

CEO Corner

Robust but slowing economic growth in a multi-polar world



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CEO BFI Infinity

A lot has happened since our [last investment update](#) was published in May. While financial markets have been resilient with no major downside moves in the past few weeks, there have been some major developments on the geopolitical front, chief among them being the Taliban takeover in Afghanistan, due to the

rushed withdrawal of western forces that were there for almost 20 years. Two decades after the attacks of September 11, 2001 I think it is important to ask the question: Was it really worth all the lives lost and resources spent to stay in Afghanistan all those years trying to build up a democratic system?

The US and its allies tried to keep up this strategy for a long time but the moment the troop withdrawal began, it became apparent very quickly that Afghanistan can't hold itself together without help from the West. The Taliban took over complete control swiftly and with very little resistance and have now emerged as the clear winner of this 20-year long war. Perhaps the lessons of the past should have been better heeded by the western allies. Several attempts were made by different countries to invade and take over Afghanistan, but every single one failed.

What seemed unimaginable even a few months ago is now reality. The Taliban have already established ties with countries such as Russia and China and they are seeking diplomatic relations with other nations, especially in Europe. Their rhetoric has also changed and Taliban representatives certainly use a softer tone, pledging to protect and respect human rights and promising to build a country that can live in peace and prosperity. Of course, it is clear that these promises need to be questioned and there is still uncertainty in the West with

regard to the Taliban and how they should be dealt with going forward. There are more and more nations openly holding talks with the new government and many seem to realize that the West is running out of options. Apart from Russia and China, countries in the Middle East and several other states have already announced their intentions to open a dialogue with the Taliban. There are hard economic interests that motivate these decisions, as it is still a country with a lot of natural resources. This is especially true for rare-earth minerals and other industrial metals that the world is hungry for. Tapping into those resources and exploiting them with help from international partners is clearly a very high priority for the Taliban in order to finance their new state and to have the financial support that it will take to rebuild the country.

All in all, Afghanistan should serve as a wake-up call for western nations to reconsider their strategic goals and the methods they use to achieve them. While the Europeans and Americans have an increasingly naïve and ideological agenda, nations such as Russia and China are moving fast to defend their interests. Global geopolitical dynamics have shifted and a new world order appears to be emerging. In recent weeks, the U.S. and China had diplomatic clashes on several fronts. China is becoming tougher on various domestic issues and it does not tolerate any interference with its strategic plans. The same is true for Russia, and it is now becoming apparent that we have shifted to a truly multi-polar system with different economic blocs.

In terms of macroeconomics, the global economic recovery continues and is still rather strong, however, there are growing concerns that the momentum is slowing down. The new wave of Covid infections around the world is partly to blame, but the gradual wind-down of the massive fiscal and monetary emergency stimulus also meant that some kind of slowdown was to be expected. This is also clearly reflected in bond markets, where yields have moved significantly lower than earlier this year. This does not mean that there is a recession around the corner, but we are experiencing a slowdown

to a growth rate that looks more realistic. One risk we are seeing is that politicians and central bankers could hesitate to press ahead with taper plans and instead continue to add more stimulus in an attempt to keep the economy going. This could result in “overcooking” the economy and it certainly remains a risk going into 2022.

From our point of view, the most important change we are currently witnessing is in the regional performances of global equity markets. While the US had the lead for most of the last 10 years, Europe has been catching up lately and is now showing promising momentum. We think there is a good chance that European equity markets will outperform the US in the coming years, despite some fundamental problems that persist in the bloc. We think that our call to overweight Europe has come at the right time. We also feel that Asia might be surprisingly strong in the coming years. The region has been a clear underperformer in recent months, despite the sound long-term fundamentals. From a valuation point of view, Asia looks very interesting. We are finding more and more attractive investment opportunities and it is likely that we are going to expand our allocation to Asia in the coming months.

Overall, while simply holding the market was enough in the past, we are convinced that active investment management with added risk management is the way to go in the future. This is why we have put a lot of work into developing a state-of-the-art investment process that allows us to screen and search for the most interesting global investment opportunities with maximum efficiency. More and more clients are recognizing that the global investment portfolios that we are building for them, combined with an international banking solution, is really the better way of managing their wealth. Also, the pandemic certainly made the world a smaller place. Everyone is now used to working from home and doing things remotely. So, whether the investment advisor is in Denver, New York, Los Angeles, or Zurich is no longer that relevant anymore.

Last but not least, as we are entering the final four months of the year, there is statistical evidence that markets tend to be very volatile during September and October and certainly the risk for larger corrections seems to be real. Despite that, we remain fully invested, but continue to hold the hedges that we included in our standard strategies. There are good reasons to be a bit cautious over the coming weeks, but we believe that there is still significant upside potential until the end of the year and then going into 2022.

Looking ahead to the next year, we feel that the increasingly positive outlook for international markets, as well as a potential decline in the value of the U.S. Dollar, make the case for international investments and diversification even stronger.

Feel free to contact us directly at info@bfiwealth.com, with any questions. We look forward to hearing from you.

The coming copper boom



Dirk Steinhoff
Chief Investment Officer

As we already anticipated in our [September 2020 edition](#) of the BFI InSights that focused on the outlook for commodities, it's been a very interesting year for base metals investors. In this edition of the InSights, we'll look at copper in particular, as through its many uses

and extensive demand it plays an integral role in the global economy, although most of the trends and dynamics we'll examine apply to other important base metals too, e.g. nickel.

The recovery phase from the Covid crisis translated into substantially higher demand levels for copper, a trend that is set to continue and accelerate thanks to the global surge of "green" investments. According to the Australian Government's Department of Industry, Science, Energy and Resources (DISER), "after increasing by an estimated 2% in 2020, refined copper consumption is forecast to increase by 5% in 2021, to

reach 25 million tonnes". However, long established market dynamics, such as chronic underinvestment, have caused severe supply shortages. This mismatch is already pushing prices higher and given the long lead times for the development of new mining projects, copper prices are poised to keep climbing in the years ahead.

A decade of underinvestment

Prior to the onset of the Covid crisis, the base metals sector as a whole has been plagued by weak prices for over a decade, which led to significant underinvestment. Copper was no exception, with capital expenditure in new mining and exploration projects stuck in a steep decline.

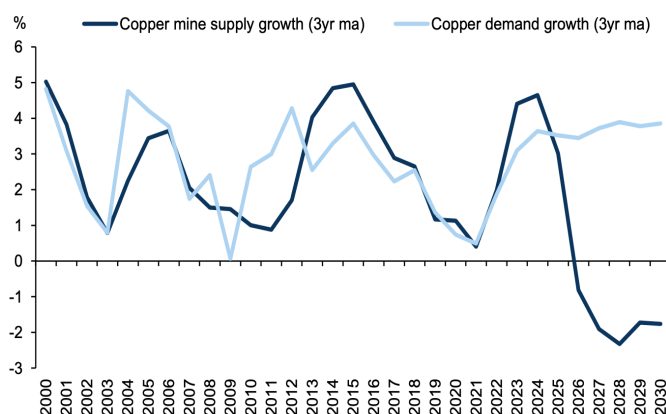
Even as prices began to pick up in 2020, sending a signal that could stimulate new mining investments, the supply gap that was created during the previous decade is still bound to persist. Given that it takes 2-3 years to extend an existing mine and up to 8 years to develop a new greenfield project, the copper market seems to be entirely unprepared to meet the now roaring demand. Today, the copper price hovers around \$4.3 per pound, but as Richard Adkerson,

Figure 1: Copper price



Source: Bloomberg

Figure 2: Copper mine supply growth vs demand growth, yoy %



Source: Goldman Sachs

the CEO of Freeport-McMoRan, one of the largest copper producers in the world, put it at an industry gathering in March, even if copper prices soared to \$10 a pound tomorrow, it would take his company seven or eight years to bring new production to the market.

On top of anaemic prices presenting a major disincentive, producers have also been reluctant to invest in new mines because of oversupply fears, a lesson they still remember from the early 2010's, when the mining sector overextended itself with fresh capital expenditure, only for the copper price to collapse shortly thereafter. After this experience, the mining sector largely scaled back spending and focused instead on offering generous dividends to shareholders.

In addition, many miners have also been hesitant to venture into new projects because of the mounting regulatory pressure from governments, as rising social and environmental awareness has translated into stringent ESG requirements, heavier compliance burdens and operational challenges. Unearthed copper deposits are often found in remote locations that can present serious social, environmental and technical challenges, while public opposition and legal battles can cost miners a lot of time and money, as was the case with important projects like Resolution Copper and Pebble in the US and Tampakan in the Philippines. What's more, according to a study by the University of Queensland, almost

half of unmined copper ore bodies are found in politically unstable or and ecologically sensitive areas: "47% of them are on or close to indigenous peoples' lands, while 64% are located within or near areas critical to biodiversity conservation". Finally, according to the same research, it is expected that future copper mines will be lower grade and generate more waste and hazardous byproducts, further complicating the decision to invest in a new project.

As a result of all these factors, global mining and smelting capital expenditure, which peaked at \$220 billion in 2012, only reached half that level in the past year, according to Wood Mackenzie. As for exploration spending, according to Tribeca Investment Partners, it also dropped dramatically from \$35.7 billion in 2012 to just over \$10 billion.

A recent in-depth report by Goldman Sachs, titled "Copper is the new oil", also identified this severe supply shortage as a key factor that is set to propel copper prices higher for longer, estimating a mine supply peak to be reached by 2024 and a long-term annual supply gap of 8.2Mt by 2030, "twice the size of the gap that triggered the bull market in copper in the early 2000s."

Inflation on the rise

Over the last few months, we saw CPI pick up significantly in a number of advanced economies, including a surprise 5% jump in May in the US and a 3% increase in the Eurozone in August, the highest level in a decade. Central bank officials rushed to reassure investors that this uptick was merely "transitory" and that inflation fears were overblown. They insisted that inflation is under control and while they adjusted their targets to accommodate higher levels than the traditional 2% goal, there were no real monetary policy changes. While there has been vague talk of tapering and tightening at some point later this year, neither the Federal Reserve nor the ECB have announced a concrete timeline for interest rate hikes or for scaling down their asset purchases.

Given the extreme disruptions caused by the pandemic and the shock to the global economy, it is entirely possible that the sudden spikes we saw

in official inflation data could indeed be “transitory”. We could very well see a drop in CPI figures in the coming months, however, this drop will most likely also be “transitory”. The long-term picture is quite clear: inflationary forces, primarily monetary and fiscal policy excesses, but also supply chain disruptions, wage pressures, de-globalization and other factors, are bound to overshadow deflationary ones. In this scenario, copper, as well as other base and precious metals, offer a reliable hedge and are thus set to see greater demand levels.

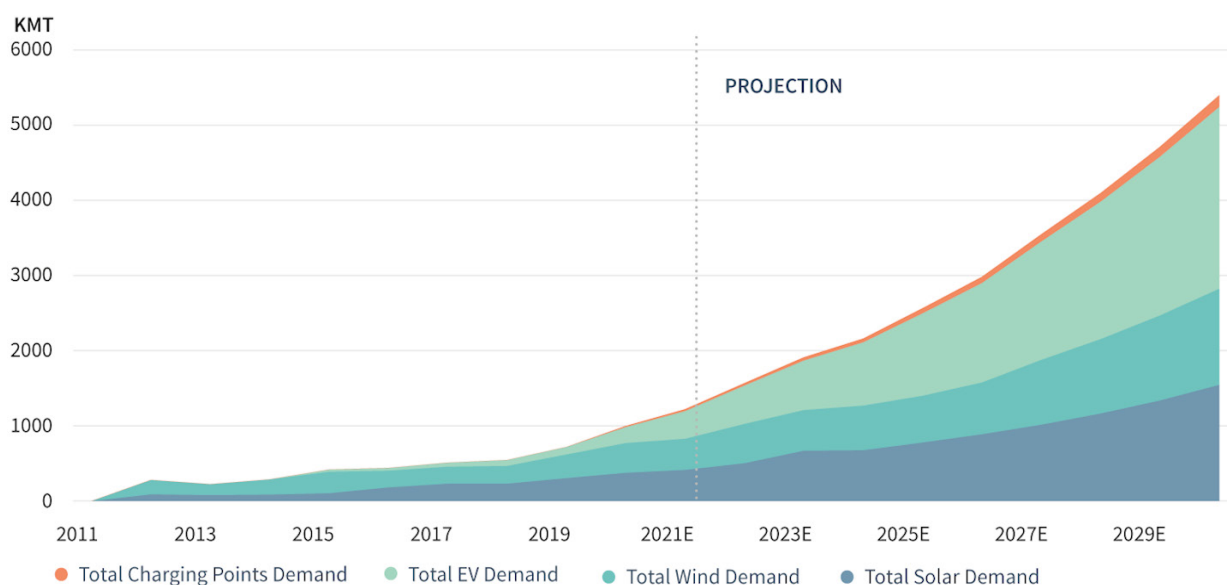
The Green transition

While copper has countless industrial uses, its primary role as the most cost-effective conductive material places the red metal at the heart of the global decarbonization drive and at the forefront of the fight against climate change. It is heavily used in wind and solar energy projects and it is a key ingredient in shifting our current energy system away from hydrocarbons and toward renewable sources, while it is also heavily used in the production of electric vehicles (EVs) and the charging infrastructure they require.

This is especially important given the fact that virtually every government, political party, international organization and multinational corporation on the planet has thrown their full support behind the “green revolution”, along with massive funding and regulatory incentives. “Green demand” for copper is set to soar over the coming years, partially driven by huge government spending programs aimed at “zero emission” goals and clean energy investments, such as the “European Green Deal” that hopes to turn the EU into the first climate neutral continent by 2050, or US President Biden’s \$2 trillion climate plan.

Another crucial demand driver is expected to come from the automobile industry and the tectonic shift toward EVs that is already underway. Copper plays an essential role in vehicle electrification: A standard EV’s copper content is four times larger than that used in an internal combustion engine, as the Goldman Sachs report points out. In addition to this, the wider adoption of EVs also brings with it the need for the infrastructure and equipment to charge them. Copper is once again central here too, as it is extensively used in charging units, port charging cables and in the wiring needed to connect chargers to electrical panels.

Figure 3: “Green” demand for copper



Source: Goldman Sachs

Thus, the exponential sales growth that hybrid and electric cars have seen in recent years strongly supports the bullish case for the metal. Government pressure and incentives towards wider EV adoption are also ensuring that the trend will not be reversed anytime soon. In the U.K., PM Boris Johnson announced plans to halt the sale of new diesel and gasoline vehicles by 2030, while similar schemes have been adopted by many other nations, including Germany, China and Israel.

The Covid effect

Even without the impact of the pandemic and the unprecedented disruptions that the lockdowns and the various restrictions caused to copper producers, the outlook for the metal would still be very positive, given the aforementioned demand drivers and pre-existing market dynamics. Supply was already tight and demand was already on the rise, however, the Covid crisis aggressively widened that gap and compounded the global shortage problem.

Forced work stoppages and mine closures, as well as serious transport and logistics challenges, have caused considerable delays and impacted output levels. As S&P Global reported, "government-imposed lockdowns reduced copper production by around 500,000 mt last year, particularly at mines in the Americas. Worst affected was Peru, the world's second largest producer of the metal, where production fell by around 15%."

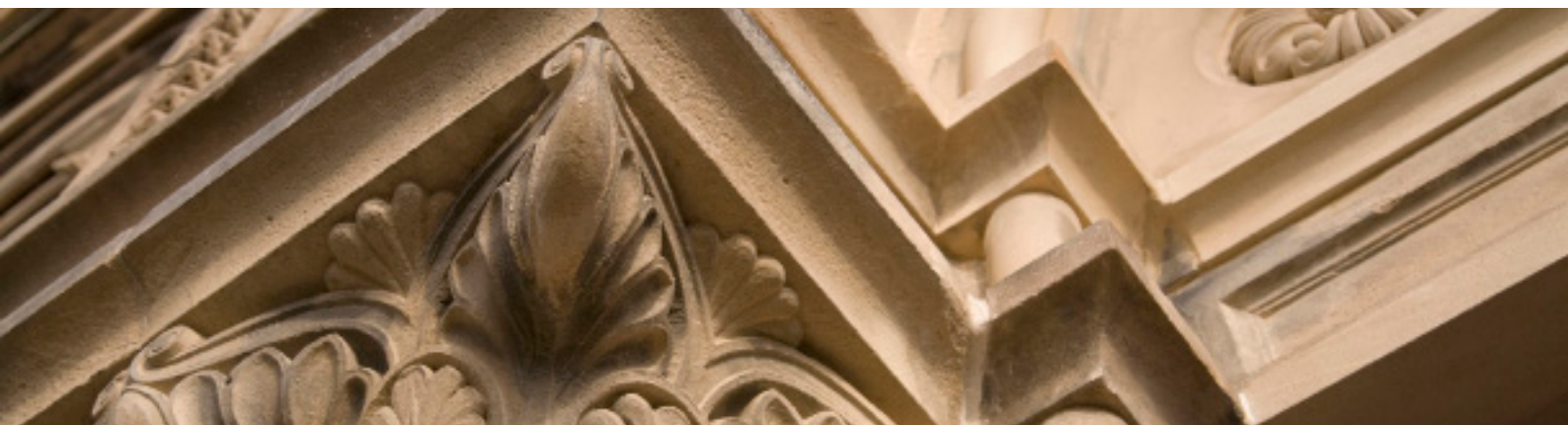
This year, demand for copper was supercharged by the reopening of major economies and the transition to the global economic recovery phase, while it was also heavily supported by the massive stimulus packages launched by governments all over the world.

Investment implications

At BFI Infinity, we are very bullish on copper, and even as prices have already rallied 80% over the last 12 months, we believe that this is very likely just the beginning of an extended multi-year bull run.

That being said, it is crucial for investors to keep in mind that nothing goes up in a straight line and that setbacks and corrections are to be expected. As in any bull market, these setbacks might be acute and periods of heightened volatility could make it hard for investors to sit tight and ride the uptrend. After the significant rise of the copper price since March 2020, we wouldn't be surprised to see some price consolidation or even a more pronounced pullback over the next weeks and months, especially against a backdrop of worse-than-expected global economic indicators after the end of the lockdowns. However, such setbacks offer excellent entry opportunities for investors with a medium- to long-term horizon.

It is also important to keep the bigger picture in mind. As we highlighted in our ["On the Brink of a New Era"](#) report, it will be crucial for investors in the coming years to adapt their investment strategies and align them with this new era. Investment strategies composed of only traditional investments like stocks and bonds that worked well in the past will not, in our view, deliver the same returns going forward. Investing more in alternative and real assets, and enhancing not only the performance of your portfolio but also its wealth preservation character, is a core element of this realignment process and the bright outlook for copper factors into these strategic considerations.



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