Our outlook for commodities & renewables in a world heading for Net Zero

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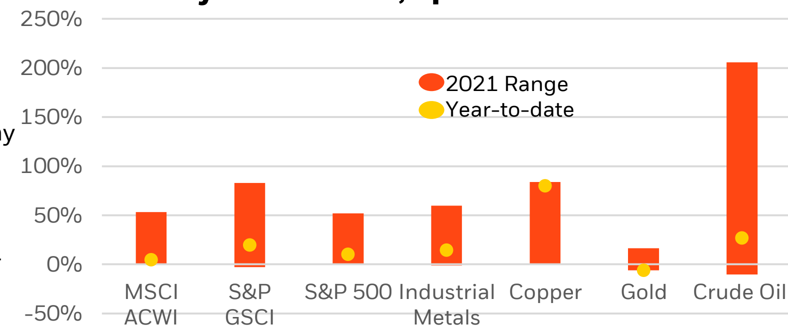
BlackRock.

Commodities have seen a strong start to 2021, with key drivers of demand including investors betting on the global economic restart and increasing concern over sustained higher inflation. At the same time, momentum surrounding the 'greening' of the global economy creates longer-term headwinds for fossil fuels and immediate tailwinds for renewable power.

In a recent *Global Weekly Commentary*, the BlackRock Investment Institute presents a near-term bullish case for commodities, but a more bifurcated longer-term outlook favoring industrial metals over oil and fossil fuels. Expectations of a swift economic restart, and economies including the U.S. and China approaching and reaching pre-COVID growth trend levels, has provided support for both oil and metals – but we don't expect this to be sustained. The green transition will ultimately have a negative impact on oil prices, whereas industrial metals including copper, nickel, and lithium look set to benefit from the structural changes for years to come.

Commodity index returns, April 2020 – 2021 & YTD



Past performance is not a reliable indicator of current or future results. Indices are unmanaged and do not account for fees. It is not possible to invest directly in an index. Sources: BlackRock Investment Institute, with data from RefinitivDatastreamas of April 21, 2021. Notes: The bars show index returns from 21-April 2020 – 21-April 2021. The dots represent index returns YTD as of 21-April 2021. All returns are denominated in U.S. dollars. Indexes or prices used are, in left to right order: MSCI ACWI, S&P 500, S&P GSCI, S&P GSCI Industrial Metals, S&P GSCI Gold, S&P GSCI Copper, S&P GSCI Crude Oil

We spoke with BlackRock experts ***Alastair Bishop***, *Global Head of Sustainable Core Investing & member of the Thematic & Sector Team*; ***David Giordano***, *Global Head, Renewable Power*, and ***Olivia Markham***, *Portfolio Manager, Natural Resources Team covering the Gold & Mining Sectors* on how they see trends in energy, other commodities, and renewables unfolding, and how they believe the transition to a net-zero emissions economy will impact these asset classes. This piece takes a deeper dive into the following themes:

Implications of economic restart for commodities

Commodity prices have benefitted from the global economic restart after last year's pandemic pause. We anticipate continued volatility in commodity prices throughout the vaccine rollout and economic re-opening, but overall prices appear well-supported. Pent-up consumer demand and infrastructure spending plans in the U.S. indicate consistent demand for oil and metals in the post-lockdown world.

Rise of ESG driving the longer-term commodities outlook

We believe ESG should be a core component of the commodities investment process, and view it as both a risk and opportunity. We see winners in this sector being companies that can effectively manage resources, operate under adequate safety standards, and reduce carbon emissions within their operations.

The infrastructure side of the transition to net-zero

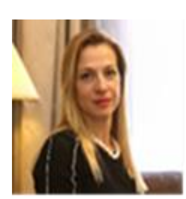
As we forecast oil demand to peak around the end of the decade, investor appetite for energy-transition related strategies is increasing – especially as growth in the traditional energy sector is declining. Beyond renewable power, there are broader infrastructure investment opportunities and capital needs that allow access to the transition, including in the way energy is delivered and distributed as well as smart grid and smart meters.

Contributors

Alistair Bishop, Global Head of Sustainable Core Investing & member of the Thematic & Sector Team

David Giordano, Global Head, Renewable Power

Olivia Markham, Portfolio Manager, Natural Resources Team covering the Gold & Mining Sectors



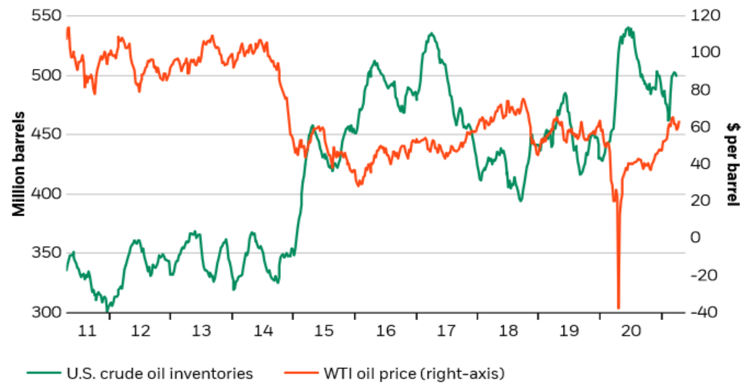
Isabelle Mateos y Lago, Global Head, Official Institutions Group

Implications of economic restart for commodities

Isabelle Mateos y Lago (IML): Alastair, we last spoke on this topic in May 2020 when the oil price was in the high 30s, and you were very confident that it was heading much higher – on which you have been proven correct. Where do you see energy prices going in the near future?

Alastair Bishop (AB): When we last spoke on the topic, the price was at $36 a barrel and talking about the return to USD $60-$70 felt brave, but now we're back at the low end of that range. Though directionally we have been correct, prices have recovered faster than we anticipated – in nine months we've seen the type of recovery you'd expect to take place over 12-18 months. This has been underpinned by strong demand, particularly in Asia, and announcements by Saudi Arabia on further production cuts and weather-related supply disruptions that have helped balance the market. Despite global demand still remaining well below pre-COVID levels, particularly in aviation, we're seeing around 75% of the excess inventories that were built up in 2020 draw down; we believe this trend will continue and global inventories will normalize by the back end of this year.

U.S. crude oil weekly stocks



Forward looking estimates may not come to pass. Source: Refinitiv Datastream, U.S. Department of Energy and BlackRock Investment Institute. 20 April, 2021. Notes: Inventories exclude U.S. Strategic Petroleum Reserve.

In terms of near-term outlook, we are expecting some continued volatility, especially as we navigate vaccine rollouts and new virus mutations that could have an impact on the economic restart. Ultimately, prices look well supported by OPEC and our expectation is that demand will continue to recover strongly post lockdown. Additionally, if you look at the stimulus that is being put in place by the U.S. fiscal package, it is quite oil intensive up front despite being geared toward sustainability in the longer-term. If our forecasts are correct, I anticipate that will also feed into extending the broad inflation narrative, and commodities and natural resource equities are both one-way investors can look to hedge inflation risk in their portfolios.

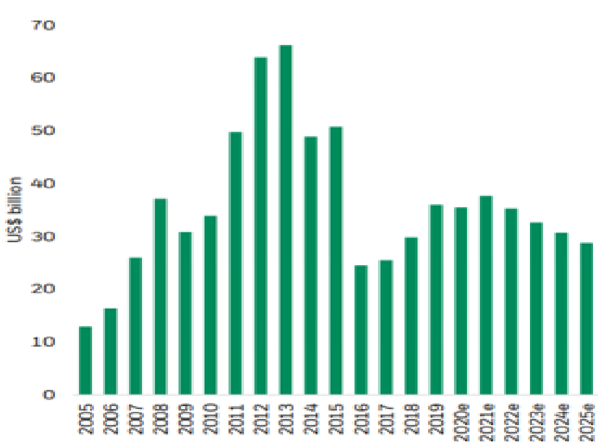
IML: Pivoting to gold and mining more generally, what's the story there?

Olivia Markham (OM): Taking a step back, 2020 was a fantastic year for the commodity sector in general. The first half of 2020 gold performed very strongly, and into the second half of the year as people became more confident in the economic recovery, more industrial-based commodities like copper did very well. We still think we have a strong demand outlook over the next six months or so, by virtue of the sheer scale of infrastructure projects. While commodities prices are at a healthy level, what we're expecting is to see prices move a bit higher but hold at higher levels for longer. This is a function of increasing demand with limited supply:

- **Supply:** Capital spending in the commodities sector has dropped by half since 2013, so there is very little new supply coming into the market. Copper is in a deficit position on a scale we have not seen for the last decade.
- **Demand**: We have a lot of confidence in a strong demand outlook, given the amount of stimulus underway.

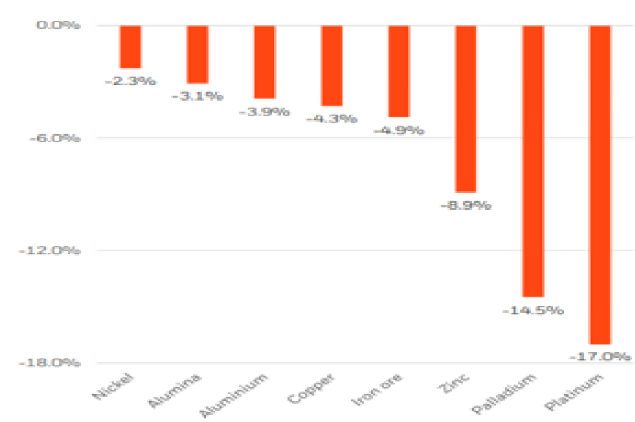
Underinvestment drives tightness across commodity markets

Global mining capex (US$bn)



Past performance is not a reliable indicator of current or future results. Source: BlackRock Natural Resources team, Morgan Stanley 31 October 2020.

2020 mined production estimates – current versus start of the year

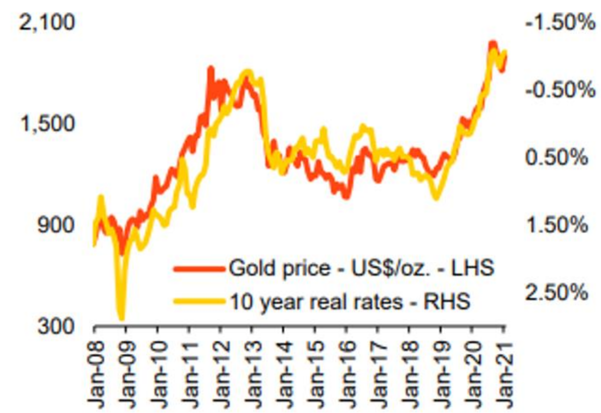


Past performance is not a reliable indicator of current or future results. Source: BlackRock Natural Resources team, Wood Mac, Norilsk, Barclays Research estimates, 30 September 2020.

Implications of economic restart for commodities

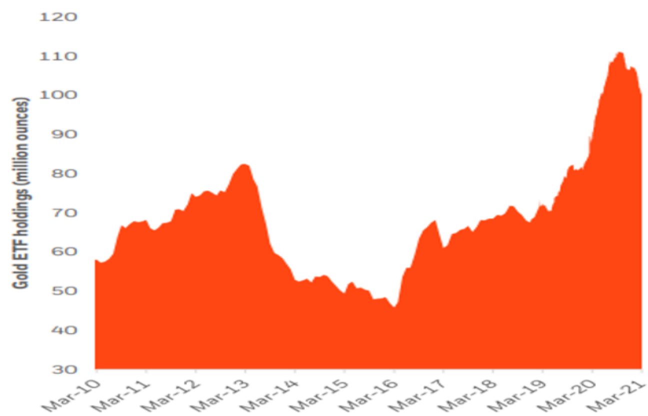
OM: Shifting to precious metals and gold, our perspective is that the gold price still seems largely range-bound. As we're going through this period of strong industrial demand, we believe it continued to underperform along with more cyclical commodities like copper and aluminum. In the medium-term, we still believe the outlook for gold to be very compelling; we are not forecasting a scenario in which nominal rates move significantly higher, yet we've seen the prospect of inflation and there is going to be propensity for real rates to move lower, resulting in a supportive environment for gold.

Gold prices versus real interest rates



Forward looking estimates may not come to pass. Source: Refinitiv Datastream, BlackRock Natural Resources Team, Bloomberg 31 March 2021.

Gold backed ETF holdings at a record high



Forward looking estimates may not come to pass. Source: BlackRock Natural Resources Team, World Gold Council, 31 December 2020.

IML: Do you see a bit of disconnect between how much catch-up we've seen in the price of the commodities versus the equity price of companies that produce them?

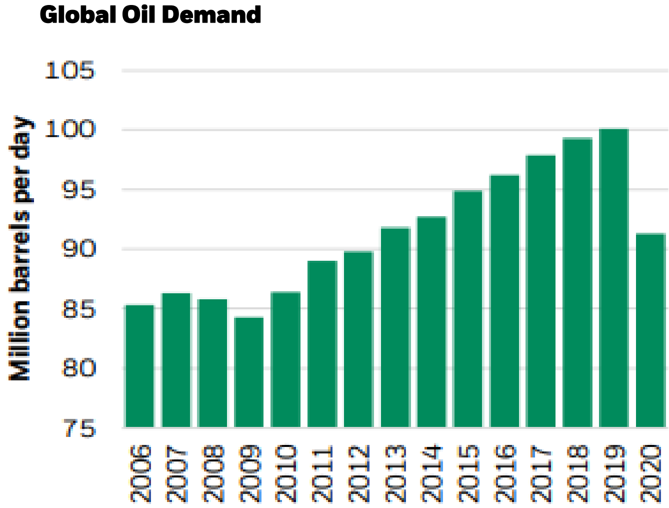
OM: These are companies that are still trading well below their historical multiples, even though they have dramatically improved the quality of their businesses. When looking at the larger mining companies in the space, they all have incredibly strong balance sheets and strong free cash flow generation which has been passed through as dividends. We believe that shareholders in the broader market are beginning to understand and believe in the change we've seen across the sector, particularly from a capital allocation perspective, and that we'll begin to see companies edge back up toward historical multiples.

Rise of ESG driving the longer-term commodities outlook

IML: Alistair, as a manager of both sustainable strategies and traditional energy ones, how strong is the longer-term headwind coming from the transition to more sustainable energy forms?

AB: People often think of this as very black-and-white, i.e. energy company 'X' is bad and solar company 'Y' is good. The reality is there's a lot more grey in that, and we'll need all of these companies to be part of the energy transition if we're going to meet a Paris Agreement- or net zero-aligned future. We're very positive on the pace of transition towards lower-carbon technologies, which naturally has implications for how we think about oil demand over the coming years. We see oil demand peaking around the end of this decade, which is quite a bit sooner than many traditional energy forecasters. But perhaps more importantly, we believe we're already well past peak oil investment. Therefore, we see the scope for an extended supply-led up-cycle, which you could perhaps call a 'super cycle.' We are going to have a tighter oil market in the coming years, because as much as we're very bullish on electric vehicles and electrification, the threat of that has been destroying oil supply quicker than it's destroying demand.

Global Oil Demand



Forward looking estimates may not come to pass. Source: BlackRock Natural Resources Team, Statista, 25 January 2021.

Rise of ESG driving the longer-term commodities outlook

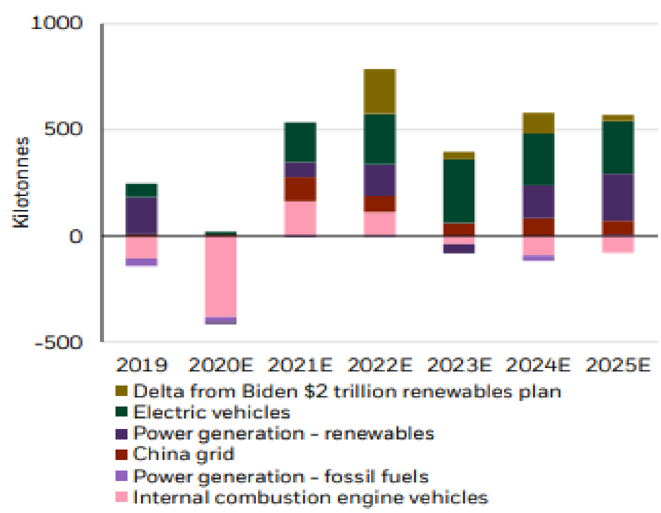
If we look into that in a bit more detail, we're seeing real pressure on companies to prioritize free cash flow overgrowth. Outside of the U.S. and particularly in Europe, we're seeing huge pressure around ESG, which is shifting the investment focus for many of the largest oil companies. We think that even with relatively modest demand growth, we could well be entering a period of structurally higher commodity prices, certainly less volatile for oil markets, and that would mark a major shift from what we've seen in the last decade. This has implications for oil prices and energy equities, and I think perhaps more interestingly broader inflation expectations.

IML: Alastair and Olivia, how do you maintain exposure to your respective sectors in an ESG-friendly way? Are you starting to see price differentiation on this basis, or is this something you expect to build up over time?

OM: ESG must be a core component of our investment process and a kind of investment philosophy, and for many years it's something we've seen as both a risk and opportunity. We spend a lot of time engaging with companies, hitting the road, and visiting assets to really understand a company's approach to managing resources, engaging with local communities, safety performance, and increasingly how they're looking to reduce carbon emissions in their operations. From a risk perspective, if companies can't get ESG right we see that as having significant headwinds to their share price and that would be expected to have a negative effect. But for companies that are improving their ESG credentials, or alternatively their commodities are benefiting from some of the broader ESG trends in the marketplace, we see that as a real opportunity.

In terms of price differentiation, we are beginning to see this. To use an extreme example: most thermal coal equities have come under significant pressure while still seeing demand today. Demand is expected to decline, however, and we're seeing capital dry up in this area. On the other hand, we're beginning to see investors pay premiums for better quality products, meaning there is typically less carbon emissions required to process it. So we're beginning to see some pricing differentials come through, which is rewarding. Higher quality production and higher quality commodities will only further drive and incentivize people to invest in more renewable power sources for their operations, recycling, and higher-grade products.

Increased usage of copper for sustainable projects: Expected usage annual change in copper consumption by usage



Forward looking estimates may not come to pass. Source: BlackRock Natural Resources Team, Citigroup Research, 30 November 2020.

AB: In energy we've spent a lot of time on the engagement side the last few years, working with companies within the space on their strategies and the development of their strategies towards a net zero future and their role within it. It's not necessarily one-size-fits-all, or the right thing for every oil and gas company to go and start building wind farms and trying to compete with renewable energy companies. Instead, it's about whether those companies have a competitive advantage to be part of that energy transition and decarbonization process. To some it may well be things like offshore wind, but it could be in renewable fuels, etc. It could be in emerging markets' renewable energy deployment, or for others who don't have those skill sets it may just be a case of making sure they are right at the bottom or as far down the carbon cost curve as they can be while still being an oil and gas producer.

IML: Are you seeing any clear geographic patterns in terms of ability of these industries to reform themselves and evolve with the transition agenda?

AB: From our perspective, Europe-based companies are farther along that journey in terms of considering their business models and how they can fit within the energy transition. We are starting to see U.S.-based companies move down that pathway as well. They can have very different strategies within those different companies, but it's clear that Europe has been leading the debate around this. Where there will be a need for more public equity capital to be allocated is around less obvious areas like energy efficiency and related infrastructure, and these will be potentially very interesting investment opportunities.

OM: It's interesting how quickly this will occur for certain companies or countries where there's good existing infrastructure and renewable-based grid power, like Chile, while other areas of Africa or Southeast Asia really lack the same necessary infrastructure. Aside from encouragement from management teams and by companies to do the right things in terms of reducing carbon emissions, it's going to take time. As we go through this transition period, it's critical to ensure we're engaging with management teams to understand which companies are properly focusing on this and are investing properly versus companies that aren't responding and making the necessary investment that needs to occur.

The infrastructure side of the transition to net-zero

IML: Following the extreme weather events in Texas earlier this year, there were a lot of questions around the reliability of renewables versus traditional energy sources. David, could you share your view on this?

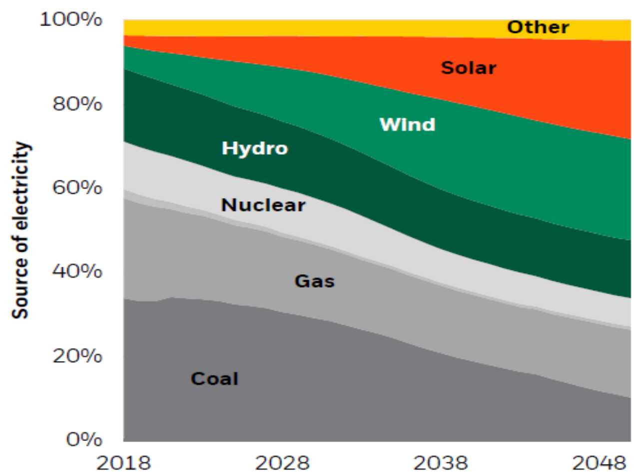
David Giordano (DG): It is an interesting phenomenon that highlights some of the challenges of the energy transition. There are a few important things to note about the polar vortex that went through all of the United States Midwest but hit Texas particularly hard:

1. About a third of all power generation was offline during that vortex. We had massive shutdowns of gas plants, gas wells and compressor stations were frozen, and there was a large nuclear plant that was offline during that period.
2. Texas has made the decision to keep it's grid very isolated from the rest of the U.S. transmission grid, so there was no opportunity to import power from other regional organizations – resulting in a kind of transmission island.
3. Texas has taken a very classic market-based approach and let the price for power dictate behavior on the supply and real-time pricing on the demand side. That system breaks down when you don't have an availability of power generation or plant operators that are being paid to be available, but not necessarily running.

IML: What are you seeing in terms of investor appetite for sustainable power and infrastructure? Are you seeing enough projects to deploy capital, or is dry powder on the radar as a significant concern?

DG: We are seeing an incredible pivot to orient portfolios around investment strategies that are part of the energy transition. If you try to look to where the investable opportunities will be and where the broader infrastructure build-out will be, it's around this reorientation from two-thirds fossil fuel to two-thirds renewables providing electricity generation. This will also have ripple effects on the way the grid is managed, and ultimately how power is generated and used. We'll likely see much more distribution-level power generation and power usage, and some significant infrastructure investment – particularly in global offshore wind as prices there continue to come down. With a lack of growth in the traditional energy sector, I think that renewable energy is where investors are seeing growth opportunities, and the pandemic served as an accelerator of demand for access to strategies that focus on the energy transition.

The world is moving from two-thirds fossil fuels to two-thirds renewables



Source: BlackRock using data from IEA, Bloomberg NEE, May 2019.

As to where projects are coming from, if you go to the lower risk more core type of infrastructure investments, you'll see a very crowded space of investors including funds, direct institutional investors, strategic players that are looking to own these assets long-term. This is a result of the combination of strong cash yields, strong credit quality and our forecast that ultimately these assets will be more valuable as we see greater requirements of other power generation technologies. We also see opportunities in retirement of older projects – such as nuclear power and gas plants. We'll be able to take advantage of the replacement of these facilities as the economy becomes increasingly reliant on nuclear power and gas throughout the energy transition.

IML: Historically, infrastructure investing has been mostly an OECD story, but there is increasing attention on the fact that if you don't address the emerging markets' energy transition, we're not going to make much headway. Are you seeing a gradual rebalancing of investors' geographical interest to align with this?

DG: Where we're seeing opportunities in the Asia-Pacific region, which hasn't been very focused on the energy transition until recently. Japan is leading there in many ways, but now we're seeing places like Taiwan, South Korea, Vietnam, and other non-OECD counties implement dedicated strategic programs with a classic European model of feed-in tariffs that's driving new investment. These are all challenging markets to invest in, and it's the biggest hurdle to attracting large scale international capital. We're seeing more creative ways for that to happen, however, such as significant commitments to figuring out how to create accessible opportunities for these investments, including via government support. The concept of climate migration and energy access are two significant global and geopolitical issues – left unaddressed, we will continue to see more pressure on immigration policy in the developed world. This pressure could result in more vehicles and investable opportunities in these countries to deploy capital at scale but won't be without challenges.

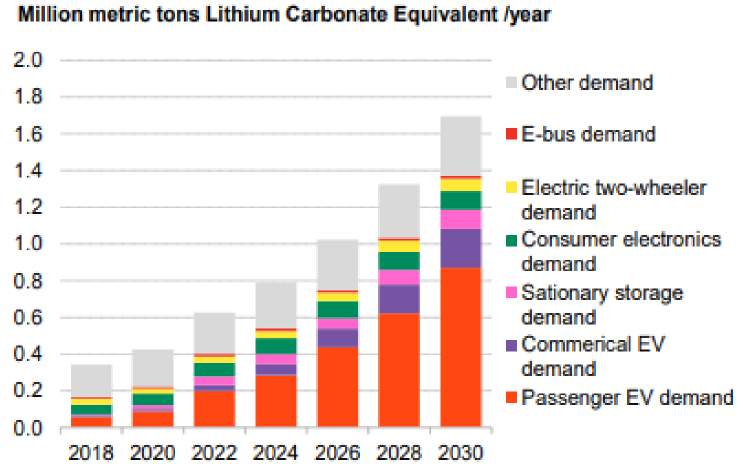
The infrastructure side of the transition to net-zero

IML: We've been talking principally about investing in renewable power generation, but is there also enough investment going into other parts of the energy transition?

DG: As we think about investing in renewable power, we want to continue to grow with the broader energy transition by thinking about wide infrastructure investment opportunities and capital needs. Power generation, onshore winds, solar and offshore winds, etc. will continue to draw the largest demand of capital, but we're also going to see a massive need for investment in how energy is delivered and distributed. Additionally, the increasing demand for electric vehicles will drive the cost of batteries down, which will make better storage a crucial part of the energy transition.

Sustainable Metals: Global Lithium demand expected to increase as electric vehicle market grows

Lithium global demand expectations



Source: BlackRock Natural Resources Team with data from Bloomberg New Energy Finance, 30 September 2020. Reference to specific securities and their issuers are for illustrative purposes only and are not intended and should not be interpreted as recommendations to purchase or sell such securities. There is no guarantee that any forecasts made will come to pass. For illustrative purposes only.

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