

Using commodities effectively in portfolios

William Lowndes of Threadneedle explains the growing role and importance of commodities in investment portfolios, including how buyers can access this asset class as well as the risks for them to consider.



Interview

William Lowndes

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- >> The growth in the importance of commodities as an asset class has taken place over recent years in line with the increasing demand across the range of commodities, from soft to hard
- >> Commodities can be a good diversifier, as well as creating a degree of hedge against inflation, so should sit alongside other asset classes in a portfolio
- >> Investors in single commodities face a concentration risk where volatility can lead to them losing money if they get the timing wrong

Given that much of the commodities market is dominated by passive investing, the approach William Lowndes said that Threadneedle takes to this asset class is exploiting the opportunities which arise from knowing how other market participants act and react.

As a result, he said the firm spends a lot of time trying to understand the flows around passive investors, as well as trying to understand their effect, especially in the derivatives market.

It then uses this information to define how it uses derivatives and the information around the flow of passive investors to minimise the costs for buyers in taking exposure to commodities, he explained.

Investing style

Rather than taking big bets on the latest hot commodity, Lowndes said Threadneedle is very risk-controlled in its approach to investing in this asset class.

As a result, the firm takes exposure to a broad basket of 17 commodities – both hard and soft – for each of which it takes a directional view, and then blends these into an overall portfolio. This also leads to the firm offering themes at different points in time based on what it likes and dislikes, he added.

Not putting a large portion of the fund in a single commodity reduces volatility and risk for investors, explained Lowndes.

In addition, he said Threadneedle takes a long-only approach to commodities.

An increasingly important asset class

According to Lowndes, the growth in the importance of commodities as an asset class has taken place over recent years in line with the increasing demand across the range of commodities, from soft to hard. And this will remain the case in the coming years, he predicted.

This is driven in part, he explained, by the demand from emerging market investors, which won't disappear.

Other factors which he said continue to help this asset class develop include the scarcity in some commodities, the volatility, strong demand patterns and greater accessibility.

The role of commodities within portfolios

In 2008, many investors saw that correlations can converge during extreme market events. However, said Lowndes, commodities can be a good diversifier, as well as creating a degree of hedge against inflation.

As a result, he said commodities should sit alongside other asset classes in a portfolio – though the amount will be different for each investor.

Risks of investing in commodities

According to Lowndes, investors in single commodities face a concentration risk where volatility can lead to them losing money if they get the timing wrong – in a similar way to what investors would experience with some other asset classes.

The benefits of the approach that firms like Threadneedle take to investing in commodities, therefore, is the diversification for investors through the broad range of commodities in the portfolio, he explained.

Lowndes said this makes it more feasible to control the risk, and in a way which can be argued is more effective than some other asset classes, given the element of diversification within commodities.

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