



# Sold on Pork Bellies (and Other Commodities)

By TIM GRAY  
Published: October 9, 2010

IN 2005, K. Geert Rouwenhorst and Gary B. Gorton, now finance professors at Yale, [published a paper](#) about the investment benefits of an asset class that was then the province of specialists: commodities. Contrary to the prevailing conventional wisdom, the researchers suggested that pork bellies, coffee and crude oil had a place in individual portfolios alongside stocks, bonds and cash.

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Five years later, commodities have become an investing vogue, and Professor Rouwenhorst has jumped, part time, into money management. As a partner in [SummerHaven Investment Management](#) in Stamford, Conn., he helped create the [United States Commodity Index](#) fund, an [exchange-traded fund](#) that opened to investors in August. SummerHaven manages the fund's assets for its sponsor, [United States Commodity Funds](#) in Alameda, Calif.

The new E.T.F. is one of a flurry of commodity offerings that have appeared since the professors published their research. In the intervening years, EPFR Global of Cambridge, Mass., a tracker of [mutual fund](#) flows, counts a fivefold increase, to about 200, in the number of commodity funds and commodity E.T.F.'s.

And these funds are scooping up money at a time when stocks have often been stumbling along and bonds are offering skimpy yields. This year through September, investors plowed \$18.3 billion into commodity offerings, versus \$11.9 billion for the first nine months of 2009, EPFR said. Equity funds, by contrast, have had net outflows.

An E.T.F. that invests across commodity sectors does not buy actual commodities — that is, barrels of oil or buckets of wheat — but instead purchases derivative securities called futures. Futures give investors exposure to price movements of commodities without forcing them to own and store the products.

Despite the current gush of enthusiasm, some investment experts say commodity offerings, particularly indexed

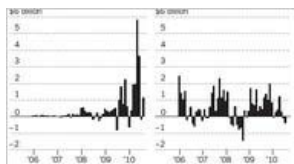
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Iron ore in China. The industrialization of developing economies like China's has helped to popularize commodities.

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E.T.F.'s that are passively managed, haven't proved that they can provide retail investors with the combination of simplicity and low costs that, say, a stock index fund built around the Standard & Poor's 500 can.

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Compared with a simple stock fund, an indexed commodity E.T.F. can be expensive and complex. As for cost, the [iShares S.&P. GSCI Commodity-Indexed Trust](#), for example, carries expenses of 0.75 percent of assets, while S.& P. 500 index funds from Fidelity and Vanguard have expense ratios of 0.1 percent.

As for complexity, the indexes and approaches of commodity funds and E.T.F.'s, can be hard for average investors to understand. For that reason, Vanguard doesn't offer them.

"Most individual investors don't get the difference between owning a futures contract and a bar of gold," said John Ameriks, Vanguard's head of investment counseling and research.

Recently, some indexed commodity E.T.F.'s have not delivered much in the way of performance. "I can't say that passive investing in commodities won't have its time," said Paul Justice, director of North American E.T.F. research at [Morningstar](#). "But it hasn't worked in the last two to three years."

The broadly diversified commodity mutual funds and E.T.F.'s followed by Morningstar lost an average of about 10 percent, annualized, over the three years through Sept. 30, while the S.& P. 500 lost 7.2 percent, annualized.

As Professors Rouwenhorst and Gorton contend, the argument for commodities investing via futures is straightforward: Over the long run, it provides stocklike returns, inflation protection and diversification. The professors' work has found an audience among investment firms and helped popularize the idea that commodities futures have a place in retail investors' portfolios.

Their findings have not been the only factor in the rising popularity. James B. Rogers Jr., an author and investment manager, has evangelized about commodities' potential for years. The industrialization of developing economies, like those of China and India, has also brought favorable attention. These countries will have to gorge on raw materials like oil and iron ore to sustain their torrid growth.

"China accounts for roughly half the growth in global demand for iron ore," said Frederick Sturm, manager of the [Ivy Global Natural Resources](#) fund.

Though the commodity story can captivate, difficulties can arise in executing the strategy. Even the matter of building a commodity index stirs debate. Unlike large-capitalization United States stocks, for which the S.& P. 500 is a de facto standard, the sector hasn't settled on a benchmark. Investment companies build their funds and E.T.F.'s around different ones, and new indexes continue to arrive.

"There's no clear, dominant index that's written into pension-plan policies or ingrained in individual investors' heads," said Christopher A. Burton, manager of the [Credit Suisse Commodity Return Strategy](#) fund.

The first index that came into widespread use was the S.& P. GSCI, created by [Goldman Sachs](#) and now owned by S.& P. It apportions weight to various commodities based on world production volumes. Critics say it overemphasizes energy, which recently accounted for about 70 percent of the index's value, and have offered alternatives. The Dow Jones-UBS Commodity Index, for example, uses production volume and trading activity to calculate weights. It caps the heft of any single commodity group at 33 percent.

The E.T.F. that Professor Rouwenhorst helped create has its own index, the SummerHaven Dynamic Commodity Index. To build it, SummerHaven screens 27 commodities monthly and, from those, picks the 14 that show signs of having the lowest worldwide inventories. These 14 are then equally weighted in the index and, by extension, the E.T.F.

Disagreement over basic questions like benchmarking is partly why Morningstar suggests actively managed funds for average investors who want to invest in commodities.

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“You want a manager who can go long and short and has flexibility to pick whatever commodities and maturities he wants,” Mr. Justice said. Futures, like bonds, come with maturities, and some index funds automatically buy the futures whose maturities are shortest.

One actively managed fund that Morningstar recommends is [Pimco Commodity Real Return Strategy](#), though Mr. Justice cautions that the expense ratio of its Class A shares, at 1.29 percent, is higher than he likes to see.

Campbell R. Harvey, a finance professor at Duke, also argues for active management when venturing into commodities. Like Professors Rouwenhorst and Gorton, he dug into commodity returns before the asset class was fashionable. But he and his co-author, Claude B. Erb, a fund manager at TCW in Los Angeles, arrived at a different conclusion.

In [a paper](#) published in 2006, they found “no premium for passively investing in commodities” as a group over the long term, Professor Harvey said. And technological change may explain why. When faced with rising prices and shortages, humans find ways to produce and use commodities more efficiently or replace them, he said.

As whale oil, for example, became scarce, people replaced it in lamps and candle wax with petroleum-based oils and waxes. Innovation counterbalances the scarcity that would raise prices over time.

A version of this article appeared in print on October 10, 2010, on page BU13 of the New York edition.

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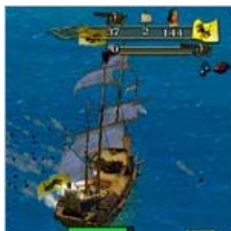
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