

# TWO WAYS TO SUPERCHARGE THE DIVERSIFICATION POWERS OF BROAD COMMODITIES

Pierre Debru – Head of Quantitative Research and Multi Asset Solutions, WisdomTree Europe.  
13 Apr 2023

There is no sugar-coating it, 2022 was a pretty difficult year for investors. Equity markets posted their worst year since the financial crisis and one of the 10 worst years since the Great Depression. At the same time, fixed income markets (as proxied by the Bloomberg Aggregate) posted their worst year in history. The only place of refuge was in commodities, which posted double-digit returns, the second year in a row where commodities beat most, if not all, other asset classes.

Figure 1: Asset class performance ranked - 2012-2022

		Year										
		2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	10 Yrs
Performance Ranking	1	Equities 20.3%	Real Estate 15.9%	Cash 0.2%	Commodities 12.4%	Equities 21.6%	Cash 1.7%	Equities 24.0%	Equities 14.3%	Commodities 27.3%	Commodities 14.7%	Equities 5.9%
	2	Real Estate 4.4%	Bonds 5.6%	Real Estate 0.1%	Equities 5.6%	Real Estate 11.4%	Bonds -2.4%	Real Estate 23.1%	Bonds 10.3%	Real Estate 27.2%	Cash 1.7%	Real Estate 3.9%
	3	Cash 0.2%	Equities 2.1%	Bonds -2.8%	Real Estate 5.0%	Bonds 10.3%	Real Estate -4.7%	Bonds 13.6%	Commodities 2.3%	Equities 16.8%	Equities -19.8%	Cash 0.8%
	4	Bonds -4.0%	Cash 0.2%	Equities -4.3%	Bonds 3.6%	Commodities 6.3%	Commodities -9.0%	Commodities 7.7%	Cash 0.3%	Cash 0.1%	Bonds -21.0%	Commodities 0.7%
	5	Commodities -10.1%	Commodities -13.3%	Commodities -21.3%	Cash 0.5%	Cash 0.9%	Equities -11.2%	Cash 1.7%	Real Estate -6.2%	Bonds -3.5%	Real Estate -24.4%	Bonds 0.5%

Source: WisdomTree, Bloomberg. Data until December 31, 2022; All returns are in USD. 10 Yrs returns are annualised from 31 Dec 12 to 31 Dec 22. Data: Equity – MSCI World, Bond – Bloomberg Barclays Agg Sovereign TR Unhedged, Real Estate – EPRA/NAREIT Global, Commodity – Optimized Roll Commodity Total Return Index, Cash – US T-Bill 3 Mth.

**Historical performance is not an indication of future performance and any investments may go down in value.**

The last two years have shown, once again, why commodities are a staple component of many multi-asset portfolios. Over the long run, commodities have historically proven:

- A strong portfolio diversifier
- A recognised inflation hedge
- A powerful geopolitical risk hedge
- A cyclical asset which can grow and outperform over the long term while reacting to macroeconomic conditions in a unique manner

These characteristics make commodities a strong potential candidate for a strategic investment as part of the alternative sleeve of a portfolio.

### The specifics of investing in commodities

Investing physically in most commodities is almost impossible due to operational constraints: they tend to be voluminous, expensive to store, move, and insure, and can be very perishable. This is why most commodities investments are made through derivatives called futures contracts, that is, contracts in which a buyer and seller agree to exchange commodities at a given price at a specified time in the future (the futures contract maturity).

Futures contracts can be purchased for a set of different expiries. It is possible, for example, to buy crude oil for delivery next month, for delivery in 6 months, for delivery in a year and so on. The collection of futures contract prices for available Futures contracts of different expiries is called the Futures curve.

A commodity is said to be in contango when the price of a distant Futures contract is higher than the price of a nearer future, and it is said to be in backwardation when the price of a distant Futures contract is lower than the price of a nearer future. The performance of an investment in a given commodity is dependent on the shape of the curve as investors would need to 'roll' from one contract, when it is about to expire, to one with a maturity in the future, if they want to remain invested. The overall return is a combination of:

- + **Spot return:** movement of the spot price of the physical commodity.

- + **Roll return:** generated yield due to the rolling of one futures contract to the next designated contract by ensuring a continual exposure to futures prices and avoiding physical delivery and contract expiry. The roll return is mainly impacted by the shape of the futures curve and the way it changes over time. A curve in contango will create a negative drag to the performance, while a curve in backwardation will create a positive drag.

Unfortunately for investors, most commodities tend to remain in contango most of the time and, therefore, broad commodities indices (such as the Bloomberg Commodity Index) tend to suffer from average negative roll yield creating a drag to the performance.

### How to improve the performance of broad commodities benchmarks

Commodities benchmarks are known to be sub-optimal because they invest in front-month future contracts (futures with low maturities) and therefore fail to consider the term structure of each future curve and suffer from high negative roll yield.

There are two main ways to improve on those basic benchmarks.

#### 1. Investing in physical commodities whenever possible

One of the easiest ways to avoid roll yield drag is simply to not invest in commodity futures contracts. Of course, as discussed earlier, most commodities are too difficult to invest in physically, but not all. Precious metals, like gold or silver, are durable, they carry a high price tag per weight, and, therefore, can be stored very cheaply in

bank vaults. Replacing precious metals futures contracts with physical bars of precious metals is a simple and straightforward way to reduce the contango drag and improve performance over the long term.

## 2. Investing in other parts of the future curve to minimise the negative roll yield

Each futures contract on a given future curve has its own roll yield depending on how steep the curve is for that maturity. Quite logically, the front end of the curve is not always the flattest part of the curve, that is, the part of the curve where the roll yield is the smallest. In fact, most of the time it is the steepest, that is, the most detrimental to long-term returns. In other words, broad commodity benchmarks are built in a pretty inefficient way. Long-term performance of broad commodity strategies could be improved over the long term by selecting on a regular basis the futures contract on each commodity curve with the lowest roll yield, minimising the drag suffered by investors.

### Related blogs

- + [Commodity outlook: cyclical pressures vs structural strengths](#)
- + [Broad commodities: an often-overlooked source of diversification](#)
- + [Commodities are more than just an inflation hedge](#)

View the online version of this article [here](#).

## IMPORTANT INFORMATION

**Marketing communications issued in the European Economic Area (“EEA”):** This document has been issued and approved by WisdomTree Ireland Limited, which is authorised and regulated by the Central Bank of Ireland.

**Marketing communications issued in jurisdictions outside of the EEA:** This document has been issued and approved by WisdomTree UK Limited, which is authorised and regulated by the United Kingdom Financial Conduct Authority.

WisdomTree Ireland Limited and WisdomTree UK Limited are each referred to as “WisdomTree” (as applicable). Our Conflicts of Interest Policy and Inventory are available on request.

**For professional clients only. Past performance is not a reliable indicator of future performance. Any historical performance included in this document may be based on back testing. Back testing is the process of evaluating an investment strategy by applying it to historical data to simulate what the performance of such strategy would have been. Back tested performance is purely hypothetical and is provided in this document solely for informational purposes. Back tested data does not represent actual performance and should not be interpreted as an indication of actual or future performance. The value of any investment may be affected by exchange rate movements. Any decision to invest should be based on the information contained in the appropriate prospectus and after seeking independent investment, tax and legal advice. These products may not be available in your market or suitable for you. The content of this document does not constitute investment advice nor an offer for sale nor a solicitation of an offer to buy any product or make any investment.**

An investment in exchange-traded products (“ETPs”) is dependent on the performance of the underlying index, less costs, but it is not expected to match that performance precisely. ETPs involve numerous risks including among others, general market risks relating to the relevant underlying index, credit risks on the provider of index swaps utilised in the ETP, exchange rate risks, interest rate risks, inflationary risks, liquidity risks and legal and regulatory risks.

The information contained in this document is not, and under no circumstances is to be construed as, an advertisement or any other step in furtherance of a public offering of shares in the United States or any province or territory thereof, where none of the issuers or their products are authorised or registered for distribution and where no prospectus of any of the issuers has been filed with any securities commission or regulatory authority. No document or information in this document should be taken, transmitted or distributed (directly or indirectly) into the United States. None of the issuers, nor any securities issued by them, have been or will be registered under the United States Securities Act of 1933 or the Investment Company Act of 1940 or qualified under any applicable state securities statutes.

This document may contain independent market commentary prepared by WisdomTree based on publicly available information. Although WisdomTree endeavours to ensure the accuracy of the content in this document, WisdomTree does not warrant or guarantee its accuracy or correctness. Any third party data providers used to source the information in this document make no warranties or representation of any kind relating to such data. Where WisdomTree has expressed its own opinions related to product or market activity, these views may change. Neither WisdomTree, nor any affiliate, nor any of their respective officers, directors, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any use of this document or its contents.

This document may contain forward looking statements including statements regarding our belief or current expectations with regards to the performance of certain assets classes and/or sectors. Forward looking statements are subject to certain risks, uncertainties and assumptions. There can be no assurance that such statements will be accurate and actual results could differ materially from those anticipated in such statements. WisdomTree strongly recommends that you do not place undue reliance on these forward-looking statements.

#### **WisdomTree Issuer ICAV**

The products discussed in this document are issued by WisdomTree Issuer ICAV ("WT Issuer"). WT Issuer is an umbrella investment company with variable capital having segregated liability between its funds organised under the laws of Ireland as an Irish Collective Asset-management Vehicle and authorised by the Central Bank of Ireland ("CBI"). WT Issuer is organised as an Undertaking for Collective Investment in Transferable Securities ("UCITS") under the laws of Ireland and shall issue a separate class of shares ("Shares") representing each fund. Investors should read the prospectus of WT Issuer ("WT Prospectus") before investing and should refer to the section of the WT Prospectus entitled 'Risk Factors' for further details of risks associated with an investment in the Shares.

#### **WisdomTree Broad Commodities UCITS ETF**

"Bloomberg®" and the Bloomberg Commodity Index(es)<sup>SM</sup> referenced herein are service marks of Bloomberg Finance L.P. and its affiliates, including Bloomberg Index Services Limited ("BISL"), the administrator of the indices (collectively, "Bloomberg") and have been licensed for use for certain purposes by WisdomTree UK Limited and its permitted affiliates including WisdomTree Management Limited and WisdomTree Issuer ICAV (together, WisdomTree). Bloomberg is not affiliated with WisdomTree, and Bloomberg does not approve, endorse, review, or recommend the WisdomTree Broad Commodities UCITS ETF. Bloomberg does not guarantee the timeliness, accurateness, or completeness of any data or information relating to the index(es).

#### **WisdomTree Enhanced Commodity UCITS ETF**

The methodology of and rules governing the index (the "Index Methodology" and the "Index") are proprietary and shall not be reproduced or disseminated without the prior written consent of the "Index Sponsor" (as defined in the "Index Rules" available on <http://www.wisdomtree.eu/home>). None of the Index Sponsor, the index calculation agent (where such party is not also the Index Sponsor, the "Index Calculation Agent") nor, where applicable, the index Investment Advisor (the "Index Investment Advisor") guarantee that there will be no errors or omissions in computing or disseminating the Index. The Index Methodology is based on certain assumptions, certain pricing models and calculation methods adopted by the Index Sponsor, the Index Calculation Agent and, where applicable, the Index Investment Advisor, and may have certain inherent limitations. Information prepared on the basis of different models, calculation methods or assumptions may yield different results. You have no authority to use or reproduce the Index Methodology in any way, and neither the Index Sponsor nor any of its affiliates shall be liable for any loss whatsoever, whether arising directly or indirectly from the use of the Index or Index Methodology or otherwise in connection therewith. The Index Sponsor reserves the right to amend or adjust the Index Methodology from time to time in accordance with the rules governing the Index and accepts no liability for any such amendment or adjustment. Neither the Index Sponsor nor the Index Calculation Agent are under any obligation to continue the calculation, publication or dissemination of the Index and accept no liability for any suspension or interruption in the calculation thereof which is made in accordance with the rules governing the Index. None of the Index Sponsor, the Index Calculation Agent nor, where applicable, the Index Investment Advisor accept any liability in connection with the publication or use of the level of

the Index at any given time. The Index Methodology embeds certain costs in the strategy which cover amongst other things, friction, replication and repo costs in running the Index. The levels of such costs (if any) may vary over time in accordance with market conditions as determined by the Index Sponsor acting in a commercially reasonable manner. The Index Sponsor and its affiliates may enter into derivative transactions or issue financial instruments (together, the "Products") linked to the Index. The Products are not in any way sponsored, endorsed, sold or promoted by the sponsor of any index component (or part thereof) which may comprise the Index (each a "Reference Index") that is not affiliated with BNP Paribas (each such sponsor, a "Reference Index Sponsor"). The Reference Index Sponsors make no representation whatsoever, whether express or implied, either as to the results to be obtained from the use of the relevant Reference Index and/or the levels at which the relevant Reference Index stands at any particular time on any particular date or otherwise.

No Reference Index Sponsor shall be liable (whether in negligence or otherwise) to any person for any error in the relevant Reference Index and the relevant Reference Index Sponsor is under no obligation to advise any person of any error therein. None of the Reference Index Sponsors makes any representation whatsoever, whether express or implied, as to the advisability of purchasing or assuming any risk in connection with the Products. The Index Sponsor and its affiliates have no rights against or recourse to any Reference Index Sponsor should any Reference Index not be published or for any errors in the calculation thereof or on any other basis whatsoever in relation to any Reference Index, its production, or the level or constituents thereof. The Index Sponsor and its affiliates shall have no liability to any party for any act or failure to act by any Reference Index Sponsor in connection with the calculation, adjustment or maintenance of the relevant Reference Index and have no affiliation with or control over any Reference Index or the relevant Reference Index Sponsor or the computation, composition or dissemination of any Reference Index. Although the Index Calculation Agent will obtain information concerning each Reference Index from publicly available sources that it believes reliable, it will not independently verify this information. Accordingly, no representation, warranty or undertaking (express or implied) is made and no responsibility is accepted by the Index Sponsor or any of its affiliates nor the Index Calculation Agent as to the accuracy, completeness and timeliness of information concerning any Reference Index. The Index Sponsor and/or its affiliates may act in a number of different capacities in relation to the Index and/or products linked to the Index, which may include, but not be limited to, acting as market-maker, hedging counterparty, issuer of components of the Index, Index Sponsor and/or Index Calculation Agent. Such activities could result in potential conflicts of interest that could influence the price or value of a Product.

#### **WisdomTree Enhanced Commodity ex-Agriculture UCITS ETF**

The Morgan Stanley RADAR ex Agriculture & Livestock Commodity Index<sup>?</sup> (the "Index") is the exclusive property of Morgan Stanley Capital Group Inc. and/or its affiliates (collectively, "Morgan Stanley"), which has contracted with S&P Opco, LLC (a subsidiary of S&P Dow Jones Indices LLC) ("S&P Dow Jones Indices") to maintain and calculate the Index. The Index Components comprising the Index are the property of S&P Dow Jones Indices, its affiliates and/or their third party licensors and has been licensed by S&P Dow Jones Indices for use by Morgan Stanley in connection with the Index. S&P Dow Jones Indices, its affiliates and their third party licensors shall have no liability for any errors or omissions in calculating the Index.

The Index is not sponsored, endorsed, sold or promoted by S&P Dow Jones Indices, its affiliates or their third party licensors and neither S&P Dow Jones Indices, its affiliates nor their its third party licensors make any representation regarding the advisability of investing in the Index. Morgan Stanley and the Index names are service mark(s) of Morgan Stanley and have been licensed for use for certain purposes by WisdomTree. The Fund referred to herein is not sponsored, endorsed, or promoted by

Morgan Stanley. Neither Morgan Stanley nor any other party (including without limitation any calculation agents or data providers) make any express or implied warranties, and hereby expressly disclaim all warranties of merchantability or fitness for a particular purpose, with respect to the Index or any Index related data. Without limiting any of the foregoing, in no event shall Morgan Stanley or any other party (including without limitation any calculation agents or data providers) have any liability for any direct, indirect, special, punitive, consequential or any other damages (including lost profits) with respect to the Index, Index related data, the Fund, or any shares or investment units, even if notified of the possibility of such damages.

The assessment of UCITS compliance is made solely by WisdomTree and not made in reliance on any representations, warranties, undertakings or statements by Morgan Stanley or any of its affiliates.

**Notice to Investors in Switzerland – Qualified Investors**

This document constitutes an advertisement of the financial product(s) mentioned herein.

The prospectus and the key investor information documents (KIID) are available from WisdomTree's website: <https://www.wisdomtree.eu/en-ch/resource-library/prospectus-and-regulatory-reports>

Some of the sub-funds referred to in this document may not have not been registered with the Swiss Financial Market Supervisory Authority ("FINMA"). In Switzerland, such sub-funds that have not been registered with FINMA shall be distributed exclusively to qualified investors, as defined in the Swiss Federal Act on Collective Investment Schemes or its implementing ordinance (each, as amended from time to time). The representative and paying agent of the sub-funds in Switzerland is Société Générale Paris, Zurich Branch, Talacker 50, PO Box 5070, 8021 Zurich, Switzerland. The prospectus, the key investor information documents (KIID), the articles of association and the annual and semi-annual reports of the sub-funds are available free of charge from the representative and paying agent. As regards distribution in Switzerland, the place of jurisdiction and performance is at the registered seat of the representative and paying agent.

**For Investors in France:**

The information in this document is intended exclusively for professional investors (as defined under the MiFID) investing for their own account and this material may not in any way be distributed to the public. The distribution of the Prospectus and the offering, sale and delivery of Shares in other jurisdictions may be restricted by law. WT Issuer is a UCITS governed by Irish legislation, and approved by the Financial Regulatory as UCITS compliant with European regulations although may not have to comply with the same rules as those applicable to a similar product approved in France. The Fund has been registered for marketing in France by the Financial Markets Authority (Autorité des Marchés Financiers) and may be distributed to investors in France. Copies of all documents (i.e. the Prospectus, the Key Investor Information Document, any supplements or addenda thereto, the latest annual reports and the memorandum of incorporation and articles of association) are available in France, free of charge at the French centralizing agent, Societe Generale at 29, Boulevard Haussmann, 75009, Paris, France. Any subscription for Shares of the Fund will be made on the basis of the terms of the prospectus and any supplements or addenda thereto.

**For Investors in Malta:**

This document does not constitute or form part of any offer or invitation to the public to subscribe for or purchase shares in the Fund and shall not be construed as such and no person other than the person to whom this document has been addressed or delivered shall be eligible to subscribe for or purchase shares in the Fund. Shares in the Fund



will not in any event be marketed to the public in Malta without the prior authorisation of the Maltese Financial Services Authority.

**For Investors in Monaco:** This communication is only intended for duly registered banks and/or licensed portfolio management companies in Monaco. This communication must not be sent to the public in Monaco.