

Should commodities play a role in your current investment plans?

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Commodities have been on the rise lately, and many investors believe the second phase of Quantitative Easing will continue to drive prices higher going forward. But commodities respond to more than federal monetary policy. Now may be a good time to talk to your Financial Advisor about the role of commodities in your overall asset allocation strategy and investment plans.

What You Should Know:

1. What are commodity investments?

Commodities are physical assets such as precious or base metals, energy products, agricultural products, livestock and other raw materials. People typically invest in commodities by buying and selling shares of commodity-producing companies or by trading commodity futures or derivative contracts.

2. Low correlation helps diversification.

Many commodities are not highly correlated with stock and bond investments, meaning those commodity prices historically tend to move in different directions from these more traditional investments. Therefore, commodity investments can offer diversification benefits and help to insulate your overall portfolio from volatility in stocks and bonds.

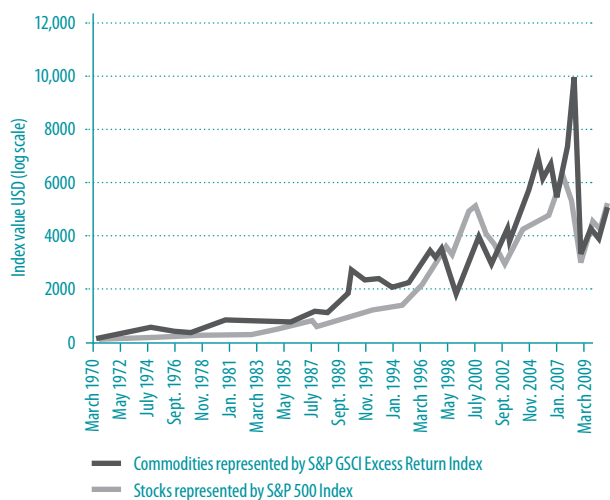
3. What factors can influence commodity investment values?

Unlike many stocks and bonds, commodities do not provide a future cash flow stream. This makes it difficult to determine a standard present value. For many commodities, simple supply and demand can dictate day-to-day pricing. However, commodities with perceived strategic value, such as gold and oil, can be subject to psychological factors and geopolitical or macroeconomic concerns. For example:

- The price of oil rose dramatically in the years following the Sept. 11, 2001, terror attacks, coinciding with increased military activity in the Middle East and an uptick in demand due to unprecedented growth in China. Previous increases had coincided with the Yom Kippur War and Arab Oil Embargo in 1973 as well ▶

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Historical performance of commodities versus equities



Source: Bloomberg. Time period analyzed: March 1970 – March 2009.

as Iranian events from 1978–1989 (e.g., the exiling of the Shah, the U.S. hostage crisis and the invasion of Iraq).

After dipping briefly in 2009 during the global economic crisis, the price of gold soared in 2010 as uncertainty surrounded the beginning of the recovery. Gold's most recent previous high had been at the end of the 1970s, a period of high U.S. consumer inflation.

- Food, cotton and copper have all seen significant increases over the past year – a period when emerging economies like China saw growth accelerate again. The last period of appreciable, consistent growth for cotton prices came between 1973 and 1980.
- As the chart above shows, commodity investment prices in general can increase during periods of rising inflation.

4. How have commodity investments performed over time?

The chart above also shows that commodity performance has been

inconsistent over the past four decades. We've already demonstrated how historical context can influence commodity prices. Some additional points worth noting:

- Commodity values fell sharply (along with many other asset classes) after peaking in June 2008 and have been on the rise – very much like equities – since February 2009.
- While equities have posted periods of negative returns lasting 10 years in the past, they have never had a 20-year period of negative returns; commodities did in the periods ending 1995, 1999 and 2008.

What You Should Do Now:

Under certain economic conditions, commodities can offer opportunities to manage risk through diversification. They can be used as at least a temporary hedge against inflation, which many investors and economists are expecting to see rise in 2011 and 2012. However, there are many factors to consider. You should consult your Baird Financial Advisor about your specific situation and goals, and discuss the potential role that commodities could play in your portfolio. ■

Commodities are not suitable for all investors. Investments in commodities expose an investor to potentially high volatility and are generally only suitable for investors with a high tolerance for risk.

Past performance is not a guarantee of future results.

Diversification does not ensure a profit nor guarantee against a loss.

Correlation is a statistical measure of how two securities move in relation to each other. Positive correlation implies that as one security moves, either up or down, the other security will move in the same direction. Negative correlation means that if one security moves in either direction the security that is negatively correlated will move in the opposite direction.

The S&P 500 Index is a representative sample of 500 leading companies in leading industries of the U.S. economy. It's considered a large-cap index. Indices are unmanaged and are not available for direct investment.

The S&P GSCI (formerly the Goldman Sachs Commodity Index) serves as a benchmark for investment in the commodity markets and as a measure of commodity performance over time. Futures of the S&P GSCI use a multiple of 250. The index contains a much higher exposure to energy than other commodity price indices such as the Dow Jones–AIG Commodity Index.