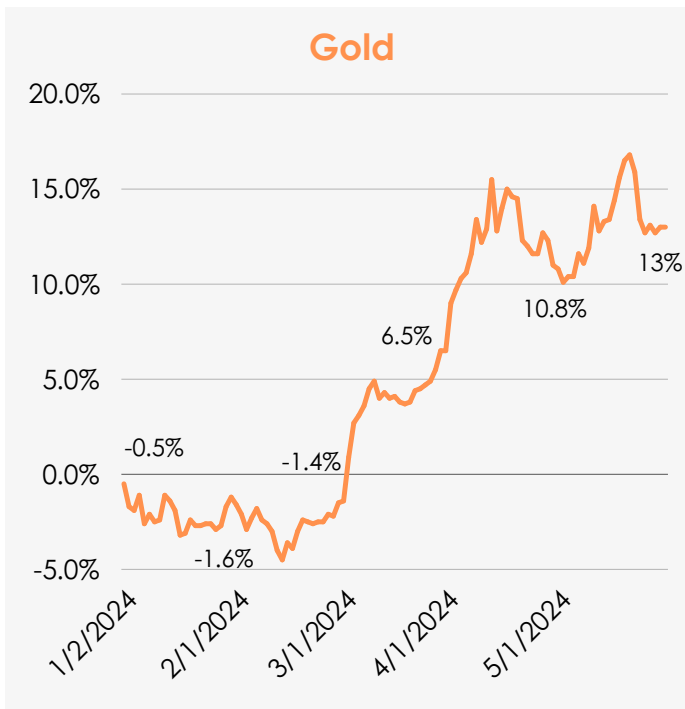


Source: ICE U.S., Bloomberg as of 5/31/24

In addition, the price of gold has been a bit of a paradox. Gold is commonly viewed as a hedge against depreciation in the U.S. dollar and as a flight-to-safety asset. Given these headwinds, as the dollar strengthened during 2024 and risk appetites improved, we would have expected a more challenging environment for gold. Instead, through the end of May, the price of gold has appreciated by 13%. The price surge is mainly attributable to increased demand out of China, while interest from gold investors has declined, as evidenced by outflows from gold funds.

[1] Apple, Microsoft, Alphabet, Amazon, Meta, Tesla and NVIDIA are commonly referred to as the Magnificent Seven.

**Figure 2 - Year-to-Date Price of Gold**



Source: Bloomberg, LBMA Gold Price Index as of 5/31/24

In the markets, there are times to take risks and times to manage risks. Given today's heightened appetite for risk, we believe the focus should shift toward managing risk. At present, we are focused on properly balancing the upside potential relative to the risk of losing money. Along this framework, we find that lower-risk assets, such as traditional bonds, have become more attractive. Alternatively, assets such as gold and commodities that have benefited from favorable sentiment look less attractive.

In the case of bonds, a positive change during 2024 has been the improving yield that bond investors can garner. As of May 31, 2024, the broad bond market<sup>2</sup> offered a 5.2% yield. This compares with a 4.5% yield at the start of the year. We expect interest rates to have some level of volatility as investors calibrate their expectations for when the Federal Reserve will begin cutting interest rates. However, we feel comfortable that present economic conditions

suggest a low probability of an outsized increase in interest rates. Therefore, our base case expectation is that investors can earn a return on bonds comparable to the yield offered on their portfolio. Alternatively, should the Fed begin cutting rates, that could provide added upside given that bond prices move opposite that of interest rates. We like this profile of what we view to be manageable downside risk and attractive upside potential.

Regarding gold and commodities, we don't believe the influences that have driven returns year-to-date can be counted on to sustain continued upward movements in price. In the case of gold, we don't know how long demand will remain from Chinese buyers, and recent indications suggest this demand may be waning. For commodities, speculative trading can continue for some time. However, if it's not rooted in underlying changes to supply/demand conditions, we expect prices to revert eventually. We consider these influences alongside the recognition that gold and commodities have a risk level that is more on par with that of stocks.

We continually adapt portfolios to market conditions. The upward move in gold and commodity prices, combined with improving bond yields, has led us to believe that now is the time to manage risk among liquid alternatives and reallocate this exposure toward more attractive risk profiles, such as those seen in the bond market today.

[2] As measured by the Bloomberg U.S. Aggregate index as of 5/31/24

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