



# COMMODITIES A GOLDEN OPPORTUNITY

Raw materials are always a useful balance, writes **Tim Blue**

COMMODITIES have long marched to the beat of a different economic drummer: when traditional assets such as stocks and bonds flop, commodities tend to flip.

And therein lies the power and appeal of commodities, the diversity they offer to an investment portfolio.

Prices may stumble for base metals and minerals, as we have seen this year, but demand for commodities and especially agriculture tends to rise.

Gold is a special case that can claim to the title of the great diversifier in a portfolio.

Commodities, however, pay no interest and offer investors no share of any future profits derived from a company. Global supply and demand for raw materials is the main driver of commodity prices.

Buying into the commodities complex is not always easily done by personal investors. In Australia, for example, much agricultural production is in the hands of co-operatives or privately held as farms.

Buying commodities directly is impractical; very few of us can take delivery of several hundred head of cattle or store several thousand of barrels of oil. "Contract sizes can also be inhibiting, at around \$US30,000 to \$US50,000 [\$41,000 to \$69,000] a contract," ANZ commodities strategist Mark Pervan says.

Buying the stocks of commodity-producing companies, on the other hand, may actually limit commodity exposure, as these companies are rarely pure plays on the raw materials they produce. Moreover, such companies typically hedge their exposure to upward price movements in these materials, further reducing any relationship they may have to the prices

of commodities.

That leaves individual investors with few practical alternatives. They can buy managed futures run by registered commodity trading advisers, either as a separate account or in a pooled fund. However, the active commodity management that this entails commands a hedge fund-like premium. Fees for managed futures accounts range from 2 per cent or more of invested capital, plus upward of 20 per cent of any gains.

An alternative is to buy into world production through a commodity index or through a managed fund that seeks to track returns of a diversified index. The major commodity indexes provide efficient price exposure to a cross-section of the world's principal raw and semi-finished goods.

Of course, investors cannot invest directly in an index.

However, a commodity-based index managed fund can seek to replicate the index's performance. Such funds have management fees and other charges and expenses.

Two of the broadest and most liquid commodity indices are the Dow Jones-AIG Commodity Index and the S & P Goldman Sachs Commodity Index. The latter is a long-only, unleveraged investment in an index that tracks 24 commodities, from natural gas and various oils to wheat, corn and soya beans, through to metals such as copper, zinc and nickel.

In Australia, Credit Suisse offers access to the index through its CS Enhanced Commodity Fund. "It offers a broad-based exposure to this otherwise difficult asset class," CS product specialist Kate Wilkie says.

A minimum direct investment is \$25,000 and annual fees are 0.66 per cent of funds under management. The

index has fallen 10.5 per cent for the year to March 31, but it made back 4.4 per cent in March.

Last month's decision by the US administration to kick-start activity by printing cash is likely to push down the value of the US dollar and push up commodity prices, according to investment house Fat Prophets.

"The money flows that flocked to the US dollar over the past six months seeking a 'safe haven' will slowly begin to reverse," director Greg Canavan says. "We believe gold and commodities will be the ultimate beneficiary."

Rising commodity prices means funds will turn to mining stocks again during 2009 and into 2010, as has been seen with strong rallies already in mining majors such as BHP, Woodside and Newcrest.

"However, there are a number of commodity related investment options that have been ignored by the market and we believe Global Mining Investments is a prime example," Canavan says.

GMI is a listed investment company with a mandate to invest in natural resource stocks. The fund is managed by Blackrock Investment Management in Britain, with the team led by founder of the fund, Evy Hambro.

Its price has rallied from a low last November of 55c to recent sales at about 85c. "Its price is forming a solid base capable of supporting higher levels in the months ahead," Canavan says. "A break above the 85c region would boost upward momentum, and project a target in the \$1.10 region."

## MANAGED FUNDS

Managed funds that invest in commodities are an option. Research house Morningstar nominates 11 funds that invest in commodities and gold, as the



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table shows. Performances have been mixed, to say the least, with the pick-up in recent months not enough to cover earlier downturns.

During the past three years the H3 Global Commodities Fund has earned more than 8 per cent a year, which includes a low over one year of a negative 18.6 per cent. Two BlackRock funds, the WS International Gold and the P Investor International Gold, have earned an impressive 30 per cent plus in the three months to the end of February, but are still well in the red over longer terms.

**AGRICULTURE**

In agriculture demand is also holding up well. Prices for grains and meat are down from the peaks of mid-2008, but are 30 to 50 per cent above their averages during the past decade.

There is reason to believe that this strength will be sustained, says Melbourne-based agricultural consultant Carlo Caiani.

“Some of the increase can be blamed on the shift of crops from food to fuel, prompted by wildly inefficient subsidies. But high prices are also a sign of progress because their single largest cause is the steady increase in demand from poorer countries, as people there eat more food, especially more protein. More people are better nourished thanks to a bit more grain, a lot more meat and much more milk.”

China’s role has been profound, he says. “China is consuming twice as much vegetable oil [instead of less healthy pork fat], 60 per cent more poultry, 30 per cent more beef and 25 per cent more wheat. Scores of niches have expanded dramatically: people are drinking four times as much wine, for example.”

Given the long-term prospects in agriculture, deals are being done at ever increasing speed. On March 13, Terra Firma, a private equity firm based in London, announced it would buy 90 per cent of Consolidated Pastoral Company, the vast Australian cattle holdings of the Packer family, which encompass five million hectares.

In February Nufarm, the agrichemical maker, won approval for its acquisition of A. H. Marks, one of Britain’s oldest chemical companies, which has a valuable portfolio of herbicides.

Nufarm itself only barely avoided being acquired in 2007 in a joint bid by an American private equity firm and a Chinese state-owned company. Shares of Mosaic, a maker of fertiliser, have been swept by one acquisition rumour after another.

**GOLD**

Meanwhile, the global financial crisis

has turned investors towards gold to protect their wealth.

And their faith has been rewarded, though investment theory says they have done better than expected.

The US administration’s stimulus efforts have pushed up the gold price, as the first signs have shown. Gold was on a low of \$US682 an ounce last October, but has since soared by close to 50 per cent. As uncertainty continues, it could be an opportunity for local investors to consider investing in the yellow metal.

**BULLION**

The most obvious way to gain exposure to the precious metal is by buying it. Australians can buy gold coins and bars from the Perth Mint, the Australian Bullion Company and the Royal Australian Mint Company by visiting their shops, online or over the telephone.

Demand ran so hot at the Perth Mint late last year that it had to suspend taking new orders for a time; from last July to the end of February it sold more than 192,000 Australian Kangaroo 1 oz gold coins, its most popular product. It is now working three shifts a day, with a little less at weekends, to clear the backlog of orders. The gold coins are selling for \$1426 each, though this can vary with the bullion price.

For investors not wanting the inconvenience or risk of storing their gold, they can take advantage of the Perth Mint’s certificate and depository programs (or buy gold on the Australian Stock Exchange). It is a more expensive option, as you will also have to pay a fee to store it, and find a minimum investment on the certificate program of \$5000.

**EXCHANGE-TRADED FUNDS**

Exchange-traded funds have emerged as a cost-effective and popular way to gain exposure, as they allow the purchase of specific commodities in small lots, without taking delivery.

“Actual delivery, however, does take place by the fund, which means it’s only available in more liquid markets such as gold, silver and oil,” the ANZ’s Pervan says.

Apart from buying bars and coins, gold ETFs offer the most direct route and way to track the price of gold. While popular in the US and across Europe, Australia has only one gold ETF, launched by ETF Securities in 2003. The GOLD fund has about \$700 million invested, up from about \$330 million six months earlier.

The GOLD ETF trades like any other ASX-listed security, says Jonathan Morgan, business development manager at ASX Listed Managed Investments. It is bought or sold on the

Australian Stock Exchange in the same way as shares, and posts several thousand trades a day.

While other listed ETFs have market makers in place, a professional securities dealer who has an obligation to buy when there is an excess of sell orders and to sell when there is an excess of buy orders, such as the international ETF range and the newly listed metal ETCs, the GOLD ETF does not need one because it has a sufficient spread of shareholders.

The advantages of an ETF are that they are cheap, there’s no storage cost and they are easily exchangeable. They are good for retail investors because they do not require the investment of large sums of money.

The minimum investment is one GOLD security, which costs about \$150, representing one-tenth of an ounce of gold. The annual management fee is about 0.40 per cent, and as the security is bought in the same way as shares, normal brokerage fees still apply.

**PRODUCERS’ SHARES**

Gold stocks have been one of the bright sectors on an otherwise poorly performing market.

Favourable sentiments have prompted a wave of equity raisings, from companies such as Newcrest, Lihir, Apex Minerals, St Barbara, Avoca, Allied Gold, PanAust, Medusa Mining, Integra and Focus.

As Perth brokers Hartleys point out, most of these companies are producers or developers and at the larger end of the scale.

“If the gold price continues to rise, taking sentiment with it, we expect to see the juniors start to raise money,” analyst Andrew Muir says.

Among the majors, Hartleys prefer Newcrest (NCM) and Lihir (LGL). “The big end of town has benefited from the flight to quality with superior liquidity, low operating costs giving good margins and substantial resources and reserves,” Muir says.

“The large oversubscription of the recent Newcrest raising highlighted the appetite for these large stocks.”

In the mid-tier, there is Dominion Mining (DOM), Avoca Resources (AVO) and Intrepid Mines (IAU), while it has a buy recommendation at the junior developer-advanced explorer stage on Andean Resources (AND), Azumah Resources (AZM) and Emerson Resources (ERM).

“Likewise,” Muir says, “there are a number of what we would call the higher risk producers that are highly leveraged to the gold price and will



**Australian**  
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**Wealth**  
**Region: Australia**  
**Circulation: 137000**  
**Type: National**  
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**MTWTF**



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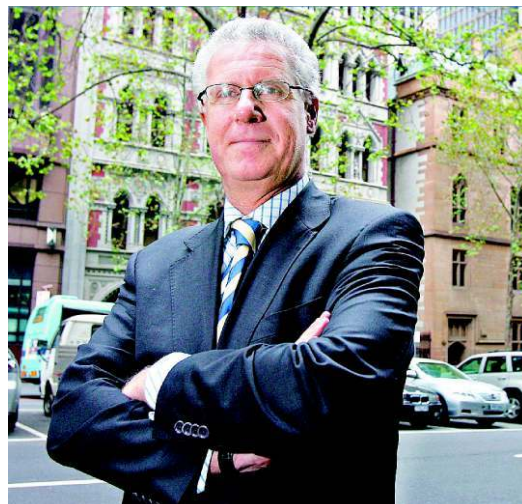


have a substantial benefit from a sustained higher Australian dollar gold price. Some of these companies include Apex (AXM), Tanami (TAM) and St Barbara (SBM).”

## COMMODITY INVESTING

| Fund name  | Start date | Assets (\$m) | Fee (%pa) | Return (%) |        |        |
|--|------------|--------------|-----------|------------|--------|--------|
|  |            |              |           | 6 mth      | 1 yr   | 3 yr   |
| Ascalon H3 Commodities Fund                        | Jan 08     | 0.62         | 1.47      | -11.61     | -16.72 | —      |
| Aurora-Barclays CORALS Commodities Fund            | Jul 08     | —            | —         | 19.29      | —      | —      |
| BlackRock P Inv International Gold (Class C)       | Jun 05     | 4.85         | 2.25      | 17.30      | -16.86 | -4.94  |
| BlackRock WS International Gold (Class D)          | Dec 04     | 38.51        | 1.25      | 17.76      | -15.94 | -4.00  |
| DWS Global Equity Gold and Precious Metals Fund    | Dec 08     | 12.44        | —         | —          | —      | —      |
| Goldman Sachs JBWere Commodity Hindsight Keystone* | May 08     | 8.71         | 0.60      | —          | —      | —      |
| Goldman Sachs JBWere Food Feed and Fuel Keystone*  | Jan 08     | 7.94         | 0.60      | —          | —      | —      |
| Goldman Sachs JBWere Food Feed Fuel II Keystone*   | May 08     | 11.71        | 0.60      | —          | —      | —      |
| H3 Global Commodities Fund                         | Nov 05     | 29.44        | 1.17      | -9.58      | -12.86 | 6.55   |
| Merrill-Instreet Reliance Commodities Fund         | Jun 07     | —            | —         | —          | —      | —      |
| Select Gold Fund                                   | Oct 03     | 59.86        | 1.90      | 20.13      | -28.32 | -11.61 |

\* Closed to new investment – Performance data to Mar 31, 2009 Source: Morningstar



Caiani & Co agriculture and commodities consultant Carlo Caiani

Picture: Michael Potter