

Making a Bet: A Client Buys Commodities

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We are somewhere between two calamities, deflation and inflation. That realization makes an impact on whether or not to invest in commodities now.

For those who are gambling that we will see inflation sooner rather than later, commodities are a reasonable bet. They will likely bring big profits for those who are simply willing to be patient, understanding that deflation continues to be a possibility. A client of mine thinks we are nearer inflation than deflation. He wants to invest in commodities now. He asks me, "How?"

Since an investor can't invest in futures like institutional investors, he has to make other choices. Commodity exchange traded funds (ETFs) or commodity stock ETFs are possibilities. The difference is that the former represents the actual underlying price changes of a commodity; the latter invests in stocks of commodity producers rather than the commodity itself.

Market Vectors Agribusiness ETF (MOO), Jimmy Rogers' brain child, is an example of a commodity stock ETF. It invests in the stocks of commodity producers for example Archer Daniels Midland (ADM), Deere CO (DE), Monsanto Company (MON), Potash CP Saskatchewan (POT), and Mosaic company (MOS) are among its top ten holdings. These stocks are correlated with the performance of the stock market. My client already has a diversified stock portfolio. Therefore choosing a commodity ETF that rises and falls with stocks would not decrease risk in his existing portfolio significantly.

Another option would be for him to buy a commodity ETF that has low correlation with stocks. To do this, iShares S&P GSCI Commodity-Indexed Trust (GSG) is a consideration. It tracks the performance of the GSCI Excess Return Index which invests in unleveraged commodity futures that are rolled forward from the fifth to ninth business day of each month. Though its return is different than it would be if the commodities themselves were purchased and sold, the easy process of simply buying an ETF makes this practice desirable for many investors. iPath Dow Jones-AIG Commodity Idx (DJP) and Power Shares DB Commodity Index Tracking (DBC) also invest in futures.

MOO and GSG are indeed different even though they are both commodity ETFs. Since December of 2008, MOO has moved significantly above the S&P whereas GSG has fallen below it. Some of this disparity could be due to the fact that the Futures Trading Commission has placed position limits on futures contracts. This limitation may have affected GSG's performance recently and could also influence its profits in the future. Thereby, a buyer needs to be aware that even though GSG seems like a good commodities play, it might not be.

For a chart showing correlation of commodities to other assets, please see [Asset Correlation](#).

There are other ways to invest in commodities. One is a pure play like a commodity fund, though what it represents is already part of a well rounded portfolio. For example, broadly diversified ETFs contain oil, energy and basic material stocks. Also, emerging markets, often a portfolio component, have a weighty edge toward commodity production. These are broader bets and thereby carry less risk. Treasury inflated protected bonds are in this category too.

Nevertheless my client stands a chance to make more money than the general market on this sector play if/when inflation comes our way. He understands the risks and is willing to take them. Many of them are profiled in my earlier article entitled "[Commodities: Now, Never, When?](#)" Others are covered in [Why We Still Don't Favor Commodities](#) by Dennis Tilley.

Jimmy Rogers started the commodity stock fund, MOO, reportedly because he believes that the sector will shoot up like a rocket in the approaching years. Rogers rarely makes investing mistakes. My client and I are hoping that will also will be true for him.

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