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Emerging markets could be prepared for a comeback – 26

Group profile
Aberdeen Asset Management's Martin Gilbert sees a glimmer of hope in the firm's fortunes – 34

Patrick Collinson
Argonaut Absolute Return fund manager Barry Norris on exploiting forecasting errors – 30

Investment trust profile
City of London trust's Job Curtis on the firm's 50 years of consecutive dividend increases – 24

MORE INSIDE
› Platforms
› Square Mile
› Sector Focus

Where next for commodity prices?

Our experts give their views on commodity prices which appear to be levelling out after a period of extreme volatility

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Laura Suter
Editor,
Fund Strategy

Last year was marked by continued talk of what was happening to the oil price. The falls in the price impacted inflation, nations and the outlook for the global economy.

However, this year the price has rebounded somewhat. It fell to lows of around $28 a barrel in February but since then has bounced back. It is still nowhere near its former highs, but is climbing back up.

However, the overall outlook is not exactly rosy. In January the World Bank cut its outlook for 80 per cent of the world's major commodities. A report from the bank blamed oversupply and sluggish emerging market growth for the downgrades.

For crude oil, the 2016 forecast was cut to $37 per barrel, down from $51 per barrel in its October report. The World Bank said it expects oil prices to drop another 27 per cent during the course of this year.

Gold has been an entirely different story. Worries generated by the US Federal Reserve raising interest rates saw the fear factor kick in for investors and led them to gold. In March the precious metal saw the largest four-week inflows in seven years of £5.59bn, leading to a price surge. The price hit a 13-week high of $1,274.70 an ounce.

With increasing moves by central banks to negative interest rates - meaning investors are effectively paying to hold some government bonds - gold is likely to remain attractive in the short to medium term as investors look elsewhere for real returns.

James Calder
Head of research
City Asset Management

Commodity investing tends to bring out the gambler as opposed to the shrewd, calculating investor.

Commodity investing has a number of facets derived from the fear trade in gold; basically, a view that all other asset classes are in dire straits so hold an asset that has no yield and limited practicable applications, jewellery aside.

The opposite end is dominated by the raw materials that drive the industrial machine, namely base metals and oil. The latter has been a deep source of speculation for the past 18 months. Calling this price is difficult. As a colleague put it to me in early 2015, few economists were forecasting its collapse in 2014 but all are wise after the event.

But where does this leave us? Physical gold does have a role to play in times of severe market stress. However, the disconnect between the value of the commodity and gold equity shares means I am uncomfortable in the equity space. Oil is too difficult to call as an asset class. Therefore I am comfortable leaving my exposure here to generalist equity managers as opposed to a sector specialist.

Jonathan Davis
Managing director
Jonathan Davis Wealth Mgmt

Commodities, of course, have collapsed over the past few years, hence prices start to look attractive. They are currently rallying hard. Problematically, though, they are doing so while the US dollar corrects after its massive bull run into early 2015.

The dollar, in the bigger picture, remains in uptrend, irrespective of a short-term correction. Thus, if the major bull market in the dollar reasserts, as it likely will later this year, the major bear market in most commodities will likely reassert.

Many commodities and company share prices are closer to bottoms than tops, with some down 90 per cent. On a medium- to long-term view, 2016 is the year to start moving back in.

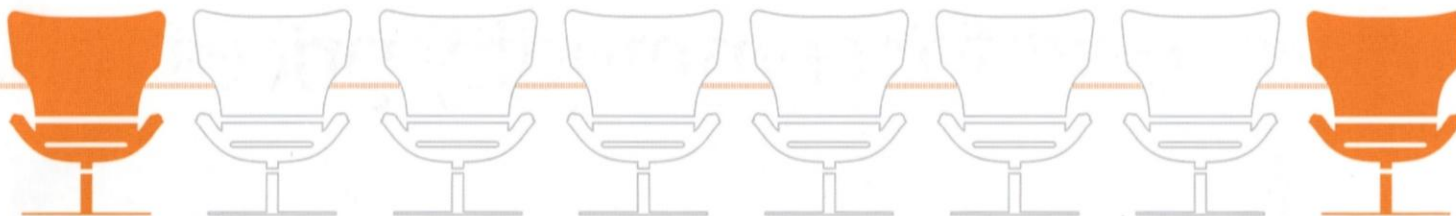
Timing is tricky though as many stock prices have soared 50 per cent in just two months, so are likely due a pullback. There can yet be even lower prices in most commodities, compared with the recent multi-year lows, but the longer-term upside is immense. Similarly, producing emerging markets' shares will benefit from growing commodity prices.

Peter Lowman
CIO
Investment Quorum

Commodity markets have been extremely volatile over the past few years, and never more so than this year. In the first quarter alone we have seen the price of crude oil bottom out at just below $30 a barrel before rallying back up by 50 per cent. In base metals the price of iron ore and copper has rallied while gold bullion has delivered its best return for some time.

Clearly, little seems to have changed in terms of supply over demand; however, what has changed over the past 12 weeks has been the recovery in commodities prices and the rally in the emerging markets.

Obviously, if the commodities rally were to be upheld, then it would be beneficial for many of the commodity-driven emerging market economies, and commodity currencies. Similarly if we do see a retraction in the crude oil price, then the likes of China, India and Japan, that import all or most of their crude oil, would benefit while those exporters, such as Saudi Arabia, Russia, the United Arab Emirates, Iraq and Nigeria, would continue to suffer.



Mike Deverell

Investment manager
Equilibrium Asset Mgmt

To be frank, I am not a fan of commodities as part of an investment portfolio.

Commodity prices are much more unpredictable than stocks, bonds or property. Those asset classes usually pay an income of some description, whether that be dividend, interest or rental yield. That allows an assessment of value.

The same cannot be said of commodities, where prices are purely a function of supply and demand. In oil in particular, politics plays a massive part. Who can say whether the Saudis will cut oil production and therefore send the price up? Or whether they will ramp it up, hoping to depress the price and send rivals out of business.

At least oil has a useful function and has some intrinsic value. The same cannot be said of gold. The main function of gold is as a "fear" trade. It tends to go up when investors are scared about the outlook, but this can change very quickly.

Most people have indirect commodity exposure in their portfolios through the stockmarket and should not take the additional risk of directly holding commodities.

Tim Cockerill

Investment director
Rowan Dartington

The inexorable decline in commodity and oil prices may now have run its course as prices appear to have started to level out.

The oil market will find equilibrium before the other commodity markets by virtue of the simple fact it is easier to switch off oil production. Behind the scenes, companies are working flat out to cut costs, become more efficient and sell off less productive assets. All this corporate activity makes these businesses far more efficient and ultimately profitable.

Disruptions in the market like this throw up opportunities. The recent rally in mining stocks shows just how quickly the direction of travel can change – yes there could be another setback, but it does feel like we have entered a new phase and I do not think the underperforming sectors of 2016 will be oil and gas or commodities.

Of course lower oil and commodity prices has meant inflation has been negligible - in time this will change as the fall in energy prices drops out of the numbers but that is a little way off yet. The commodity cycle is slowly turning.

John Husselbee

Head of multi-asset
Liontrust Asset Management

Commodity prices have fallen precipitously due to softening demand from China, and global production, which remains high.

China's economic slowdown and transformation has also been a factor in the oil price's decline.

A fall in the price is akin to a global cut in taxation to both corporates and individuals, the magnitude of which neither governments nor their central banks could possibly replicate. Lower energy costs clearly support the consumer, and in particular the western consumer.

This dynamic – slowing emerging market growth contributing to lower energy prices, which in turn boosts developed market consumption – has led to the prospect of a de-synchronised global economy. It should clearly yield investment opportunities.

With respect to investment in the commodities asset class itself, ongoing price weakness shows this remains a contrarian trade, but one which could be worth consideration for investors willing to accept the accompanying volatility.

INDEPENDENT VIEW

Nik Bienkowski

Co-chief executive
WisdomTree

We are pretty positive on commodities generally at the moment from a high level. Obviously it is affected by fund flows and asset allocation decisions, but if you look at the broad commodity indices it has been five years of negative calendar year returns, which I do not think has been seen since the indices started. On that alone we could be quite bearish, but I do not think there will be six years of negative returns.

Equity markets have been extremely volatile over the past five months. When that happens cash comes out of equities and looks for a house elsewhere and that has largely gone into fixed income, but it has also gone into commodities.

Gold has taken the lion's share of the inflows, and the ETF issuers that have taken most inflows in Europe happen to be the issuers that have a large portion focused on commodities and gold.

We have the US presidential election, a potential Brexit and some of the other fundamentals in the economy are not looking so bright, so gold tends to shine in those periods. Whether gold is in a long-term upward trend is a different question.

Oil only 18 months ago was at $100 a barrel and it recently hit $29 a barrel so over the medium to long term there will be more upside in the oil price than downside, whether that happens in the short term is a little harder to predict.

Scarcity of commodities will be a factor longer term. Producers will have to go to riskier countries or find new ways to dig out more oil and gold. Over time the cost of extracting commodities will generally increase, meaning costs will increase.