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Hydration Break: El Super Niño

Discover our perspectives on macro themes, investments, and structural factors affecting your portfolio.

Monthly Commentary

English Version

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Mauricio Viaud
Senior Investment Strategist and PM

Melissa Ochoa Cárdenas
Investment Strategist

Andrés Salamanca
Investment Strategist

Hydration Break: El Super Niño

El Niño is a recurring climate phenomenon that alters weather patterns globally, creating droughts in some regions and excessive rainfall in others. The current episode could intensify global warming and increase the frequency of weather-related disruptions across economies and markets.

Agricultural commodities are among the most vulnerable areas, as major crop-producing countries face unfavorable growing conditions. Reduced supply can contribute to higher food prices, creating inflationary pressure and lowering consumer purchasing power in many countries.

Beyond agriculture, weather disruptions can affect mining operations, transportation networks, and energy generation. These interruptions may tighten supplies of key raw materials and increase production costs across several industries.

From an investment perspective, the impacts are often uneven, creating both opportunities and risks. Companies tied to agricultural inputs, water management, and certain commodities may benefit, while businesses exposed to rising food and raw-material costs could face margin pressure.

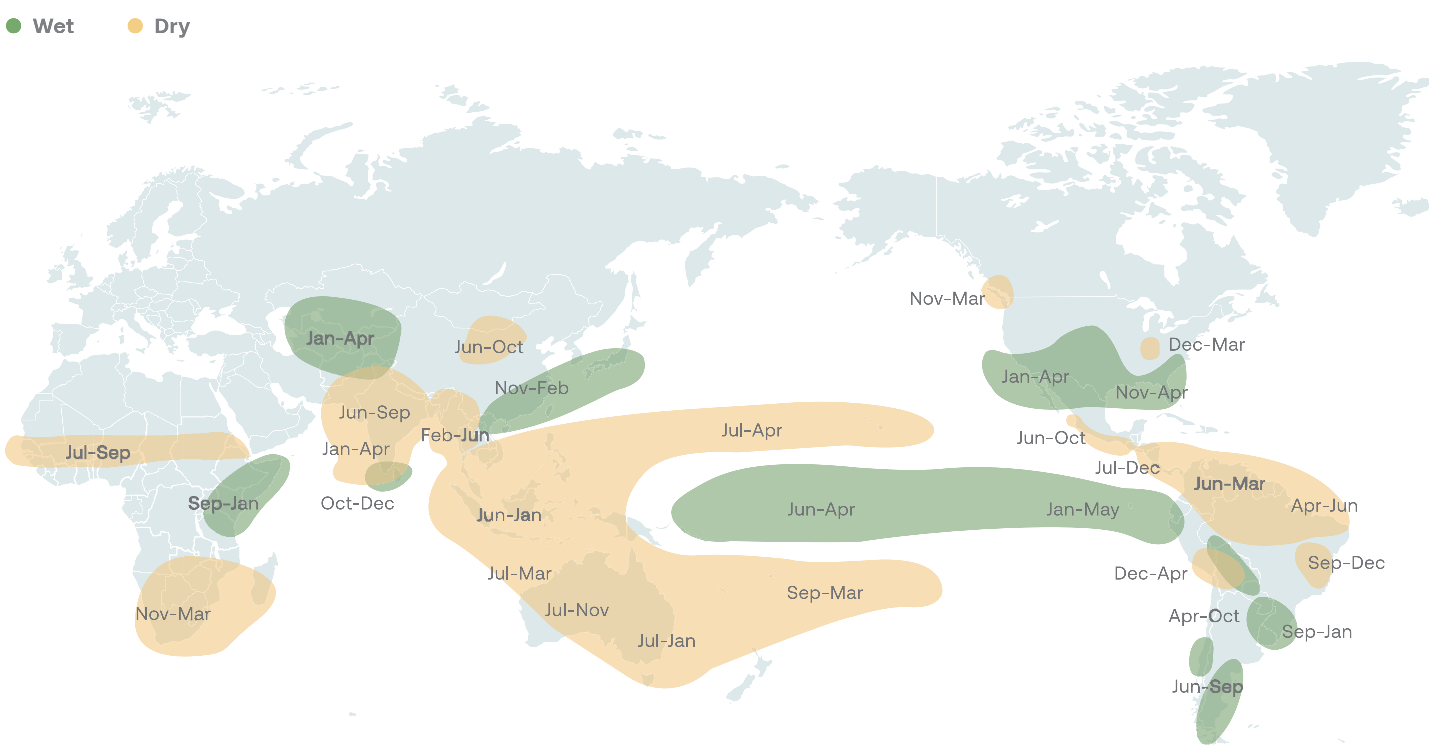
Often, the climate conversation revolves around when the Earth will experience an extreme El Niño. This is currently very relevant, after the meteorological community announced that yet another El Niño began last June. **Today's weather conditions seem to be siding with climate experts who have been warning about the consequences of global warming.** Given that these consequences permeate various economic and social layers, we wanted to revisit what it means when an El Niño develops, how it can affect markets and raw material supplies, and how investors can position to navigate it.

According to the National Oceanic and Atmospheric Administration (NOAA), **El Niño is a natural climate**

phenomenon that occurs when the surface waters of the central and eastern tropical Pacific Ocean become warmer than normal, and the usual easterly trade winds weaken. This phenomenon is part of a larger climate cycle called the El Niño–Southern Oscillation (ENSO). Whenever an El Niño occurs, the trade winds that usually push warm surface water towards Asia and Australia and allow cooler water to rise near the coast of South America weaken, causing warm water to spread east across the Pacific Ocean. Additional effects of El Niño include intense heat and deficient rainfall conditions in South Asia, ASEAN countries, Australia, Central America, Colombia, and many other parts of the world. In contrast, this phenomenon causes heavier rains in East Africa and on the western and southern coasts of South America. This map illustrates the global impact.

Translating this framework into current conditions and the outlook looks bleak. According to models developed by the University of Miami, the current El Niño could push global warming as high as 2°C. For context, the world currently sits at 1.4°C above pre-industrial levels. Furthermore, the Earth's warming trend has worsened since 2010, with four times as many new heat records set from 2016 to 2024 versus a baseline level. The last three years are among the three hottest years ever recorded, according to Bloomberg. This hotter Earth has caused accelerated glacial melting, which in turn reduces the amount of sunlight reflected back to space. Ultimately, this energy imbalance could lead models to underpredict future warming trends, according to Phil Duffy, chief scientist of Spark Climate Solutions.

Geographic distributions during El Niño phenomena



Source: International Research Institute for Climate and Society, Citi

Commodities: The Inflationary Risk

The world may be transitioning from one commodity shock to another. Just as the Strait of Hormuz conflict triggered sharp price spikes across energy markets, investors may now face the consequences of a potential Super El Niño shock. **Unlike geopolitical disruptions, El Niño affects regions unevenly, producing highly differentiated impacts across commodities.** The magnitude of these moves will depend on weather intensity, supply chain disruptions, inventory levels, and geographic production concentration.

While energy and industrial metals will face disruptions, food remains El Niño's most important transmission channel. Economies highly dependent on agriculture are likely to face the greatest stress as weather-driven supply disruptions push food prices higher. In emerging markets such as the Philippines, where rice alone accounts for nearly 8.9% of the CPI basket, agricultural shocks can quickly translate into inflation. As with the Hormuz disruption, **the ultimate macroeconomic consequence of El Niño is likely to be lower household disposable income in places where food represents a significant proportion of consumption.**

Soft Commodities: A Decaf Coffee with No Sugar... Please

Agricultural commodities are particularly vulnerable as El Niño simultaneously creates droughts and excessive rainfall globally. Palm oil illustrates this exposure well. Around 82% of global production is concentrated in Indonesia and Malaysia, two countries prone to drought during El Niño episodes. According to the Malaysian financial services firm MBSB, crude palm oil prices have historically risen between 10% and 75% during these events.

Sugar faces similar risks. India and Thailand account for roughly 30% of global sugar production, making global supply highly sensitive to adverse weather in both countries. During the 2014 Super El Niño, ICE raw sugar prices surged nearly 140% as cumulative production losses exceeded 10 million metric tons. Coffee markets are equally exposed. Brazil and Vietnam together produce more than half of the world's coffee, and both experience drought during El Niño years. In 2023, expectations of a strong event pushed Robusta prices up approximately 58%, reaching multi-decade highs. Similar dynamics extend to grains such as maize, wheat, and rice, as well as oilseeds, tightening food supplies while increasing feed costs.

— "Higher grain prices represent a second-order effect for livestock markets, where feed represents roughly 60% to 70% of operating expenses. "

Higher grain prices represent a second-order effect for livestock markets, where feed represents roughly 60% to 70% of operating expenses. Livestock prices typically follow a two-phase cycle during El Niño. Initially, drought forces ranchers to liquidate herds as pasture deteriorates, temporarily pushing prices lower. Once herd sizes shrink, meat supplies tighten, and prices rise sharply. The United States experienced this dynamic in 2022, when drought reduced cattle prices by roughly 25%. One year later, the national herd had fallen to its lowest level in 73 years, driving feeder cattle futures up by approximately 63%.

Basic Materials: When It Rains, It Pours

Industrial metals are more affected through disruptions to production and logistics, facing challenges in both dry and wet scenarios. Most mining operations rely on open pit extraction, making them especially vulnerable to heavy rainfall. At the same time, droughts reduce hydropower generation, raising electricity costs for energy intensive mining and refining operations. In addition, flooding can also disrupt railways and ports, compounding supply losses. Brazil's mining and metals industry is a good case study. While the country's northern regions typically experience drought during El Niño, the south often faces intense rainfall. For example, Vale (VALE), one of the world's largest metals and mining companies, operates in Minas Gerais, a region particularly exposed to wet conditions. For iron ore extraction, the company has historically reported production 15% to 20% below normal levels during rainy seasons.

Among industrial metals, copper, aluminum, lithium, zinc, and iron ore appear to be the most vulnerable. Chile and Peru account for approximately 37% of global copper production, making supply susceptible to rainfall-related disruptions in both mining and transportation. Lithium and zinc share similar exposure through their reliance on open pit mining, with Chile producing roughly 19% of global lithium and Peru accounting for about 10% of zinc output. Aluminum is exposed through a different mechanism. China produces more than 60% of global aluminum, and much of its smelting capacity depends on hydropower. Drought-induced electricity shortages increase production costs, providing support for aluminum prices even without direct disruptions to mining activity.

Energy: Cooling Down with Charcoal

Electricity systems generally operate according to a merit order, dispatching the lowest-cost generation first. Hydropower typically sits at the bottom of this cost curve, making it the preferred source of electricity where available. During El Niño, however, drought reduces reservoir levels and hydroelectric output, forcing utilities to rely on more expensive thermal generation fueled by natural gas or coal. Rising temperatures further amplify electricity demand through greater air conditioning use. In China, for example, a 1°C increase in temperature is estimated to raise residential power demand by approximately 14.5%.

Natural gas has traditionally been the preferred backup fuel because of its lower emissions and greater efficiency relative to coal. However, the Strait of Hormuz conflict has already tightened gas markets, providing additional support for thermal coal prices. Governments have consequently shifted their focus toward energy security. South Korea has delayed the retirement of 1.5 GW of coal-fired capacity, while Japan and Taiwan have expanded coal-based electricity generation. Historically, El Niño episodes have coincided with record LNG imports in countries such as India and thermal coal price increases ranging from 15% to 50% above pre-season levels. **Against an already constrained global energy market, another widespread drought would likely reinforce demand for both fuels and keep energy prices elevated.**

Table 1. El Niño's Impact on Commodity Prices

Source: Barclays, Insigneo

Asset	Price Impact	Rationale
Wheat	Positive	Australian droughts reduce global supply.
Rice	Positive	Asian droughts hit major exporters.
Maize	Mixed	US benefits, Brazil may lose safrinha crop.
Soy	Mixed	Argentina improves, parts of Brazil weaken.
Sugar	Positive	India and Thailand output declines.
Coffee	Positive	Dry weather reduces robusta production.
Palm Oil	Positive	Indonesia and Malaysia yields fall.
Copper	Positive	Weather disrupts Andean mining.
Aluminum	Mixed	Limited direct impact; energy disruptions possible.
Zinc	Positive	Mine disruptions in South America tighten supply.
Lithium	Mixed	Rain delays brine evaporation.
Iron Ore	Negative	Chinese Demand effects outweigh limited supply disruption.
Thermal Coal	Positive	Indonesia/Australia supply disruptions.
Nickel	Positive	Weather affects Indonesian and Philippine supply.
Met Coal	Positive	Australian exports face disruptions.
Chemicals	Negative	Lower agricultural demand for chemicals.
Oil	Mixed	Supply disruptions offset by weaker demand.
Natural Gas (LNG)	Positive	Higher power demand and lower hydro output.
Power	Positive	Higher cooling demand and reduced hydro supply.

Considerations for Investing Around El Niño: Potential Winners, Losers, and Risks of the Trade

A Super El Niño is more than a weather phenomenon—it is a potential global economic and market event. By altering rainfall, temperatures, and storm patterns across key agricultural and mining regions, El Niño can affect commodity production, transportation networks, energy markets, and ultimately corporate earnings. **Historically, some of the largest impacts have been felt in agricultural commodities such as coffee, sugar, cocoa, and grains, while metals such as copper have also experienced supply disruptions.**

Historical Corporate Winners and Losers

The companies most affected by El Niño are often those with significant exposure to commodity prices rather than those directly exposed to weather.

Agricultural input providers can benefit when crop prices rise because farmers often increase spending on fertilizers, crop protection chemicals, improved seeds, and irrigation technologies to protect yields and maximize production. Companies frequently cited as potential beneficiaries include Nutrien (NTR), Corteva (CTVA), CF Industries (CF), and Mosaic (MOS). At the same time, agricultural merchants such as Archer Daniels Midland (ADM) and Bunge Global (BG) may also benefit from increased market volatility, as regional supply dislocations can create opportunities for merchandising, trading, storage, and logistics optimization. Additionally, water-management and irrigation companies, including Lindsay Corporation (LNN), Valmont Industries (VMI), and Xylem (XYL), could see increased demand if drought conditions intensify and water efficiency becomes a higher priority. Lastly, in the mining sector, copper producers such as Freeport-McMoRan (FCX), Southern Copper (SCCO), and Antofagasta could potentially benefit from stronger copper prices if weather-related disruptions tighten supply.

On the other hand, food manufacturers often face the greatest pressure because agricultural commodities are critical inputs. Companies such as Hershey (HSY), Mondelez (MDLZ), Nestlé (NESN), General Mills (GIS), and Kraft Heinz (KHC) may encounter margin pressure if cocoa, coffee, sugar, wheat, or vegetable oil prices rise faster than they can pass costs on to consumers. At the same time, beverage companies can be particularly sensitive to coffee price volatility, resulting in Starbucks (SBUX), JDE Peet's, and Keurig Dr Pepper (KDP) experiencing higher raw-material costs if coffee-producing regions suffer weather-related production shortfalls. Even Consumer Staples companies with substantial emerging-market exposure, including Unilever (UL), Procter & Gamble (PG), and Colgate-Palmolive (CL), may face slower demand growth if food inflation erodes household purchasing power in agricultural economies.

On the ETF side, although there is no dedicated "El Niño ETF," investors interested in getting exposure to this theme could potentially do so through commodity and agribusiness-oriented investment vehicles. The Invesco DB Agriculture Fund (DBA) offers exposure to a basket of agricultural futures including corn, wheat, soybeans, sugar, and coffee. Agribusiness investors could also potentially consider the VanEck Agribusiness ETF (MOO), whose holdings often include Nutrien, Corteva, ADM, and other companies that may benefit from stronger agricultural spending. Investors looking for copper exposure may consider the Global X Copper Miners ETF (COPX), which provides exposure to copper-producing companies, or the United States Copper Index Fund (CPER).

The Risks of Betting on El Niño

Despite the appeal of the investment thesis, significant risks remain. First, weather forecasts are notoriously uncertain. El Niño may develop later than expected, weaken, or produce less severe disruptions than scientists anticipate. In such cases, commodity prices can fall despite widespread expectations of shortages. Second, supply disruptions do not automatically guarantee higher prices. Demand matters. A slowdown in China, weaker global industrial activity, or recessionary conditions can offset supply constraints, particularly in commodities such as copper. Third, investors should also remember that not all commodities react the same way. Some grain-producing regions may actually benefit from El Niño-related rainfall patterns, resulting in improved yields rather than shortages.

For investors, El Niño is best viewed as a potential global supply shock rather than a simple weather event. **The most direct exposures are typically found in cocoa, coffee, sugar, selected grains, and copper. Potential beneficiaries include fertilizer producers, agricultural merchants, irrigation companies, and copper miners, while food manufacturers and beverage companies suffer as input costs rise.** However, successful investing around El Niño requires careful attention to valuation, timing, demand conditions, and the possibility that markets have already discounted the expected weather impact.

Ultimately, El Niño is not simply an agricultural event. Through its effects on food, industrial materials, and energy markets, it represents a broad inflationary shock with important macroeconomic implications. Countries with significant agricultural production or heavy reliance on hydropower, such as Brazil and Colombia, are likely to face persistent inflationary pressures that could delay monetary easing and support higher interest rate differentials. For investors, understanding these transmission channels will be essential to identifying the sectors and commodities best positioned to benefit from a potential Super El Niño. Although El Niño can potentially turn weather forecasts into investment theses, investors should remember that markets, like the climate, rarely move in a straight line.

It is important to note that we are not endorsing any of the stocks or ETFs mentioned above for investment, just presenting ideas for potential consideration. These investments carry varying levels of risk, are not suitable for every investor, and are best evaluated on a case-by-case basis. Please consult with your financial advisor before investing. ■

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House View Matrix

Global Asset Allocation	Tactical (Up to 3 Months)	Cyclical (Up to 12 Months)
Equities	NEUTRAL	OVERWEIGHT
Fixed Income	NEUTRAL	NEUTRAL
Cash	OVERWEIGHT	NEUTRAL
US Equities[1]	NEUTRAL	OVERWEIGHT
European Equities	UNDERWEIGHT	NEUTRAL
Japanese Equities	OVERWEIGHT	OVERWEIGHT
Emerging Market Equities	OVERWEIGHT	OVERWEIGHT
Chinese Equities	OVERWEIGHT	NEUTRAL
US Treasuries[2]	NEUTRAL	NEUTRAL
Investment Grade Fixed Income	OVERWEIGHT	NEUTRAL
High Yield Fixed Income	UNDERWEIGHT	NEUTRAL
Emerging Market Sovereign	NEUTRAL	OVERWEIGHT
US Dollar	NEUTRAL	UNDERWEIGHT
Energy[3]	NEUTRAL	UNDERWEIGHT
Precious Metals	OVERWEIGHT	OVERWEIGHT

[1] Relative to global equities in USD

[2] Relative to aggregate fixed income markets in USD

[3] Relative to an overall commodity allocation

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