

Alternative opportunities

2024 outlook and methodology | USD | Q2 Update

Invesco Solutions

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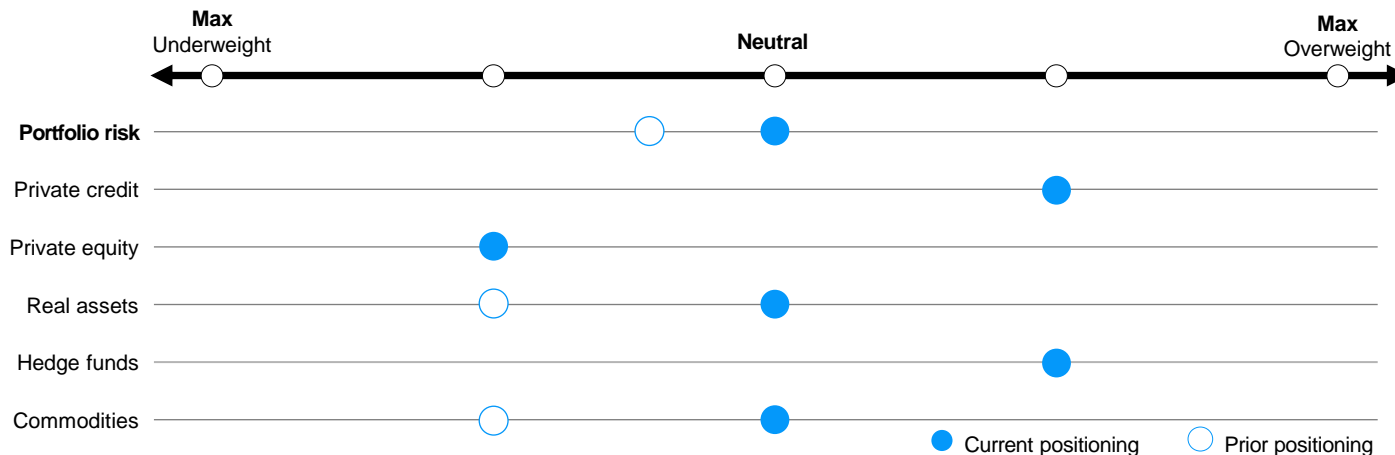
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2024 alternative opportunities – Q2 update: Alternatives outlook

Executive summary



Jeff Bennett, CFA
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Private credit

The backdrop supporting a more favorable transaction environment is firmly in place, including better visibility into the macro environment, softening inflationary pressures, potential rate reductions, and heightened pressure from LPs for PE firms to generate realizations and invest in new platform companies.

Private equity

Leveraged buyouts (LBOs) are facing tremendous pressure to realize distributions to limited partners in a constrained exit environment due to elevated valuations and a limited appetite within public markets for IPOs. We reassert our focus on growth strategies versus those that require expensive levels of debt.

Real assets

We remain confident that, depending on the region, we are either at or close to the trough of private real estate valuations. Looking forward, it is our conviction that the next couple of years will offer very strong forward-looking returns, hence our upgrade of real assets to neutral.

Hedge funds

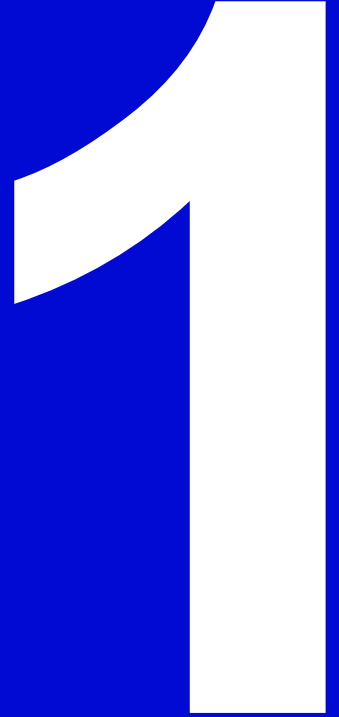
At present, merger arbitrage spreads are slightly above their long-term average and represent a decent total return potential. Allocations to merger arbitrage hedge funds will likely come from fixed income in this environment.

Commodities

Commodities hit a 15-month high during the quarter, led by the surging price of metals, including silver and copper. As a result, trend measures saw the largest improvement in Q2 and allowed the asset class to transition from underweight to neutral.

Private credit

Direct lending
and real asset debt



2024 alternative opportunities – Q2 update: Private credit



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Head of Direct Lending
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Global Head of Commercial
Real Estate Credit

Presently overweight direct lending due to attractive valuations and terms on new vintages

Asset class	Overall	Valuations	Fundamentals	Secular trend
Direct lending	Overweight	Attractive	Neutral	Attractive
Real asset debt	Overweight	Attractive	Neutral	Attractive
Distressed/special situations	Overweight	Neutral	Neutral	Attractive

Direct lending

The macroeconomic conditions, geopolitical events, and the US Federal Reserve's (Fed) aggressive tightening stance in 2023 created a challenging environment for merger and acquisition (M&A) activity. While the transaction activity was slow, the quality of the deals that were executed was among the most compelling we've seen in direct lending. Only the strongest credits with conservative capital structures and tight documentation were able to cross the finish line. Further, given the floating rate nature of the asset class, direct lending offers yields of 12-13%, unlevered – a very attractive level when compared to historical yields of 7.5-8.0%.

In 2024, so far, the Fed continues towards a more accommodative monetary policy. While the timing and magnitude of their actions remain to be seen, we expect the impact on direct lending yields to remain fairly muted. If

our assumption is correct, the Fed cuts three times in 2024, along with potentially modestly tighter spreads and original issue discounts, we believe direct lending yields should only decline 50-100 basis points (bps). Further, we maintain that the backdrop supporting a more favorable transaction environment is firmly in place, including better visibility into the macro environment, softening inflationary pressures, potential rate reductions, and heightened pressure from LPs for private equity firms to generate realizations and invest in new platform companies.

Distressed debt and special situations

2024 is likely to remain a difficult year for many small-capitalization companies and, in particular, over-levered corporate issuers.

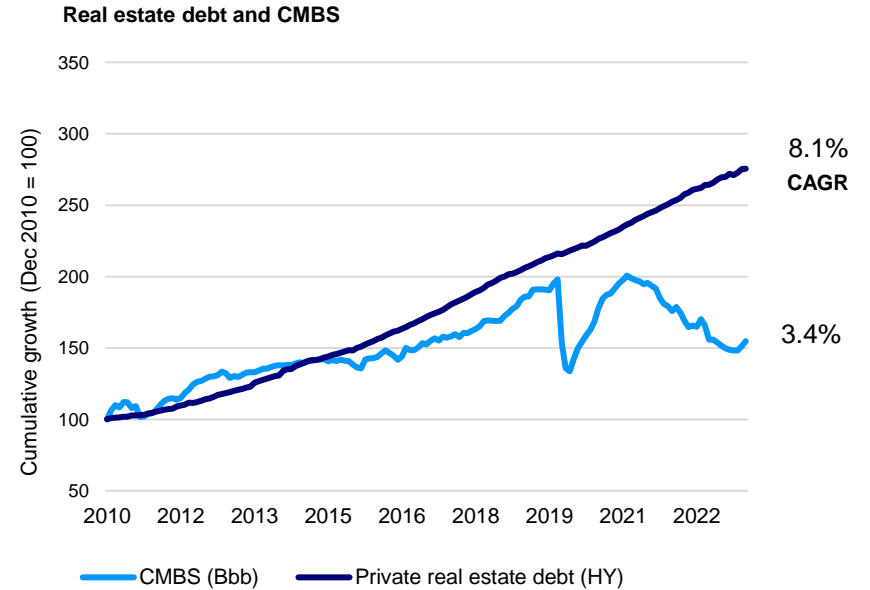
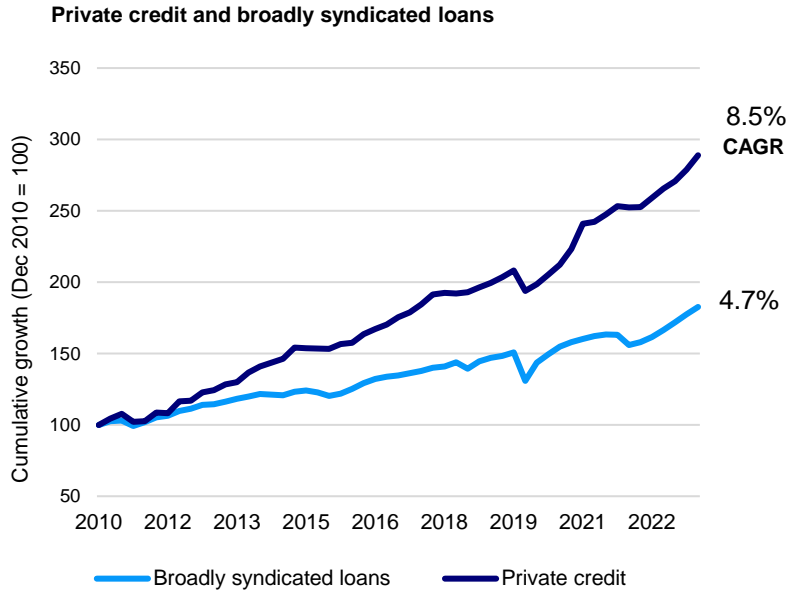
We believe the special situations market, which encompasses everything from rescue financings through capital solutions and strategic capital investments, is very attractive.

We believe such opportunities, especially where restructurings can be avoided altogether, allow for equity-like returns while remaining in a strong credit position within a capital structure – offering the potential for strong risk-adjusted returns.

Commercial real estate debt

Despite uncertainty around rate cuts, general market sentiment is that green shoots are beginning to emerge as the market widely believes commercial real estate values have likely bottomed out since the end of 2023. Further, while expectations for rate cuts are now in question, overall debt costs are decreasing, with spreads generally tightening across capital markets, providing some relief for real estate valuations.

Cumulative growth of private credit vs. public credit



Sources: Investment growth of 100; Private credit represented by the Pitchbook Private Debt Index and broadly syndicated loans represented by the Credit Suisse Leveraged Loan Index quarterly from Dec. 2010 to Dec. 2023; CMBS (BBB) represented by Bloomberg Non-Agency Investment Grade CMBS: Bbb Total Return Unhedged Index and private real estate debt (HY) represented by the Gilberto-Levy High Yield Commercial Real Estate Debt Index (G-L 2), monthly from Dec. 2010 to Dec. 2023. Private credit is net of normative fees, while loans are gross of fees. **Past performance does not guarantee future results.**

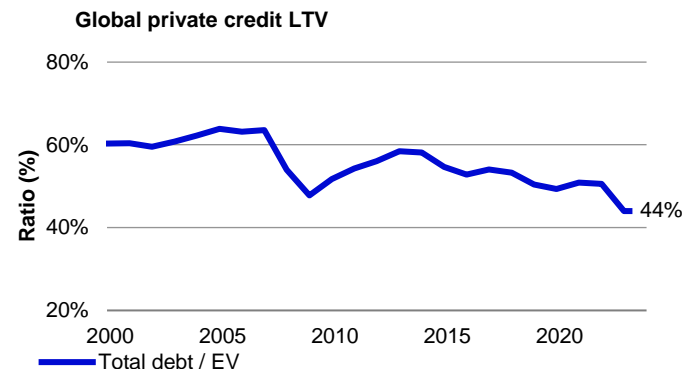
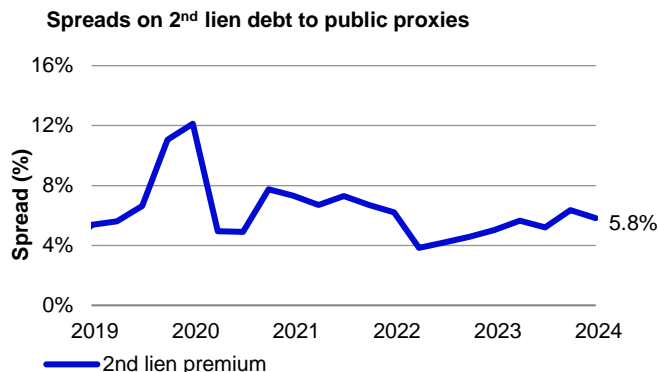
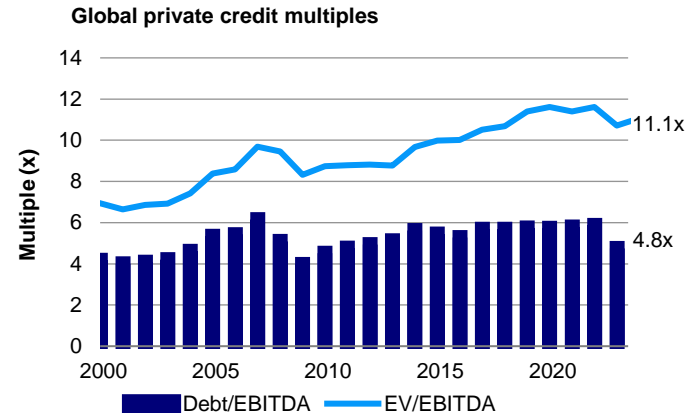
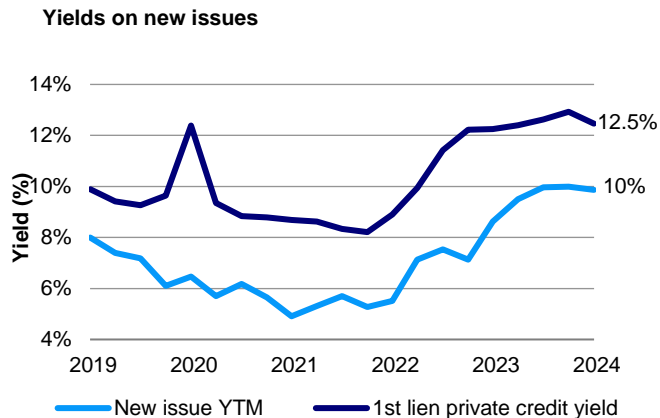
Views on private assets: Private credit

Investment type	Spread (SOFR+, bps*)	Allocation range			Comments
		Underweight	Neutral	Overweight	
Direct lending senior (1 st lien)	550-650				<ul style="list-style-type: none"> Anchor for diversified private debt portfolios. Favorable environment for creditors, with strong covenants and call protections. Improving M&A transaction environment has resulted in a pickup in activity in Q1.
Direct lending junior (2 nd lien/mezz)	800-1000				<ul style="list-style-type: none"> Borrowing that occurs behind senior/1st lien private corporate debt. Potential for opportunistic financing with attractive risk/reward.
Real estate debt (Whole loan/mezz)	350-500 / 600-800				<ul style="list-style-type: none"> Mortgage secured by a lien on a commercial property. High single-digit, low double-digit returns with conservative terms and modest LTVs. Low CMBS issuance and pullback from US regional banks has improved opportunity.
US infrastructure debt (HY)	550-750				<ul style="list-style-type: none"> Current environment allows for 1st lien secured Opco loans. Long-term contractual cash flows, CPI linkages, and lower defaults/higher recoveries. Secular trends driving growth in digital and renewables sectors and limited competition from regional banks drive favorable supply-demand dynamics.
Alternative credit	600-1000				<ul style="list-style-type: none"> Non-traditional markets such as loans, leases and other receivables. Asset-backed nature of collateral and amortization schedules enhances protection. Provides diversification and relies on current income.
Venture debt (1 st lien)	1000+				<ul style="list-style-type: none"> Loans to well-capitalized venture-backed borrowers with LTVs typically below 20%. Limited access to IPO markets and increased cost of capital for venture equity drive favorable pricing and higher creditor protections.
Distressed debt/special situations	1000+				<ul style="list-style-type: none"> Focus on capital solutions and special situations opportunities. We see many small companies pressured by higher rates and inflation looking for capital solutions.

Valuations and fundamentals:

1st lien private credit – new issue YTM and leverage ratios

Spreads on offer to 1st lien lenders are attractive on an absolute, relative, and risk-adjusted basis.

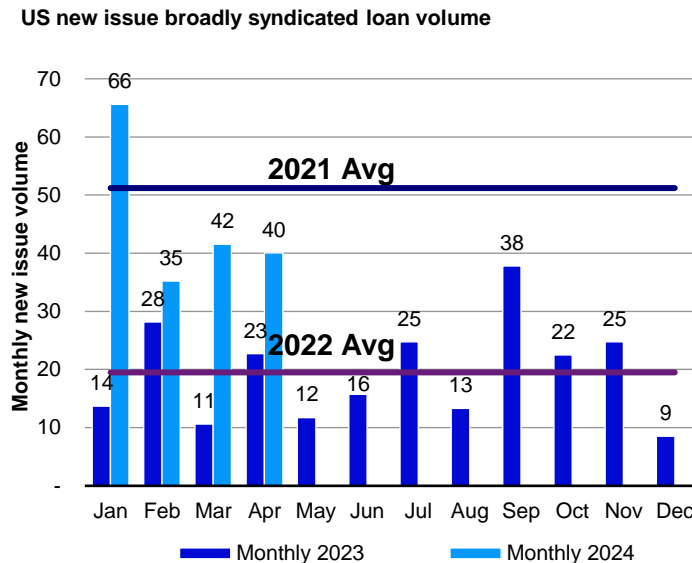
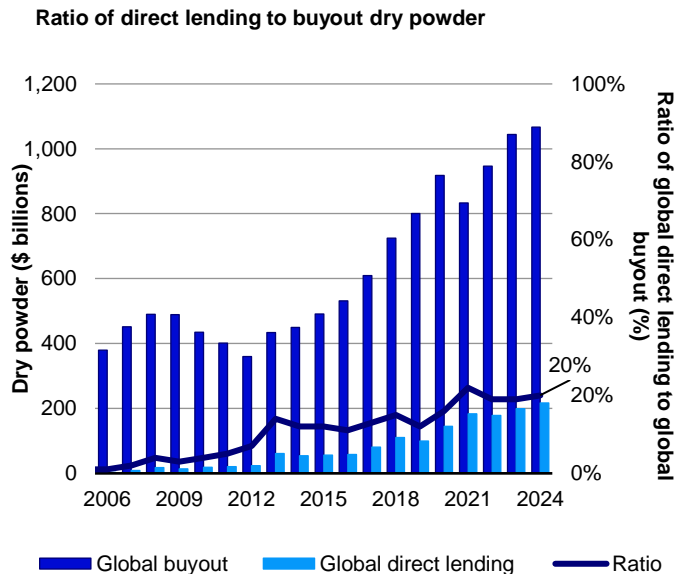


Sources: Pitchbook, LCD Leveraged Loan, SEC EDGAR, JPMorgan, Bloomberg L.P., as of Mar. 31, 2024. New issues refer to bonds issued within the quarter. 1st lien spread over LIBOR estimates are based on SEC filings by a representative sample of BDCs, and the spread is calculated by subtracting a broadly syndicated loan yield based on Spread-to-Maturity on JPM Lev Loan Index. 2nd lien spread over LIBOR estimates based on SEC filings by a representative sample of BDCs and is calculated by subtracting an HY corporate bond yield based on Option-Adjusted Spread on BBG US Corp HY Index.

Supply-demand dynamics

Direct lending and buyout dry powder and loan issuance

Supply-demand dynamics support a robust environment for lenders with available dry powder. 2024 has started with a notable uptick in broadly syndicated loan volume as markets reopen from depressed 2022 levels.

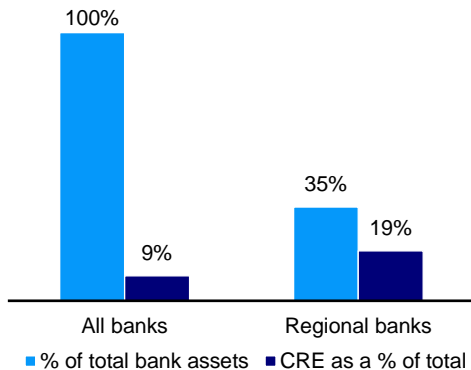


Sources: Invesco Solutions, Preqin, Pitchbook LCD, data as of Apr. 30, 2024.

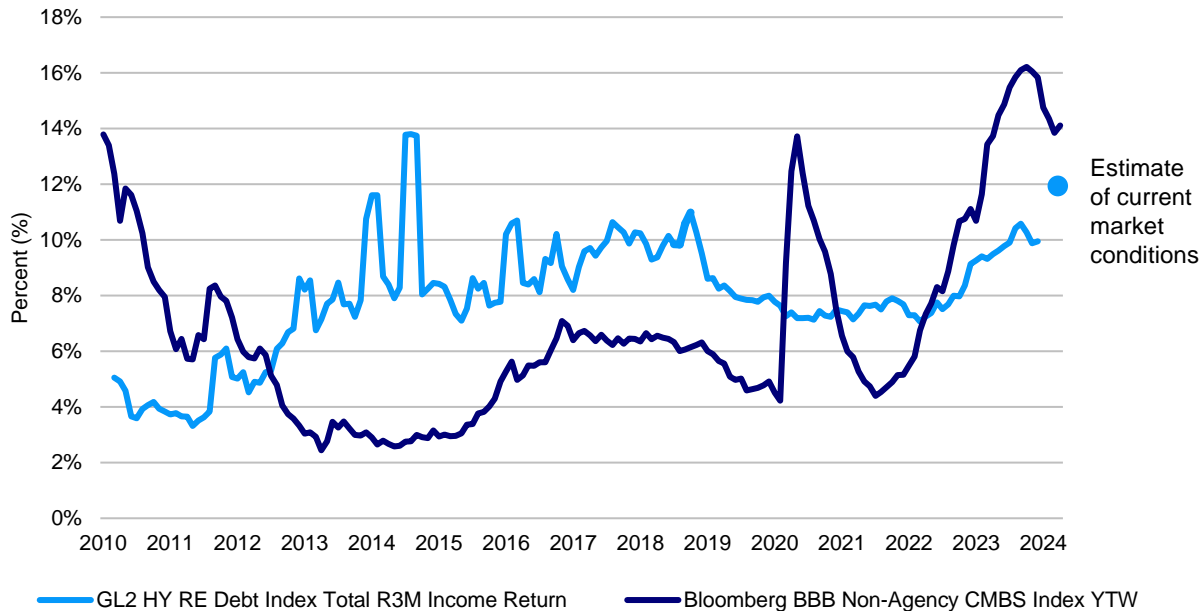
Real estate credit

High absolute yields and “illiquidity premium” supported by reduced supply of loans from regional banks.

Regional banks as a percentage of CRE loans



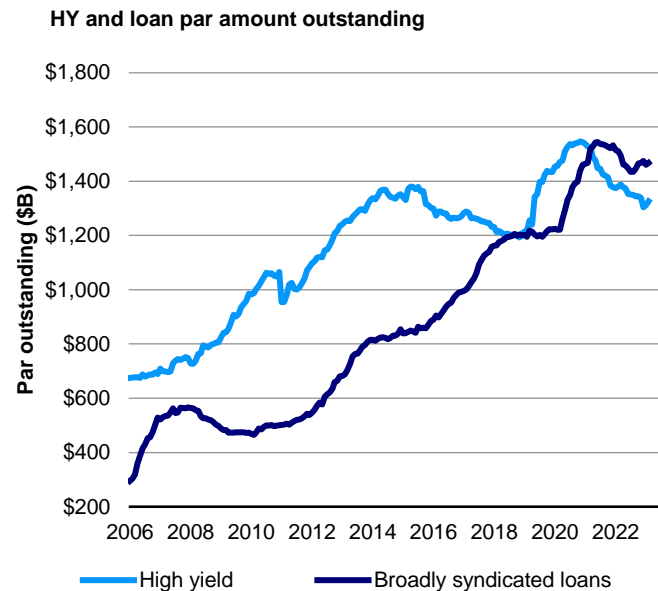
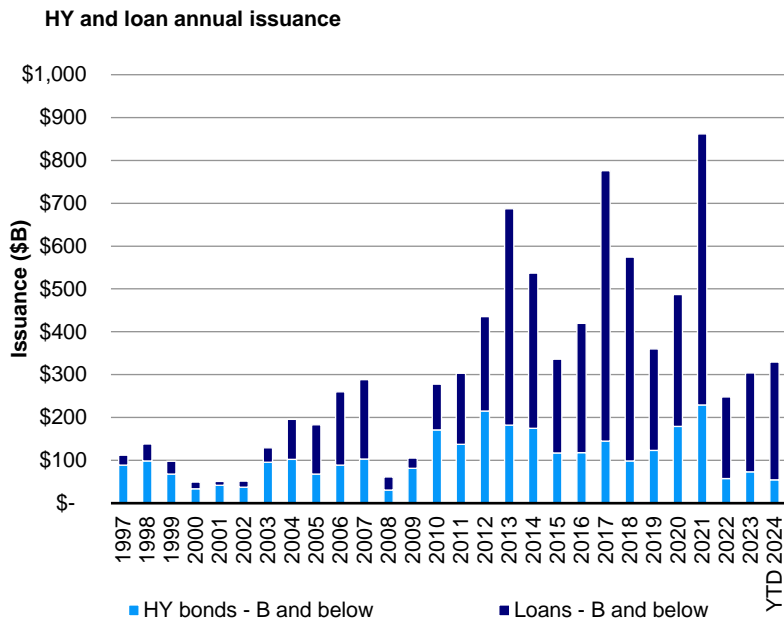
Real estate credit yields compared to proxy CMBS YTW



Sources: Invesco Solutions, Gilberto-Levy, FDIC, Bloomberg L.P., as of Apr. 30, 2024.

Distressed

Significant issuance in the loan market rated single B and below, showcasing the opportunity set relative to history.



Sources: Invesco Solutions, ICE BofA, JP Morgan, as of Apr. 30, 2024.

Private equity

Large buyout

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2024 alternative opportunities – Q2 update: Large buyout



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Underweight PE as valuations are moderating, with pockets of opportunity in private-to-private transactions

Asset class	Overall	Valuations	Fundamentals	Secular trend
Private equity: LBO	Underweight	Unattractive	Neutral	Neutral
Growth equity	Neutral	Neutral	Neutral	Attractive
Venture capital	Neutral	Neutral	Neutral	Neutral

Private equity (PE) historically has delivered tremendous outperformance relative to public markets and other private asset classes. Presently, PE faces headwinds as elevated interest rates and inflation have constrained liquidity for exits while valuations on deals continue to attempt to establish a bottom.

Limited exit opportunities

Leveraged buyouts (LBOs) are facing significant pressure to realize distributions to limited partners (LPs) in a constrained exit environment due to elevated valuations and a limited appetite within public markets for IPOs. Over 30% of buyout-backed companies have been held for over five years, with 12% of companies held for seven-plus years. Meanwhile, the reopening of the broadly

syndicated loan market is primarily focused on refinancing rather than M&A activity as PE borrowers seek to reduce their debt burdens.

The positives:

Improving financial environment

Inflation continues to slowly fall back within the Fed's comfort zone, increasing the chances of a soft landing for this tightening cycle. At present, the path of interest rate normalization is likely to be slow, thus challenging private equity firms relative to the pre-COVID-19 environment. However, this scenario is a preferred outcome when compared to a recession and is reflected in tighter credit spreads.

Prospective opportunity for turnarounds

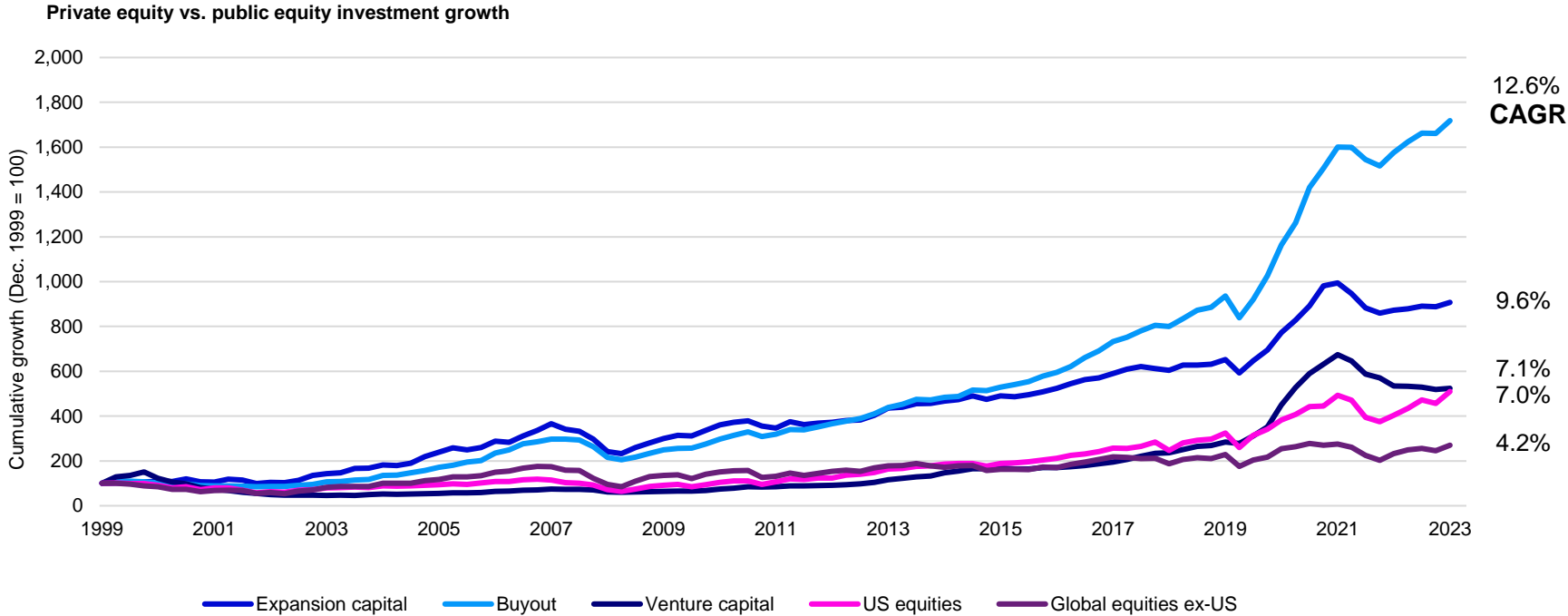
General partners are deploying significant amounts of capital towards carveouts and divestitures as they look to deploy capital in cheaper portions of the market. Firms with turnaround experience could benefit significantly in these markets.

Continued focus on growth

Growth and expansion capital has surpassed LBOs as a share of PE deals for the first time in 10 years. These deals represent a desire to shift away from costly debt as firms aim to capitalize on a stronger-than-anticipated economy through operational leverage. Valuations in venture capital have reset significantly and are beginning to appear more attractive.

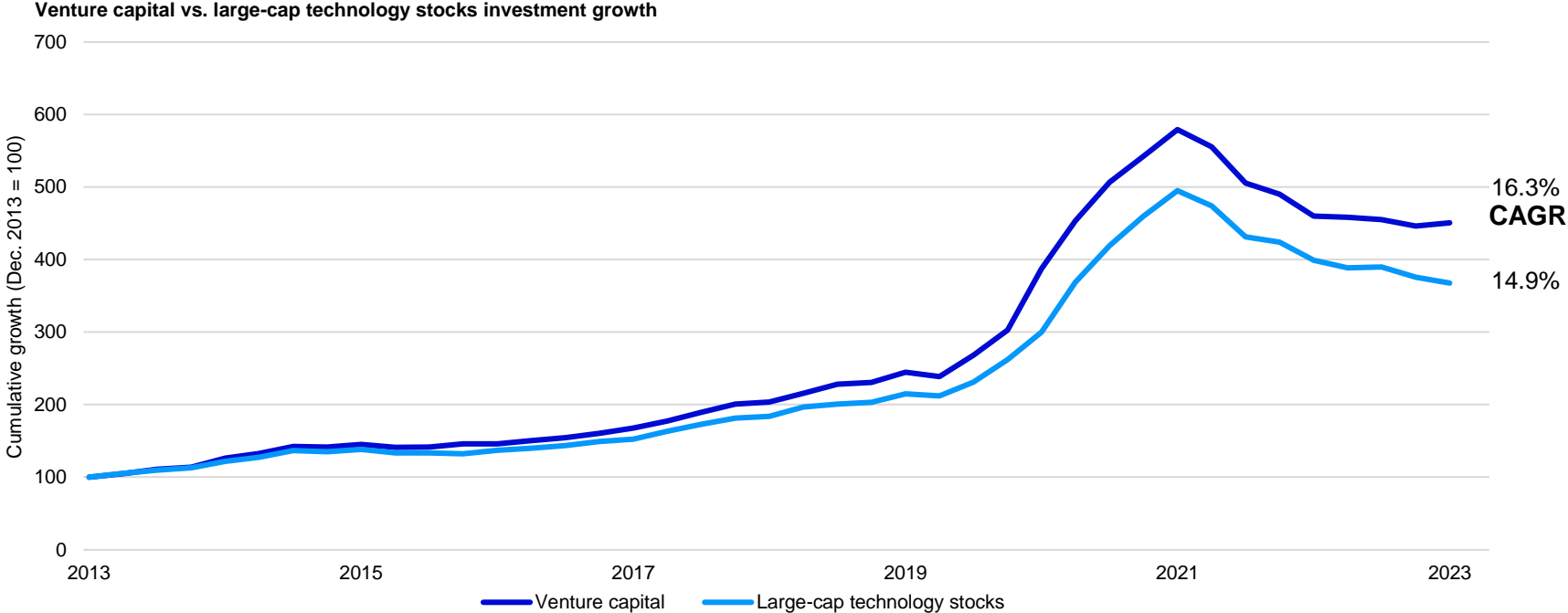
Sources: Invesco Solutions, Pitchbook, views as of May 31, 2024.

Cumulative growth of private equity vs. public equity



Sources: Investment growth of 100; Private asset index return data (large buyout, expansion capital, and VC / growth equity) from Burgiss and are net of fees; US equity returns represented by Russell 3000 TR index; Global ex-US equity returns represented by MSCI ACWI ex USA net TR index are gross of fees, quarterly from Dec. 1999 to Dec. 2023. **Past performance does not guarantee future results.**

Cumulative growth of venture capital vs. large-cap technology stocks



Sources: Investment growth of 100; Private asset index return data (VC) from Burgiss and are net of fees; Technology stocks represented by Nasdaq Composite TR Index are gross of fees, quarterly from Dec. 2013 to Dec. 2023. **Past performance does not guarantee future results.**

Views on private assets: Private equity

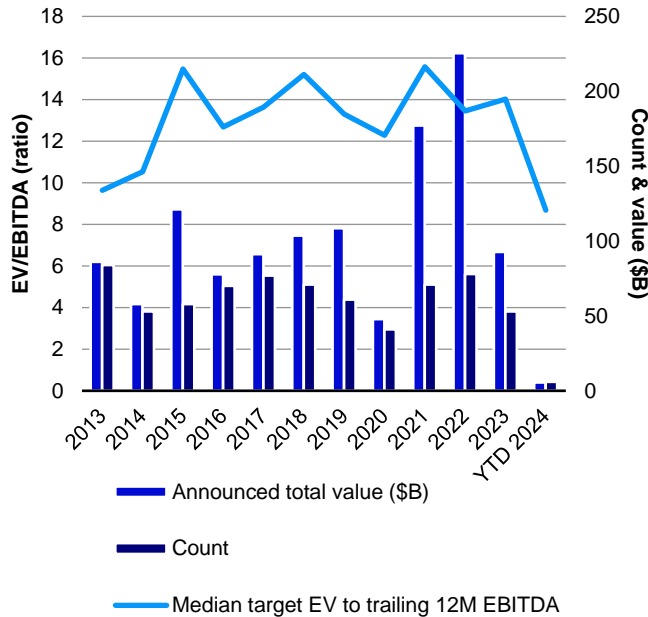
Investment type	Allocation range			Comments
	Underweight	Neutral	Overweight	
Large buyout				<ul style="list-style-type: none"> • Exposure to high quality companies backed by strong management teams. • Renewed opportunity for take-private transactions and private-to-private exits at favorable valuations balanced by headwinds from high cost of debt.
Growth/expansion equity				<ul style="list-style-type: none"> • Profitable franchises exposed to secular growth themes. • Less competition for deals from the IPO or SPAC markets. • Heightened focus on platforms.
Venture capital				<ul style="list-style-type: none"> • Exposure to a wide variety of disruptive technologies and secular growth themes at an early stage. • Challenging exit environment with the potential for a sustained period of “down rounds.” • Valuations have corrected meaningfully in recent quarters.

Source: Invesco Solutions, views as of May 31, 2024. For illustrative purposes only.

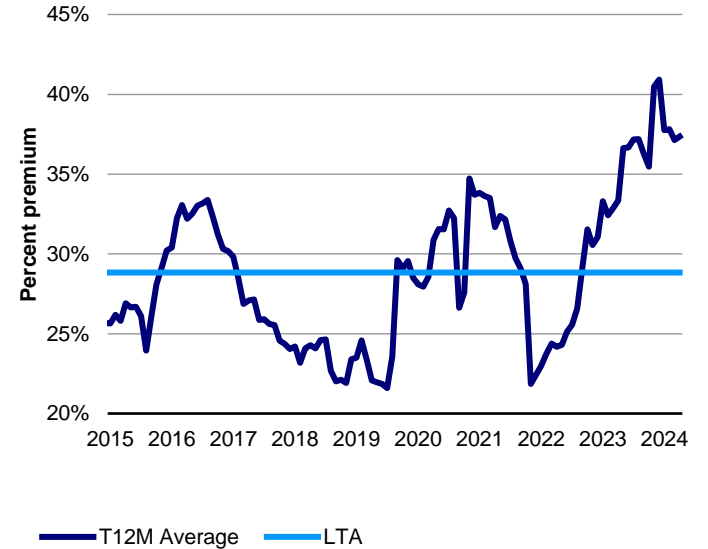
US large buyout take-private volume and EV/EBITDA valuations

Transaction volume has plummeted while premiums are at the high end of their historical range

Take-private deal volume compared to EV/EBITDA



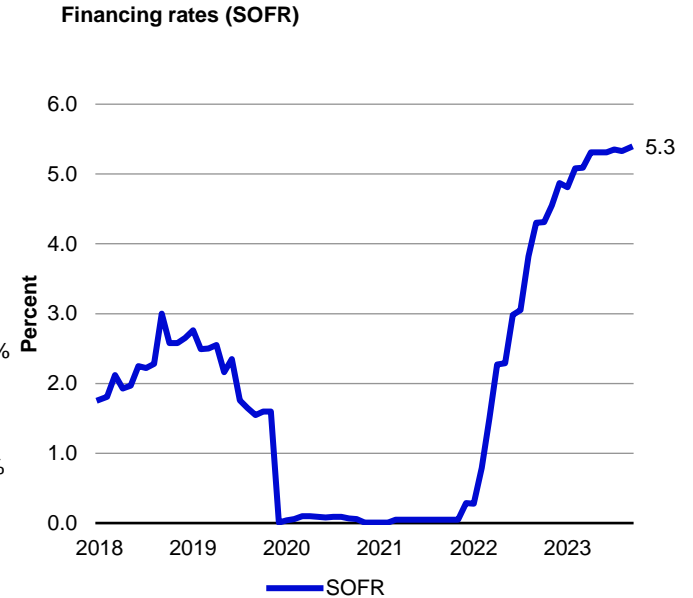
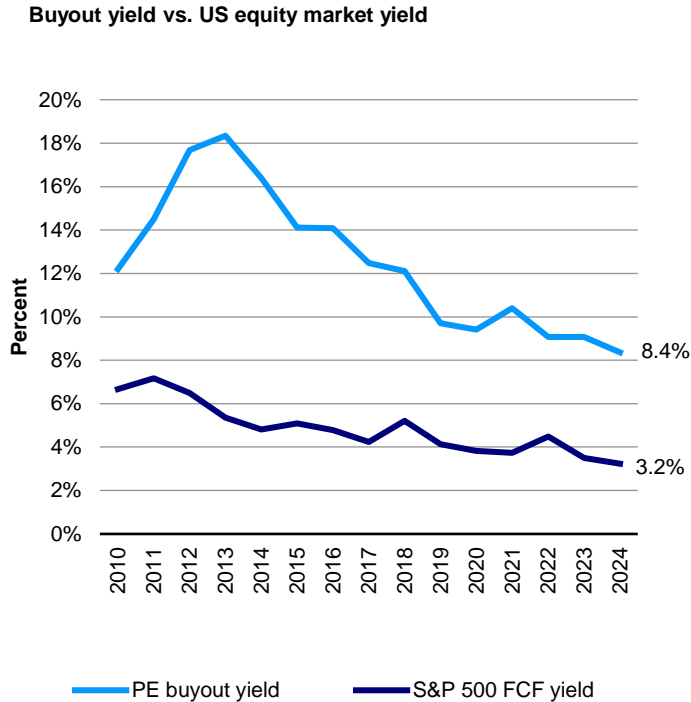
M&A deal premium vs. long-term average



Sources: Invesco Solutions, Pitchbook, Bloomberg L.P., as of Apr. 30, 2024.

US large buyout vs. equity market yield

While purchase prices have moderated slightly, this is more than offset by rising financing costs.

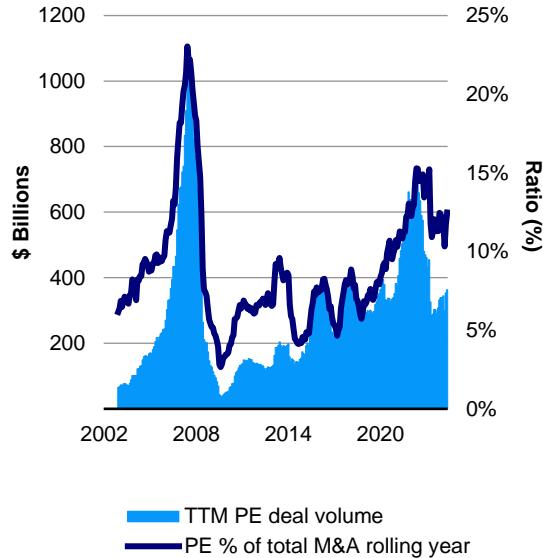


Source: Invesco Solutions, Pitchbook LCD, Bloomberg L.P. as of Mar. 31, 2024.

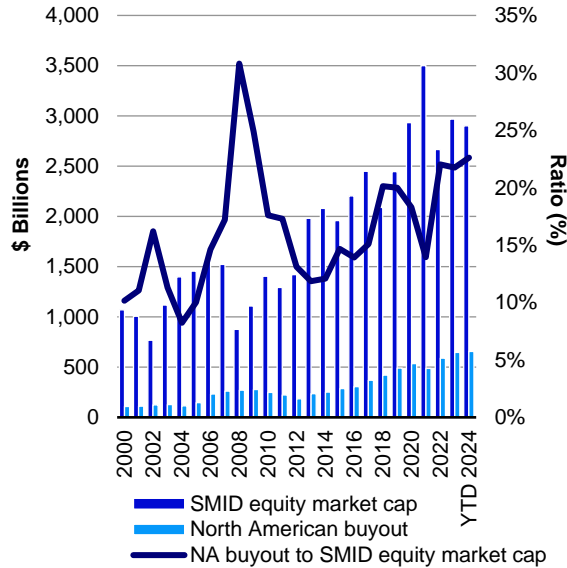
Buyout and IPO deal volume

Limited exit opportunities favor those with dry powder and should drive an increase in private-to-private deal activity

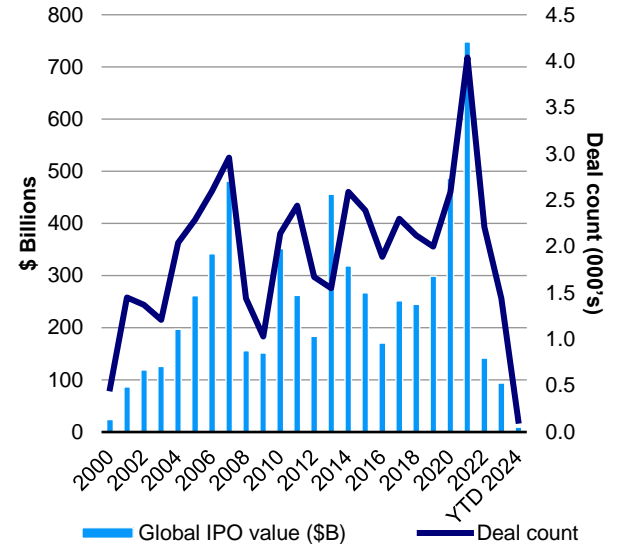
PE deal volume



PE dry powder to target's market cap



Trailing year IPO activity



Sources: Invesco Solutions, Pitchbook, Preqin, Bloomberg L.P., latest data available, as of Apr. 30, 2024.

Real assets

Real estate and infrastructure

3

2024 alternative opportunities – Q2 update: Real assets



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Mike Bessel, CFA
MD, Investment Strategist
Invesco Global Real Estate

Neutral real assets as valuations approach trough

Asset class	Overall	Valuations	Fundamentals	Secular trend
Core RE	Neutral	Neutral	Neutral	Neutral
Value add	Neutral	Neutral	Neutral	Attractive
Infrastructure	Neutral	Unattractive	Attractive	Attractive

Real estate

We remain confident that, depending on the region, we are either at or close to the trough of private real estate valuations. Looking forward, it is our conviction that the next couple of years will offer very strong forward-looking returns. Tight monetary policy has reduced inflation, which should, in-turn, lower debt costs. We have seen a convergence of public and private real estate pricing and capitalization rates have bounced from recent lows, leading us to upgrade core real estate to a neutral rating.

Transaction prices are changing fluidly. Expect transaction activity to improve in 2024. Overall, valuation changes have been more methodical and are taking longer; expect trough values to

be reached later this year. Despite persistent job growth, North American real estate's leasing pace decelerated through most of last year. Expect tenant caution to persist until capital markets loosen. High supply deliveries in 2024 are on track to fall in 2025, given the dearth of new starts.

Historically, forward investment returns have been strongest for vintage years occurring at a market trough. Attractive opportunities are expected, but outsized levels of dry powder suggest the optimal buying window may be short.

Infrastructure

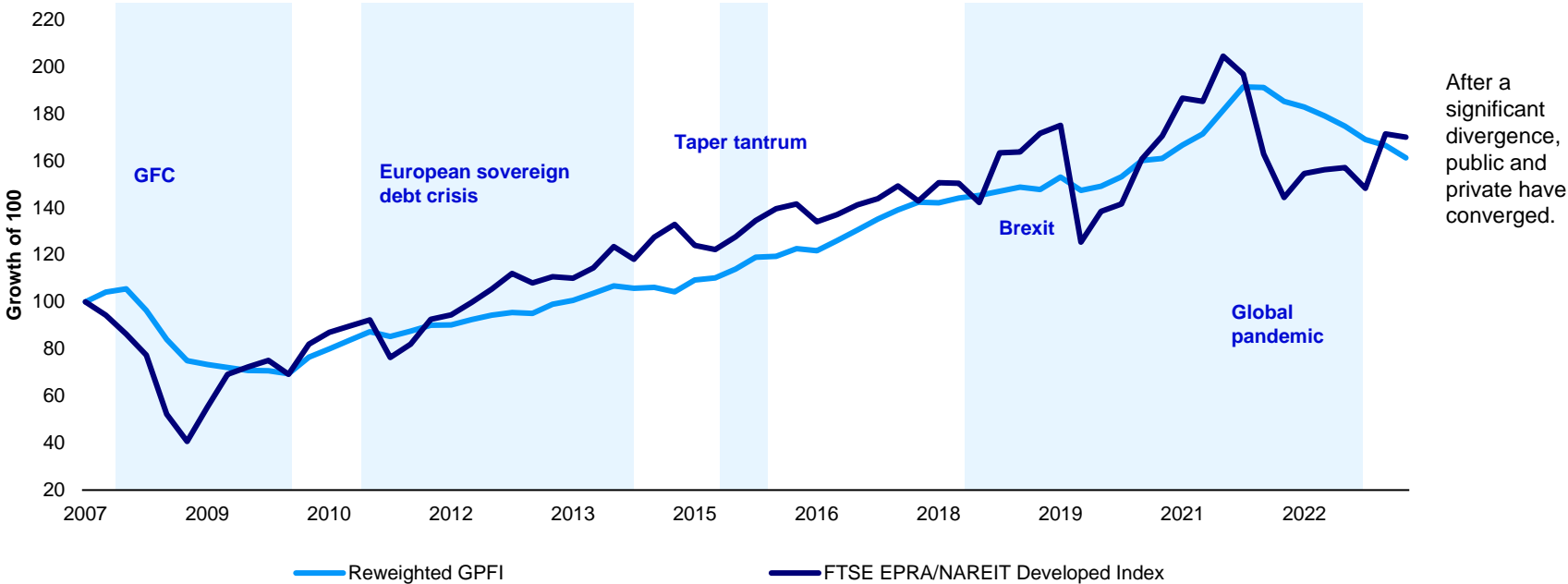
Fundraising for infrastructure equity remains benign as valuations are still on a downward

trend, and dry powder is elevated relative to trailing deal values. 2024 is on track to have an even lower value of assets raised than in 2023, which was the lowest in a decade. Secular tailwinds include but are not limited to (1) the estimated domestic and global need for infrastructure investment over the next decade supported by the Infrastructure Investment and Jobs Act as well as the Inflation Reduction Act; (2) the strong fundamentals within the transportation sector in part driven by the post-pandemic rebound in travel and commerce; (3) energy infrastructure in the wake of conflict in Ukraine; and (4) continued secular tailwinds in both the digital and energy transition /renewables sectors. These tailwinds are moderated slightly by the increasing cost of financing, largely driven by the turmoil in the US regional banking sector.

Sources: Invesco Solutions, IRE, views as of May 31, 2024.

Cumulative growth of listed real estate vs. unlisted real estate

Listed and unlisted global real estate performance 2007-2023, Dec. 2007=100



Sources: MSCI Global Quarterly Property Fund Index (GPF) was reweighted to 25% Asia Pacific, 25% Europe and 50% North America. All returns shown in USD. Source: Invesco Real Estate based on data from MSCI Global Quarterly Property Fund Index, as of Mar. 31, 2024, and Macrobond as of Mar. 31, 2024. Listed real estate is gross of fees while unlisted is net of fees.

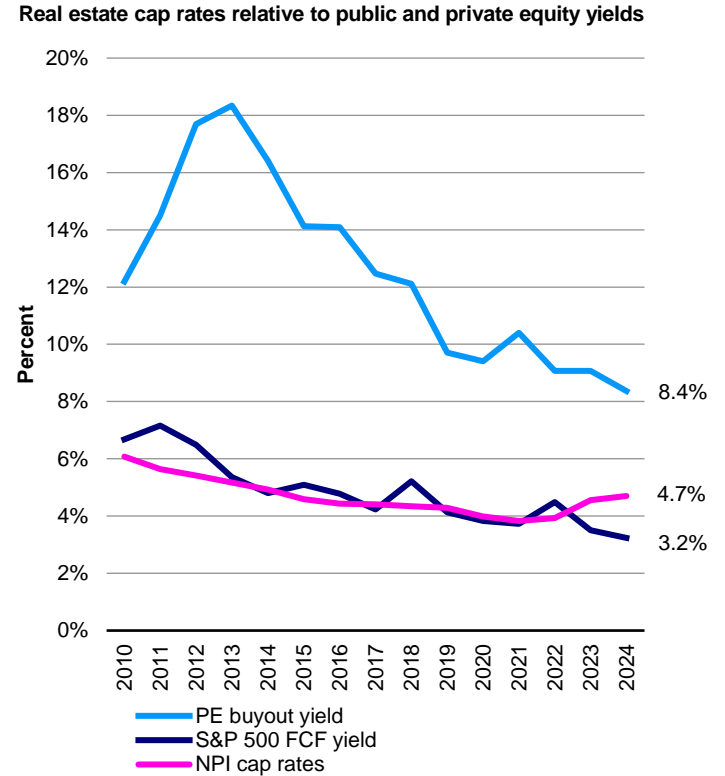
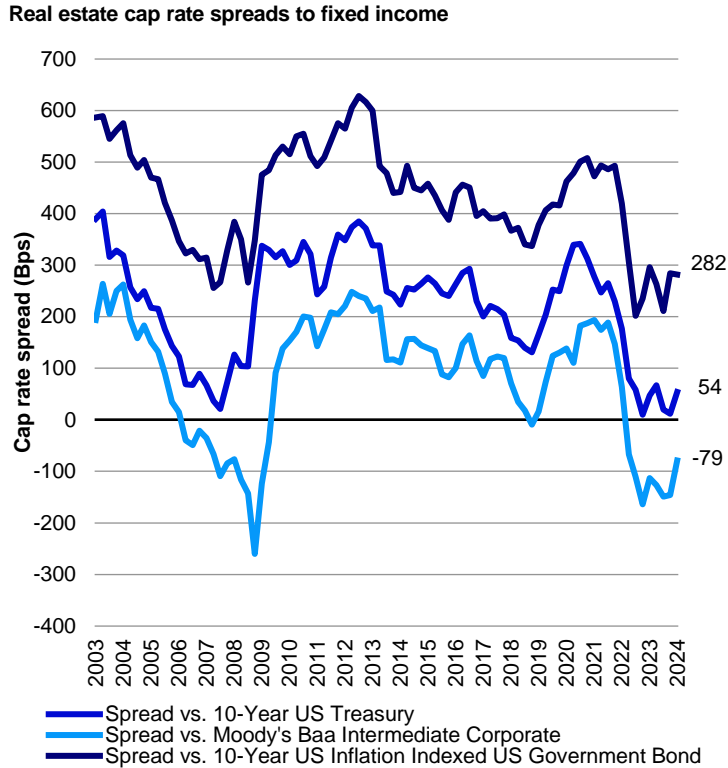
Views on private assets: Real assets

Investment type	Allocation range			Comments
	Underweight	Neutral	Overweight	
Real estate core				<ul style="list-style-type: none"> Public and private valuations have converged, and we expect the trough in valuations is imminent. Exposure to high quality real estate assets with stable current income. Potential headwinds to existing cap rates resulting from rapid rise in interest rates. Mixed outlook varies by sub-sector.
Real estate value add/opportunistic				<ul style="list-style-type: none"> Focus on dislocations in credit markets. High levels of economic and market volatility may create attractive opportunities.
Infrastructure core				<ul style="list-style-type: none"> Exposure to current inflation-linked income backed by long-term contracts and/or concessions. Broad-based fundamental tailwinds across sub-sectors balanced by high valuations.
Infrastructure value add/opportunistic				<ul style="list-style-type: none"> Includes exposure to brownfield and greenfield projects. Tailwind from secular growth themes (renewables, digital) and increased government support (IIJA).

Source: Invesco Solutions, views as of May 31, 2024. For illustrative purposes only.

Real estate cap rate spreads

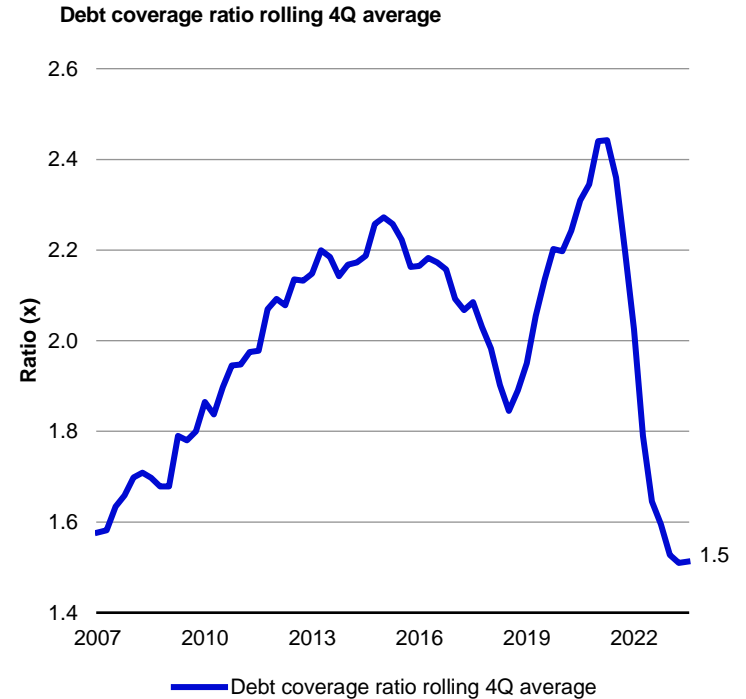
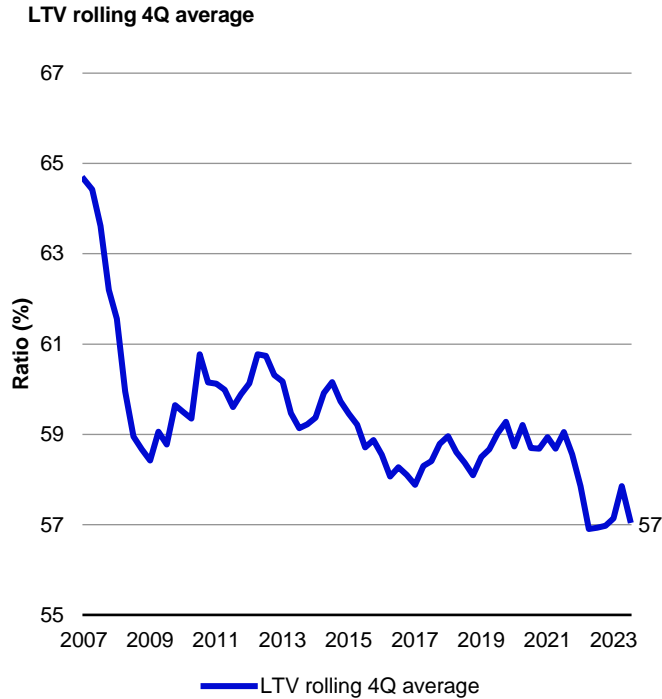
Direct real estate valuations remain elevated relative to other income-generating alternatives; however, they appear to have bounced from recent lows. Cap rates relative to public equity yields are the most attractive they have been post-GFC.



Sources: Invesco Solutions, NCREIF, Moody's Analytics, S&P, Pitchbook LCD, as of Mar. 31, 2024.

Real estate leverage (loan-to-value, LTV) and debt coverage ratio

Modest levels of leverage in the system post-GFC should moderate systemic risk. We are currently monitoring interest coverage ratios.

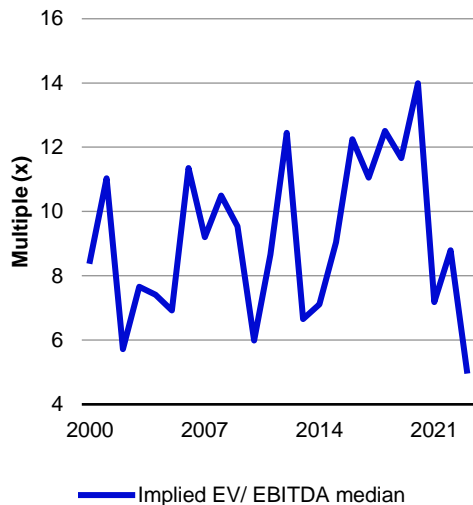


Sources: Invesco Solutions, NCREIF, Moody's Analytics, as of Mar. 31, 2024.

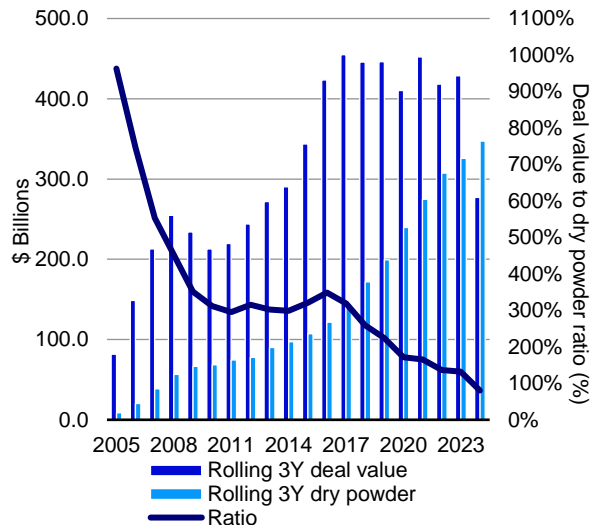
Infrastructure

Relatively high valuations combined with robust dry powder are offset by an expanding opportunity set with long-term secular tailwinds

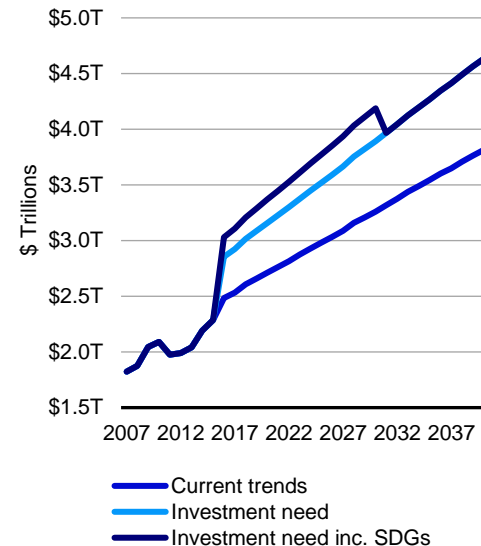
Infrastructure EV/EBITDA



Deal value to dry powder ratio



Investment need in infrastructure



Sources: Invesco Solutions, Pitchbook, Preqin, Global Infrastructure Hub, as of Dec. 31, 2023.

Hedge funds

Event driven and arbitrage

4

2024 alternative opportunities – Q2 update: Hedge funds



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Head of Manager Selection
Invesco Solutions

Overweight hedge funds, given current levels of arbitrage spreads

Asset class	Overall	Valuations	Fundamentals	Secular trend
Event-driven and arbitrage	Overweight	Neutral	Neutral	Attractive

M&A deal activity continues to recover

Private equity's aging stock of inventory is incentivizing a rebound in deal activity. With a significant amount of dry powder and aging portfolio companies, general partners (GPs) are highly motivated to enter the M&A market. As such, deal activity has begun to recover in the first quarter of 2024 from 2023's depressed levels. These lows in activity tend to be attractive entry points for event-driven strategies as a rebound is expected to form over the next few quarters from pent-up demand as firms put capital to work.

Macro environment improves

Interest rates are expected to slowly normalize as the Fed foreshadows a period of rate cuts in the coming quarters, solidifying the cost of capital. This increased level of certainty, positive growth surprises, and downward trend of inflation will likely prompt CEOs and dealmakers to reenter the capital markets in search of strategic opportunities. Increased access to financing as the loan market continues to reopen is likely to narrow bid ask spreads and improve the speed of transactions.

Value within spreads

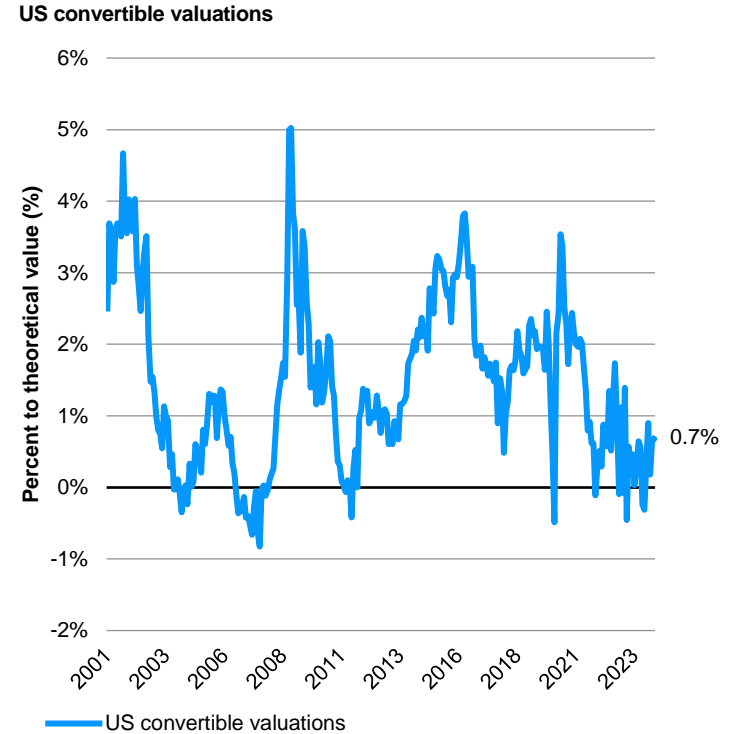
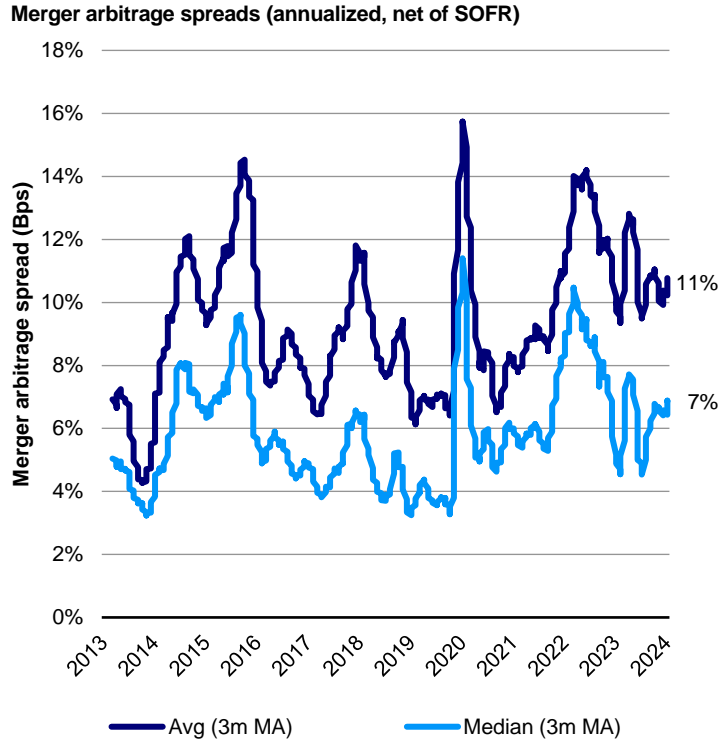
At present, merger arbitrage spreads are slightly above their long-term average and represent a decent total return potential. Allocations to merger arbitrage hedge funds generally come from a mix of equities and fixed income, and predominately fixed income in today's environment.

Compared to their theoretical value, convertibles still trade at a discount, albeit below the long-term average.

Source: Invesco Solutions, views as of May 31, 2024.

Merger arbitrage and convertible arbitrage

Spreads are wide on a variety of measures within merger arbitrage. Convertible value relative to theoretical is slightly below average.



Sources: Invesco Solutions, UBS Special Situations, Moody's Analytics, S&P, Pitchbook LCD, as of May. 31, 2024.

Commodities

Metals, energy, and
agriculture

5

2024 alternative opportunities – Q2 update: Commodities



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Current net neutral positioning for Bloomberg Commodity Index due to attractive trends and neutral valuations

	Overall	Secular trend	Valuations	Fundamentals
Asset class	Neutral	Attractive	Neutral	Unattractive
Agriculture	Underweight	Unattractive	Attractive	Unattractive
Energy	Neutral	Unattractive	Attractive	Neutral
Industrial metals	Neutral	Attractive	Neutral	Unattractive
Precious metals	Underweight	Attractive	Unattractive	Unattractive

The Bloomberg Commodity Index hit a 15-month high during the quarter, led by the surging price of metals, including silver and copper. As a result, trend measures saw the largest improvement in Q2 and allowed the asset class to transition from underweight to neutral. Industrial metals prices rose due to improving global growth demand optimism as copper reached an all-time high in May, finally escaping from its multi-year consolidation pattern that formed since its correction in 2022. Copper was also fueled by speculation about the growing demand for utility infrastructure required to support AI data centers along with further downgrades to the 2024 mine supply. Precious metals saw gains in gold driven by geopolitical tensions in the Middle East that finally included a surge in silver prices due to its crossover use as an industrial metal.

For valuation, a comparison of spot prices to exponentially weighted five-year average prices is utilized. Agriculture and energy remain attractive despite second-quarter price increases in key components

such as natural gas and wheat. Despite a rally in natural gas that was triggered by production cuts, oil and refined products gave back half their gains earned between December and early April. Metals sub-complexes remain challenged due to their recent price increases, especially gold, given it is the top holding in the Bloomberg Commodity Index.

Fundamentals, as measured by annual carry, are broadly unattractive due to the Bloomberg Index's larger weight to gold, whose carry is negative given a persistently inverted yield curve. Carry remains slightly positive in oil but is weakened in refined products as geopolitical tensions have not impacted supply, and maintenance season has concluded in the US and Europe. Natural gas remains the most unfavorable commodity despite its recent price rally. Copper's carry also remains unattractive and provided a warning sign that intra-quarter prices had likely exceeded short-term fundamentals.

Source: Invesco Solutions, views as of May 31, 2024. Views reflect the Bloomberg Commodity Index and do not translate directly to any Invesco commodity strategy.

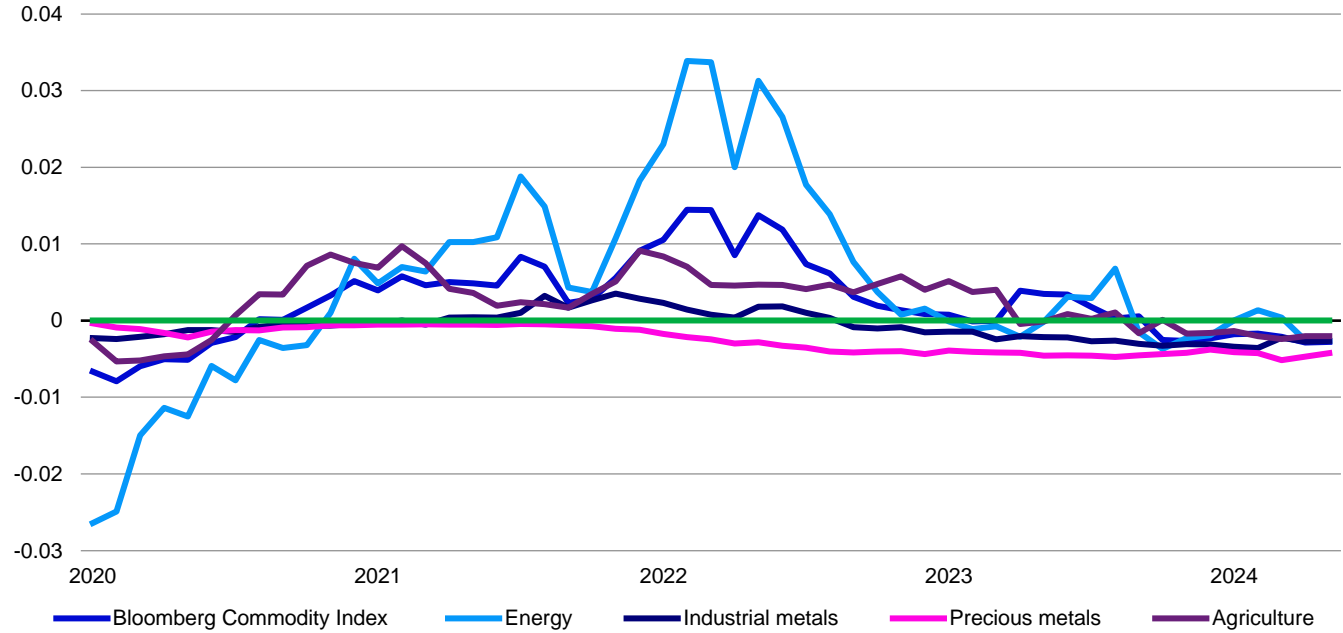
Carry has weakened since 2022's cycle peak

Carry remains unattractive mostly due to the Bloomberg Commodity Index's exposure to gold and natural gas.

Energy carry has faded with OPEC's decision to reduce some voluntary production cuts in Q4 coupled with reduced geopolitical tensions.

Copper's carry remains negative despite its recent AI/data center-induced rally.

Proprietary carry signal

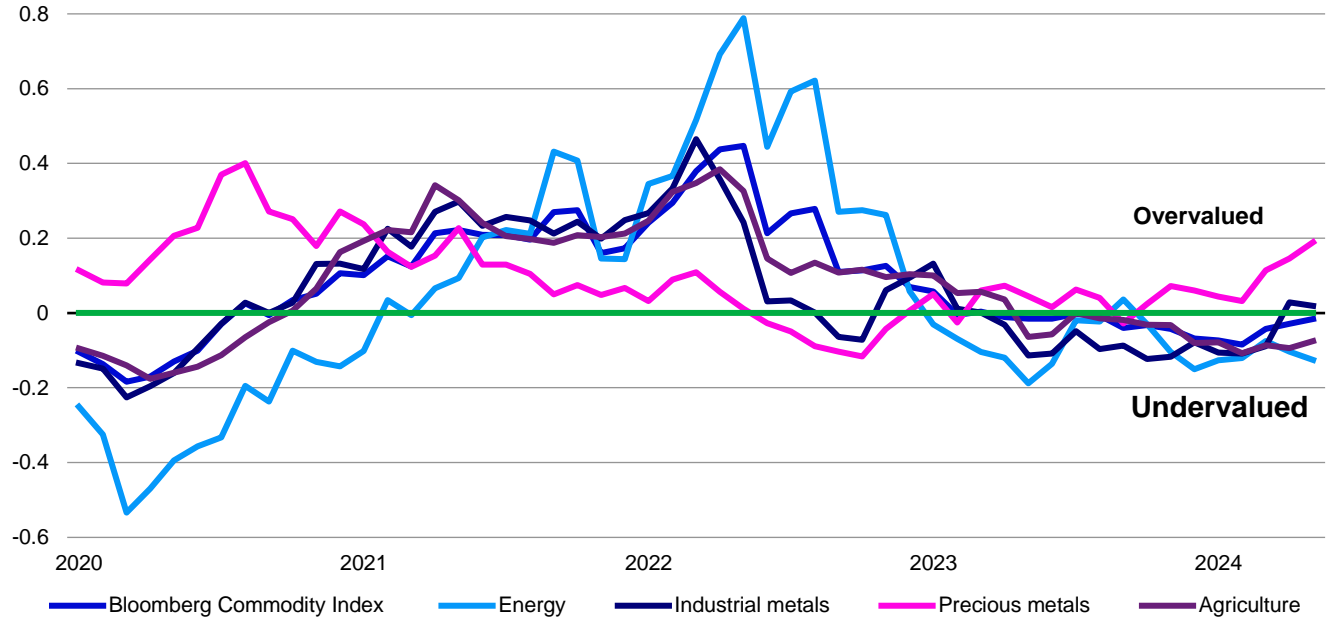


Source: Invesco Solutions, views as of May 31, 2024.

Valuations may have bottomed

Gold's resilience, despite higher real interest rates and dollar strength, has increased its overvaluation. The broad rally in industrial metals has returned them to neutral. The declines in oil and refined products improved energy's valuation despite the rally in natural gas.

Proprietary valuation signal



Source: Invesco Solutions, views as of May 31, 2024.

Outlook for commodity markets

Signs of improving global growth and persistent inflation

Q2 2024 outlook

- 1 Underinvestment remains a positive long-term catalyst and the recent improvements in global PMIs have signaled an end to the 14-month worldwide manufacturing contraction.
- 2 Central banks in major developed economies have been providing dovish forward guidance, and now rate cuts in Europe and Canada, but resilient economic data, including inflation, may delay the timing and magnitude of US interest rate cuts. US fiscal policy remains aggressive and at levels typically seen only in war time or post-recession.
- 3 Geopolitics remains an ongoing risk, but premiums have been reduced in petroleum markets as detrimental impacts on supply have not materialized. The upcoming US Presidential election may bring further foreign policy uncertainty to global markets.
- 4 The El Nino weather pattern propelled soft commodities prices, including cocoa, to a 45-year high and sugar to a 12-year high in 2023. A transition to La Nina is now expected and may counter the impacts of El Nino. As an example, after two years of bumper crops, wheat prices recently reached 10-month highs due to poor weather in Russia, Europe, and the US.
- 5 Protectionism measures have been increasing since weather-related supply issues have impacted commodity markets over the past few years. For example, India and Thailand implemented sugar export bans or limitations in 2023.
- 6 Green energy and now AI computing are the primary new sources of long-term metals demand beyond basic housing and construction applications. More copper and aluminum will be required to build the electrical infrastructure needed to power data centers. The supply of many metals remains constrained by underinvestment, regulations, and mature geology.

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