



From the Desk of the Asset Allocation Team



Update on Commodities

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Key takeaways:

- Commodity markets continue to post positive returns, with some segments such as precious metals reaching record highs.
- Inflation remains range bound as central banks, including the U.S. Federal Reserve ("the Fed") embark on a new cutting cycle.
- Robust demand and generally tight supply conditions from years of underinvestment continue to provide potential upside for many commodities.

Q1. What's driving gold price momentum?

Gold typically outperforms in periods of uncertainty and recessionary hard landing scenarios (where you'd expect to see bigger Fed cuts, steeper drops in real yields). Despite equity markets climbing to record highs and inflation remaining range-bound, some investment banks continue to revise their gold price targets upward. Some of the factors impacting the price of gold today include:

- U.S. dollar (USD) weakness, global trade and geopolitical uncertainty, central banks diversifying reserves as well as retail investors investing in gold through ETFs, are all factors driving the gold price up. SPDR Gold Trust holdings climbed to their highest level since July 2022 and Gold itself reached almost \$4,000 (USD) on October 6 as investors anticipated additional interest rate reductions from the Fed while monitoring ongoing political turmoil in Washington.
- Disappointing employment figures are acting as a catalyst for renewed speculation about monetary policy easing. Private sector payrolls contracted slightly in August and more significantly in September.
- The partial closure of U.S. government operations, triggered by congressional gridlock over budget negotiations, has added to investor anxiety whilst potentially delaying key economic releases.

Since the early 2000s, TD Asset Management ("we", "our") has seen a very strong linkage between real yields and investment demand for gold. Falling real yields drive inflows into gold ETFs and other gold investment vehicles due to the opportunity costs between gold and yield-bearing Treasury notes.

Q2. What about other metals such as copper or silver?

We have seen notable supply disruption for copper, combined with the copper tariffs announced on July 30 in the U.S. That said, there is still solid underlying global demand for the material, especially within construction industries.

Silver is faring well right now. It has actually outperformed gold in some cases, and tends to follow a gold price pattern with a bit of a lag. Silver also has industrial applications and much of the current interest has to do with skyrocketing power infrastructure demands.

Q3. How about oil? What are the key factors currently influencing global oil prices?

We expect prices to remain range bound over the next little while as supply announcements from Organization of the Petroleum Exporting Countries ("OPEC") are offset by adjustments in demand as the transition to winter fuel takes place.

But we do not see demand slowing down in a structural way, nor from any concerning recessionary indicators. We're actually seeing a very strong global demand trend. Flight activity in China, Asia more broadly, but also Europe and Middle East is continuing to be strong, just slightly under a 3% increase over last year's levels. Similarly, when we take a look at the port activities in the U.S., particularly Boston, and in China, the numbers are supportive of demand.

Q4. We've had lots of geopolitical events that have led to volatility within oil. If we look specifically at Russia-Ukraine, have recent Ukrainian attacks on Russian oil infrastructure impacted global oil supply or fed through into the price side?

Ukraine has intensified its attack on Russian energy infrastructure since May of this year, and September signalled a strategic shift in Ukraine's approach to targeting Russian infrastructure. Previously, Ukrainian attacks were targeting only Russian refined oil infrastructure as refining serves only the Russian domestic market. There were no 2024 attacks on Russian port infrastructure as those services export to other global markets and would have a big impact on prices. However two weeks ago we saw the first attack on Port Primorsk, one of Russia's largest ports.

Ukraine appears to be targeting the same infrastructure repeatedly, and each time it is taking longer for Russian refining capacity to restart after an attack. As a result, we have seen a visible step down in Russian refining output, and Russian diesel and gasoline prices are at record levels. We're not currently seeing shortages, but the prices are high and that is pushing inflation higher.

Q5. How is the Fed rate cutting cycle impacting the commodities market?

A year after the Fed first began to lower rates, we saw a 25-basis-point cut this September of this year. The consensus forecast calls for four or five more quarter point reductions over the next 12 months. Many are taking an optimistic view where growth and inflation moderate just enough to permit for more accommodative monetary policy, but not so much as to trigger a recession. This optimism is evident in the S&P 500 Index consistently hitting new all-time highs and commodity prices rising approximately 7% since bottoming in mid-August. If this consensus is correct, we would expect commodities to continue to outperform, however recession risk remains elevated and inflation indicators are currently above Fed targets. In a less ideal scenario we would still expect to perform well, but we'd expect a much more modest return of around 1.5% to 2%, based on historic trends.

Q6. How would a reflationary environment influence specific commodity prices in the coming months?

Historically, reflationary scenarios have been positive for commodities, driven by energy prices, however we do not believe energy prices will drive performance this cycle. Very high prices in 2021 and 2022 incentivized increased oil supply and we expect to see that supply in 2025. Some of the oil price action in the coming months will be attributable to a storage premium, as the majority of the inventory built is in China, which is outside of the price formation regions of the OECD. This combined with a \$2 risk premium due to Ukraine's attacks on Russian infrastructure will put pressure on oil prices. For 2026 we expect oil prices to be range bound between \$60-\$80.

Q7. What potential risks could emerge that may influence the outlook?

U.S. tariff uncertainty remains a concern for global growth, and we recently saw an escalation in retaliatory measures between the U.S. and China, which could spillover into business confidence and activity. Employment and demand are also important considerations, as we have seen sequential weakness in the data.

The main question moving forward will be how much support can fiscal spending and easing monetary policy provide? The fundamental balance in most commodities is tight, so any unexpected news flow could be disruptive to commodity prices and equity markets as a whole. As always we would encourage investors to diversify their exposure across asset classes, and to consider an allocation to commodities as a way to mitigate downside risk.

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