



Louis Boulanger Now Ltd presents: The Case For Commodities



APAFS 7th Annual Conference, Manila, 19 October 2007

**A new bull market is underway
... and it is in commodities.**





Agenda

- History
- Key rationale
- Goodbye, cheap oil!
- Gold – mystique vs. reality
- How to invest
- Sources
- Q&A



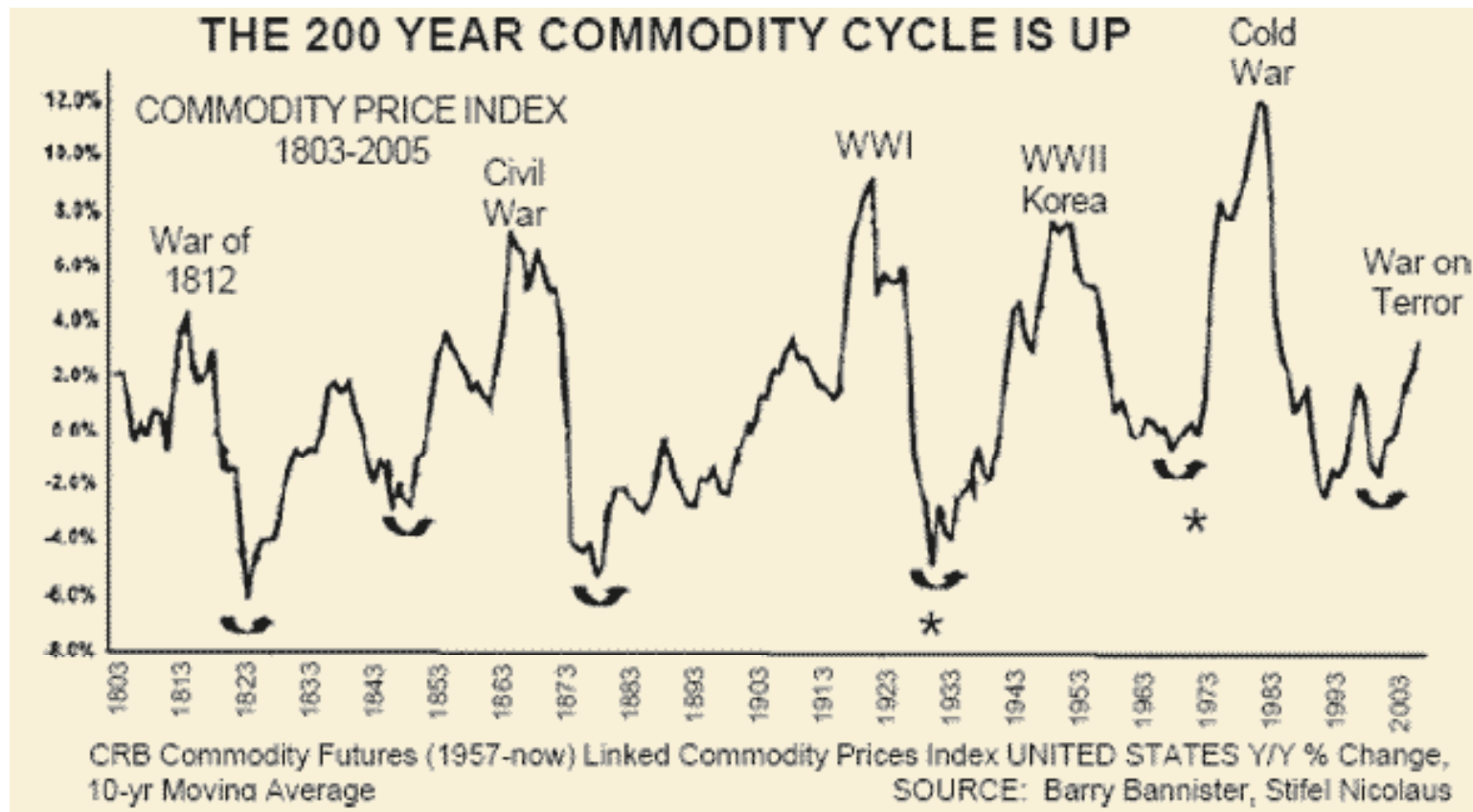


A bit of history...





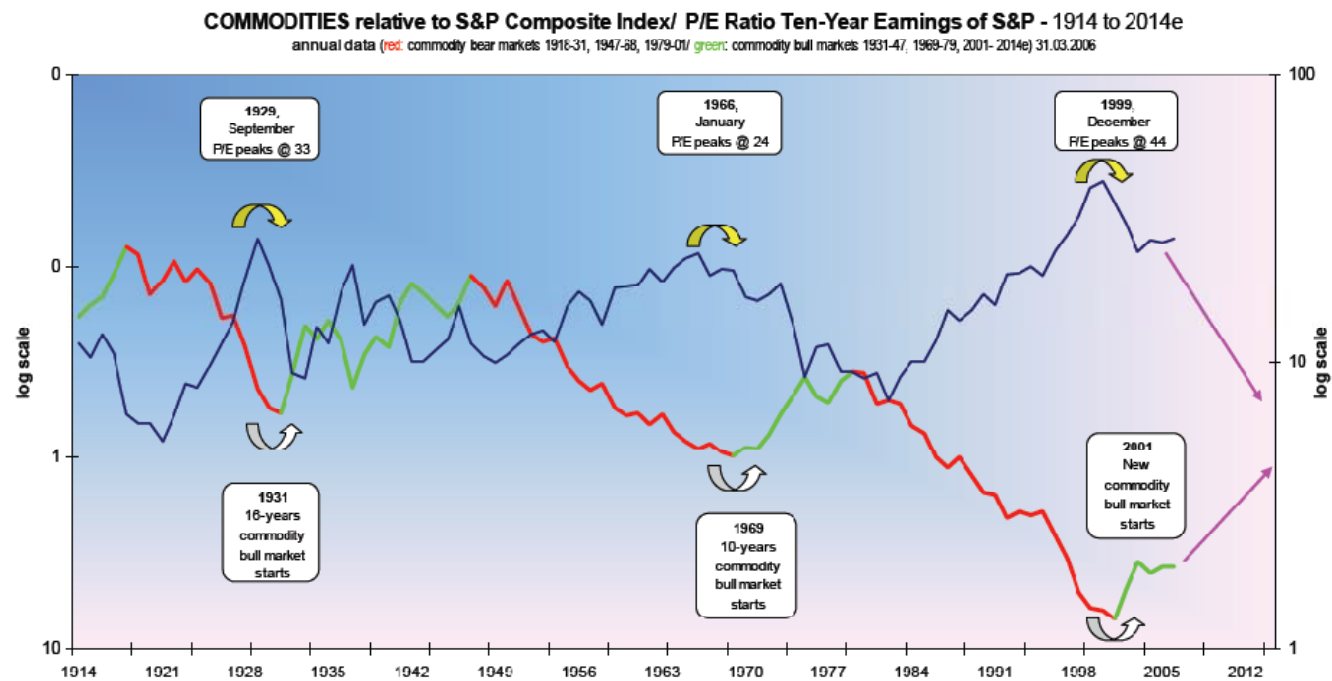
The commodity cycle





Plus ça change...

Commodities relative to equities

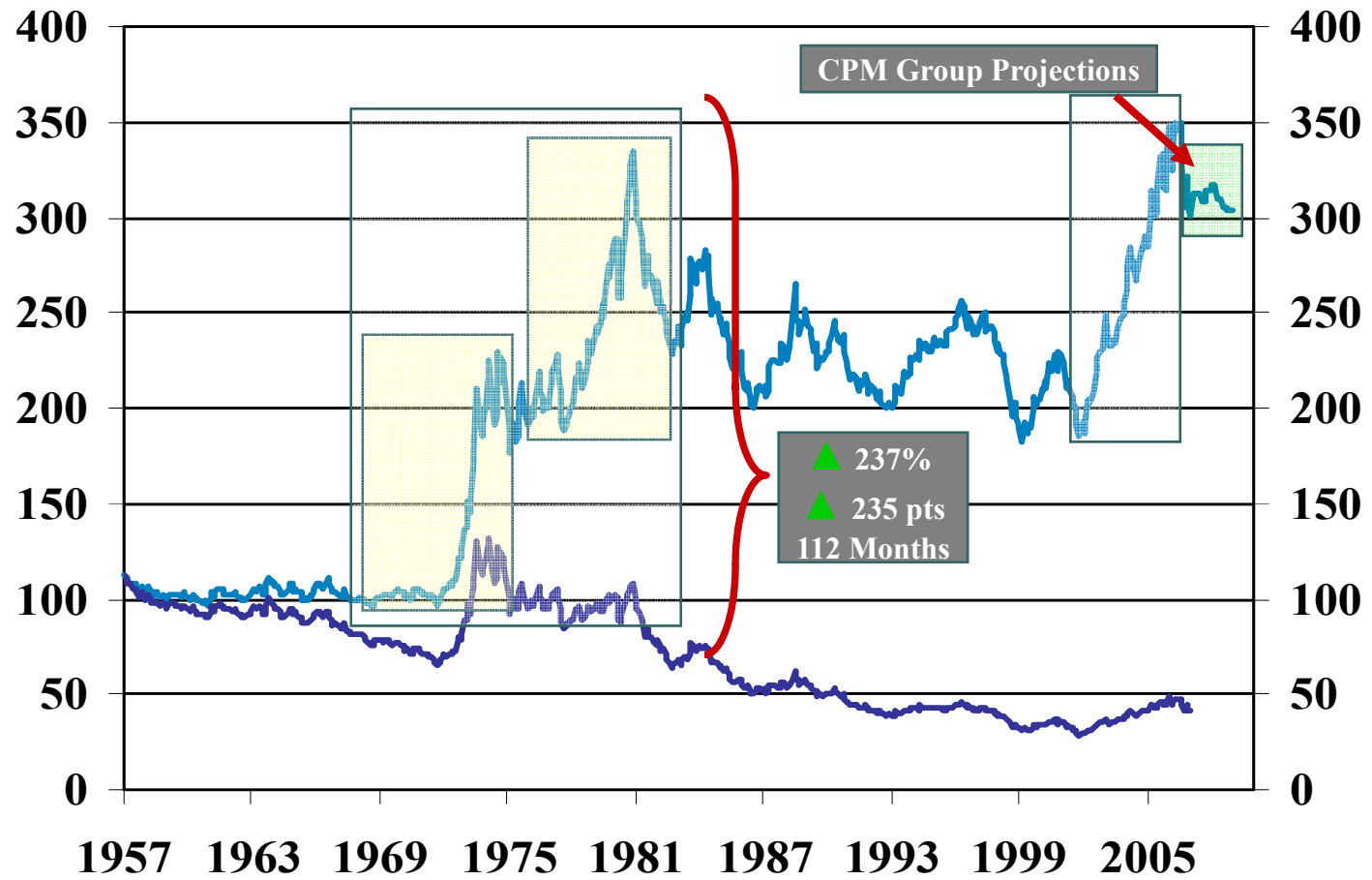


Source: S&P, CRB, eh.net, Robert J. Shiller, DIAPASON CM Research



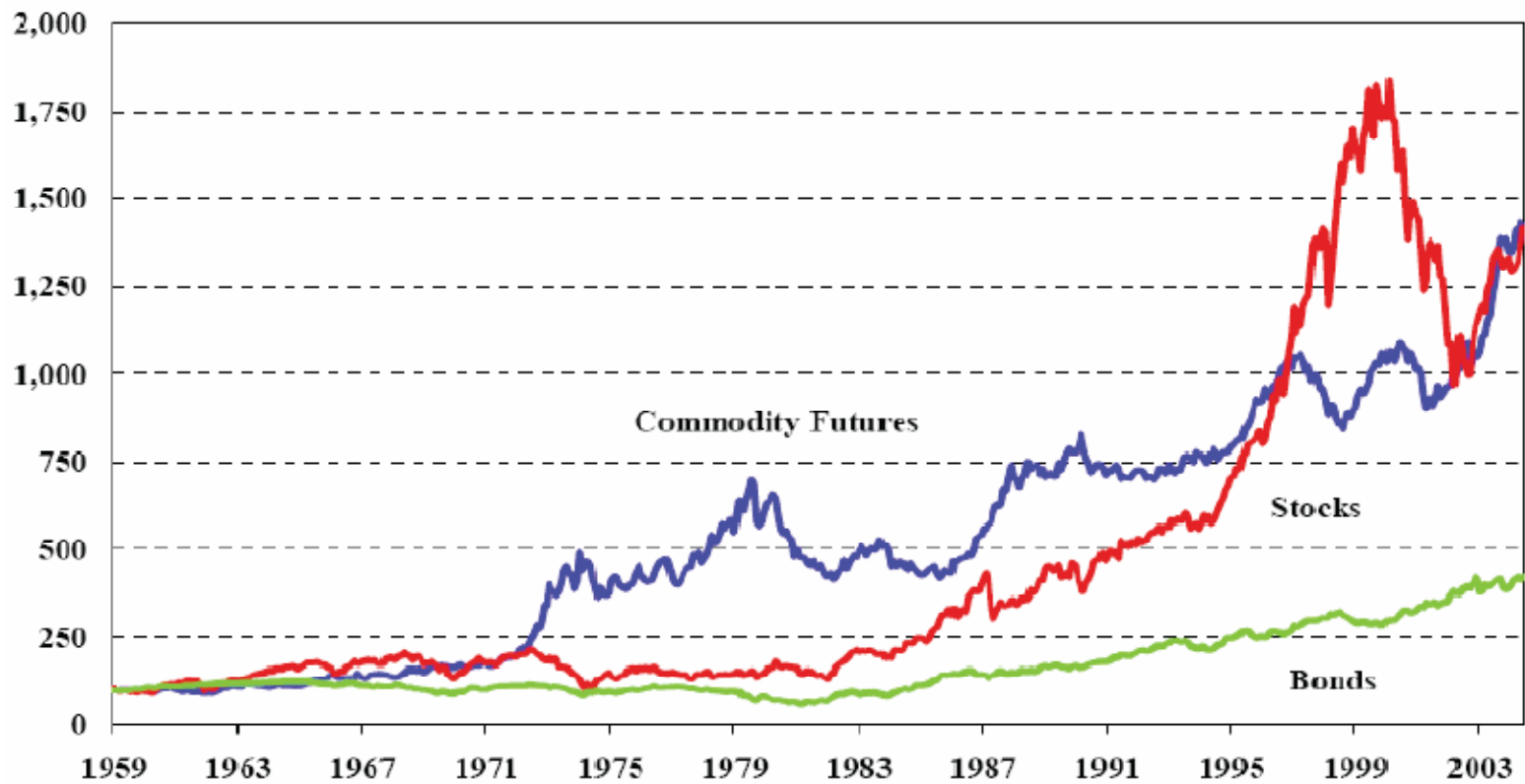


... plus c'est pareil?





Track record of commodities

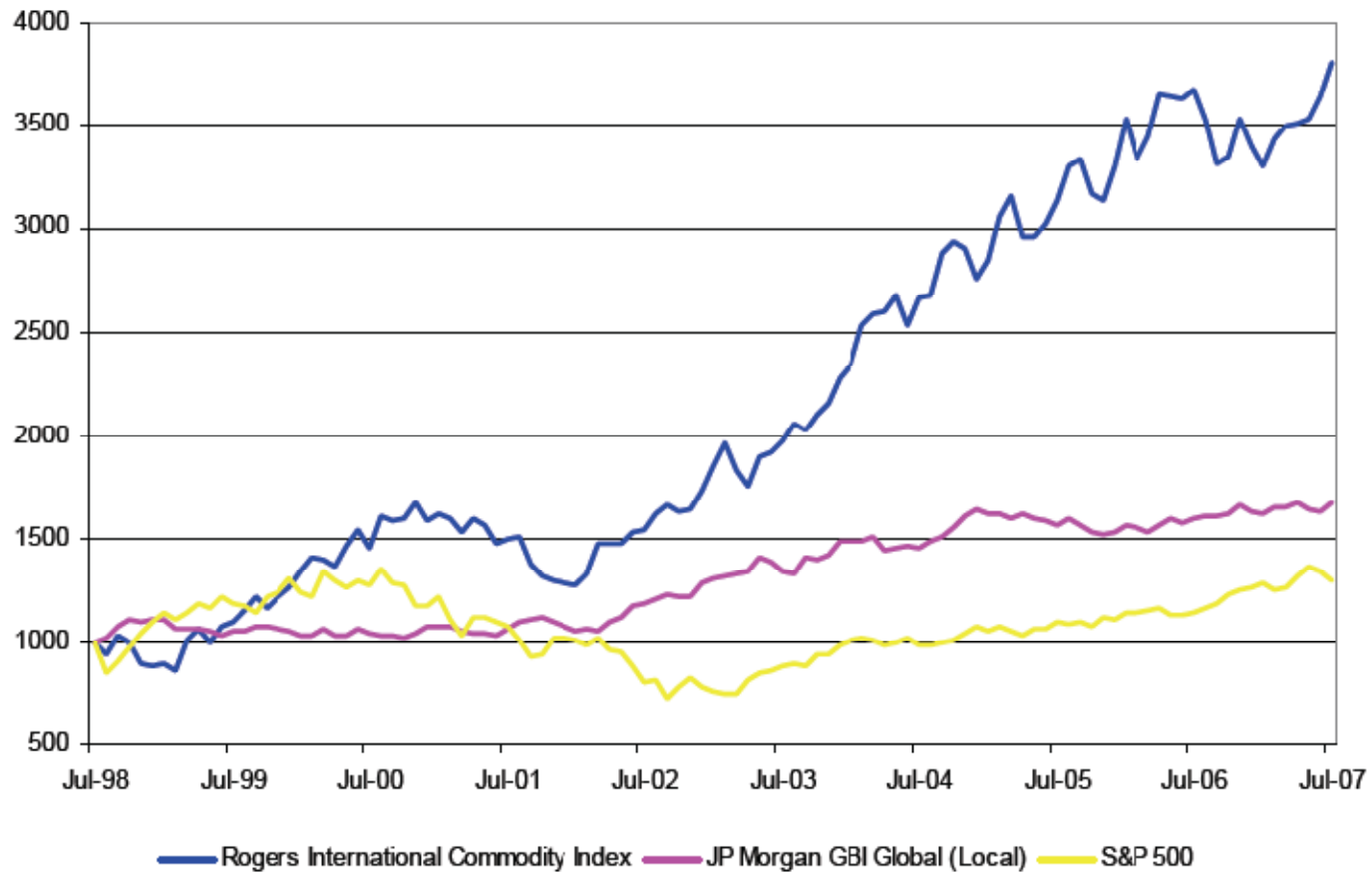


Source: YALE School of Management 2005



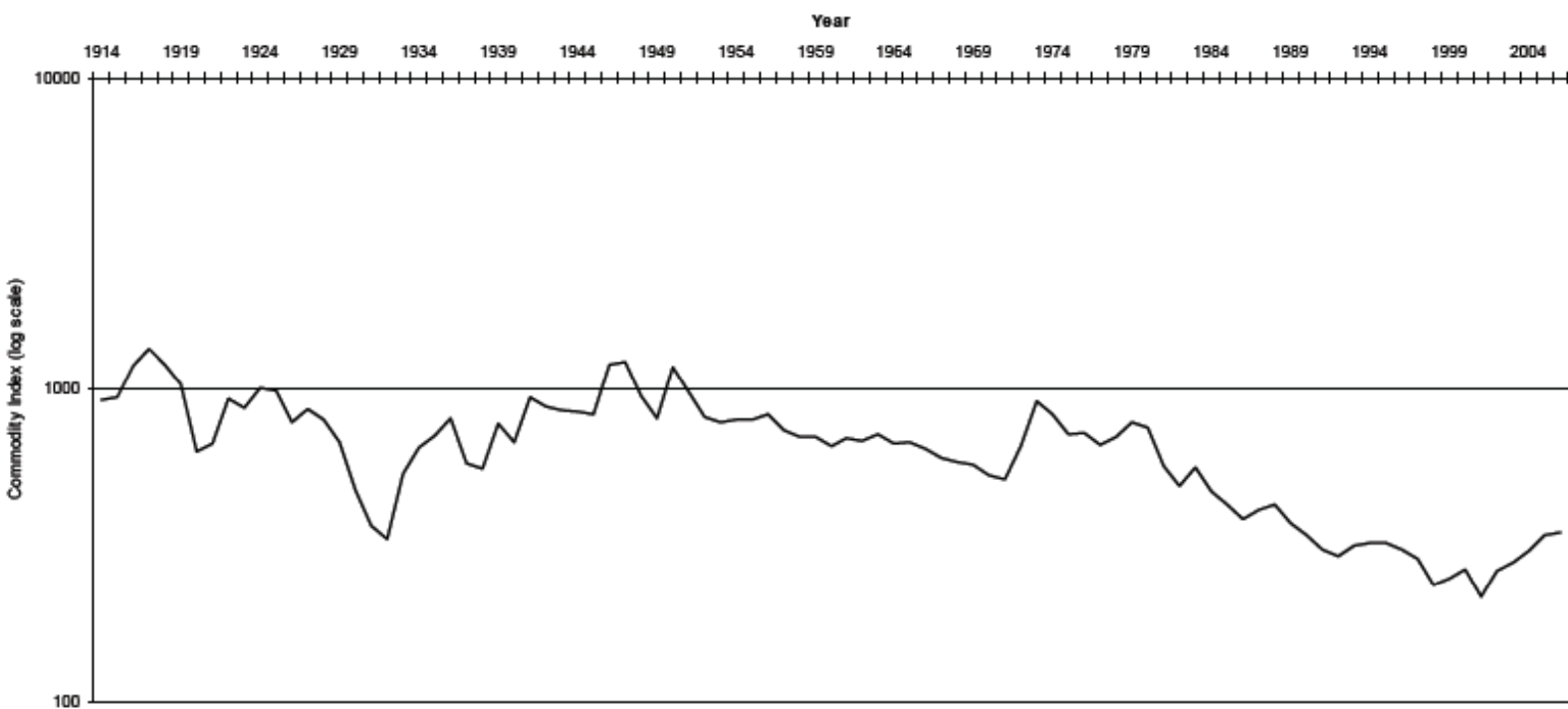


A new bull market



Remember the 'real' picture... Commodity prices are still low

Commodity Index (CRB) - inflation adjusted (2006 USD)
01.01.1914- 26.05.2006, annual data



Source: S&P, CRB, eh.net, Robert J. Shiller, University Oregon state, DCM Research





Why commodities





Many positive factors in place

Economic

- Since late 19th century, commodity bull markets have appeared every 32 years on average and lasted approximately 13 years, possibly due to the supply inelasticity of commodities
- generally higher prices are needed to attract new investments in productive capacity (e.g. finding oil, new mining exploration, etc)

Supply/ Demand

- Favorable supply/ demand/ inventory situations are emerging or are already in place for most commodities
- Demand continues to rise (concentrated on Asia) but not supply (as demonstrated e.g. by copper mines & oil fields since 2001)
- there was a long under-investment period (1980-2001) in global productive capacity, transport and transformation of commodities

Monetary

- International US\$ based monetary system is crippled with debt
- Global central bank reserves (including gold) of US\$5.3 trillion backed 'officially' by 977 million ounces of gold (=US\$5,425/oz!!!)



● ● ● | Commodities as an asset class

- ✓ Natural resources are the building blocks of civilizations
- ✓ World production estimated at close to US\$1.5 trillion
- ✓ Commodities offer different characteristics:
 - ✓ no credit risk
 - ✓ no ongoing revenue stream valuation
 - ✓ global economic value assessed
- ✓ Correlation of prices with stocks & bonds is -VE
- ✓ Correlation with consumer price inflation is +VE
- ✓ Superb total portfolio diversification benefits



The portfolio case

Based on 45 yrs history: 1959-2004

	COMMODITY FUTURES	EQUITIES
Average monthly returns	0.89	0.93
Standard Deviation	3.47	4.27
Correlation (1-year)	1	-0.30
Skewness	0.71	-0.34
Bottom 5% Equities Returns (Average)	1.03%	-8.98%
Bottom 1% Equities Returns (Average)	2.38%	-13.87%
Inflation hedge	Yes	No

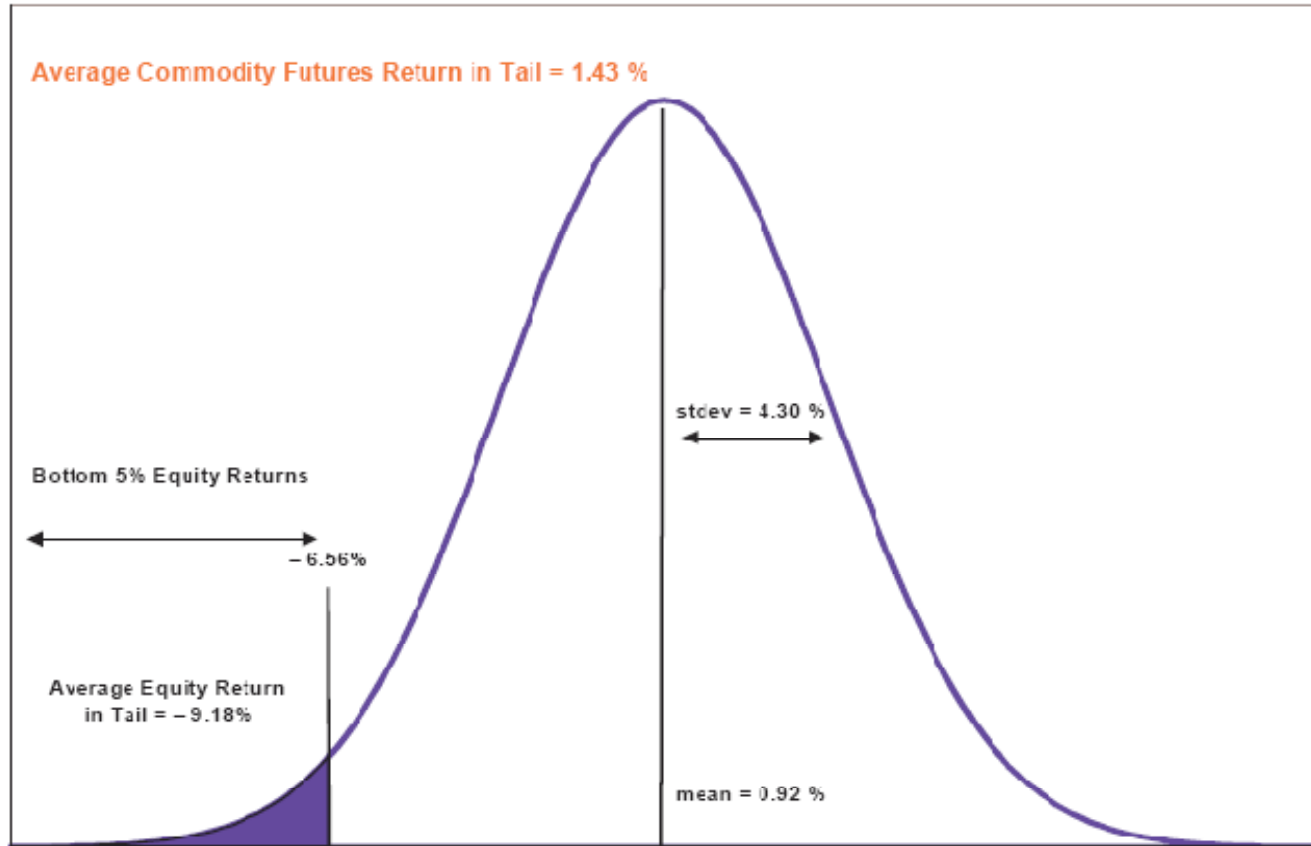
Commodity futures deliver a return stream that diversifies the risk of holding stocks and bonds, while also delivering equity-like returns over the long term

Source: Yale University, 2005





Let's look at that tail...

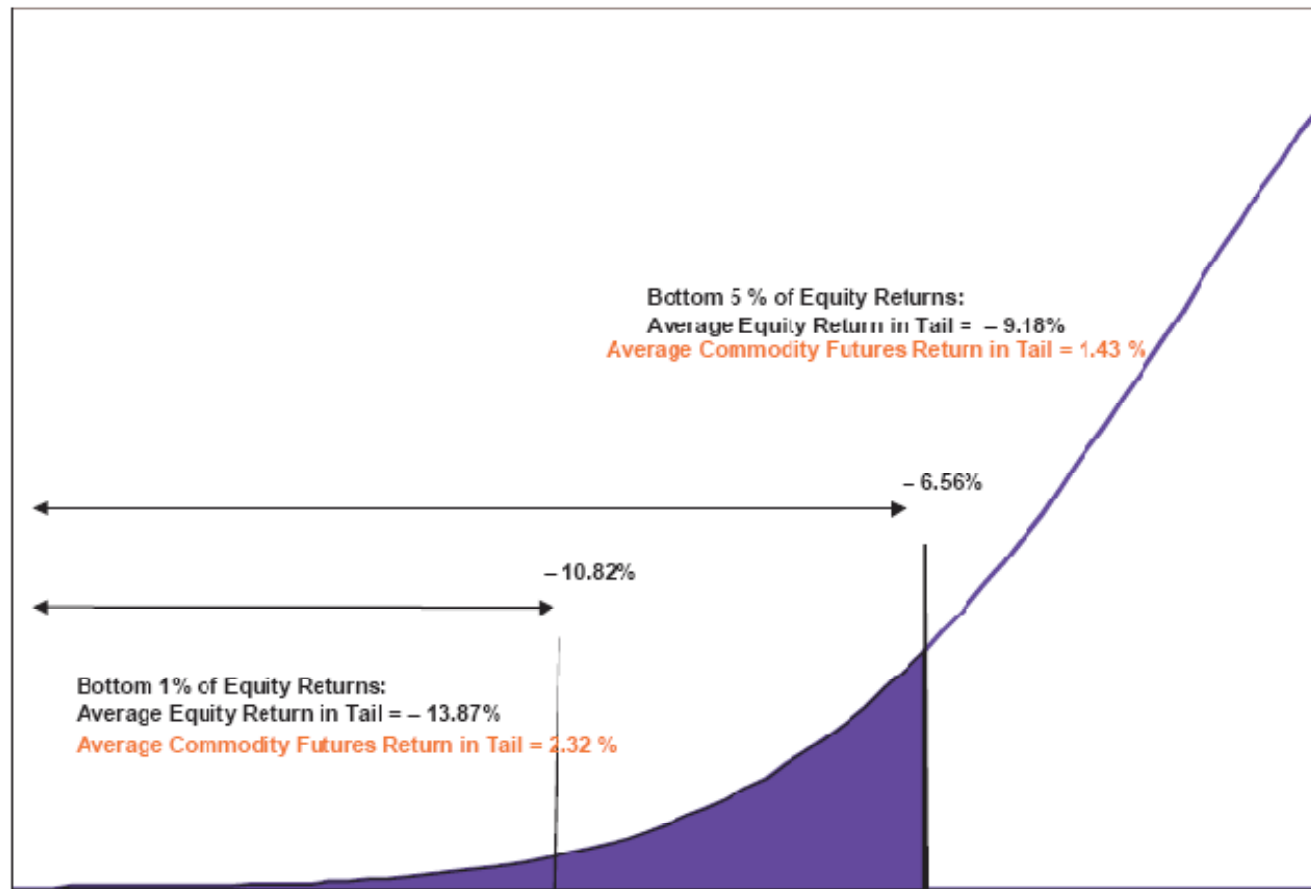


Source: Yale University, 2005





... and a bit more closely now



Source: Yale University, 2005





We live in 'interesting' times...

- These are times of crises and resource wars
- Knowledge of what is happening is key:
 - ❖ A credit crisis is unfolding
 - ❖ Geopolitical tensions are rising
 - ❖ A global energy crisis is coming
 - ❖ Money is borrowed into existence
- In times like these... you need commodities



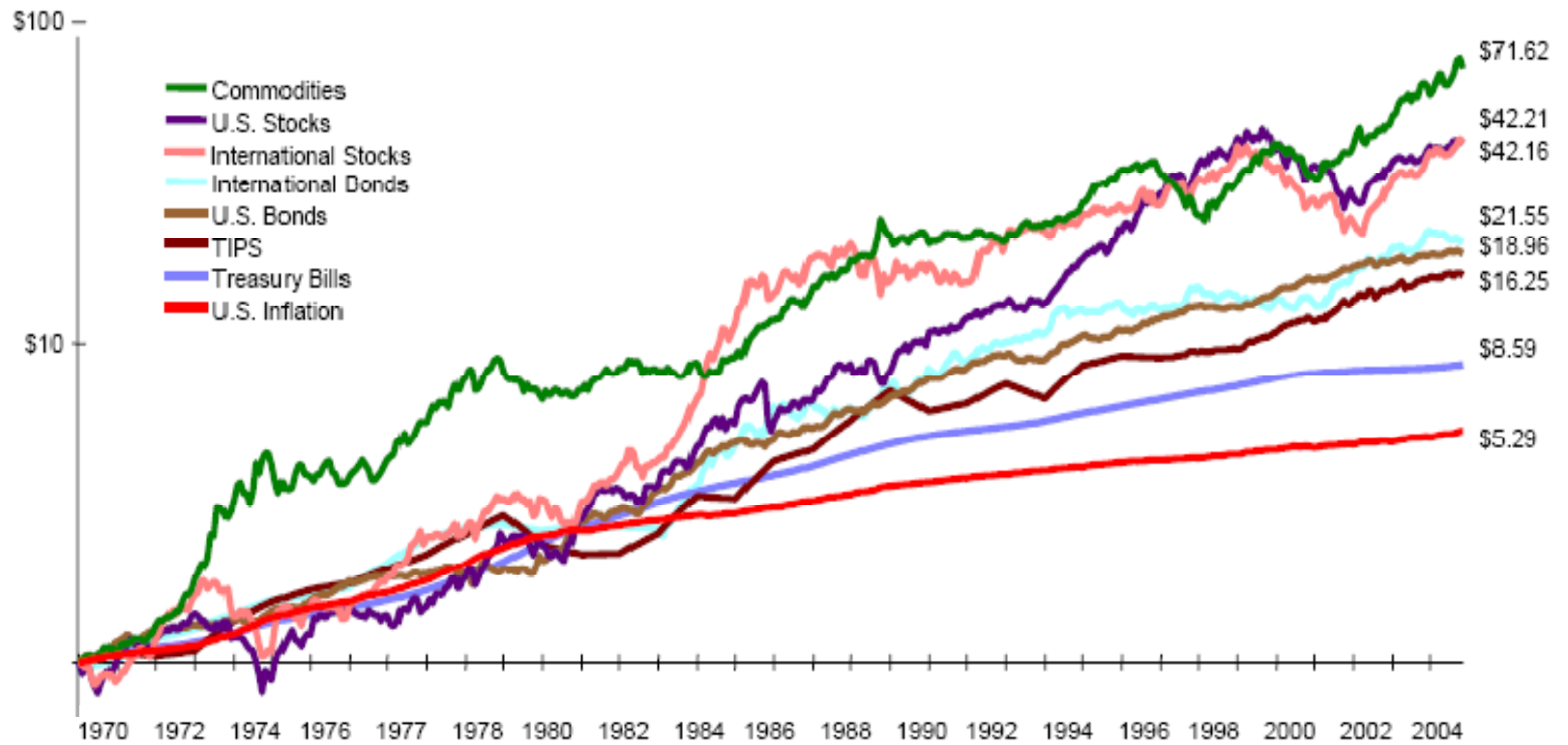
● ● ● | Here are the compelling facts

- Commodities are:
 - ❖ Generating long term returns like stocks
 - ❖ Negatively correlated to stocks and bonds
 - ❖ Positively correlated to inflation
- Stocks are getting expensive
- Interest rates are increasing
- Inflation is on the rise...

... NOT convinced yet? OK, then...



Growth of US\$1 invested January 1970 – October 2005



Source: Ibbotson Associates' Study for PIMCO, 2005, page 15



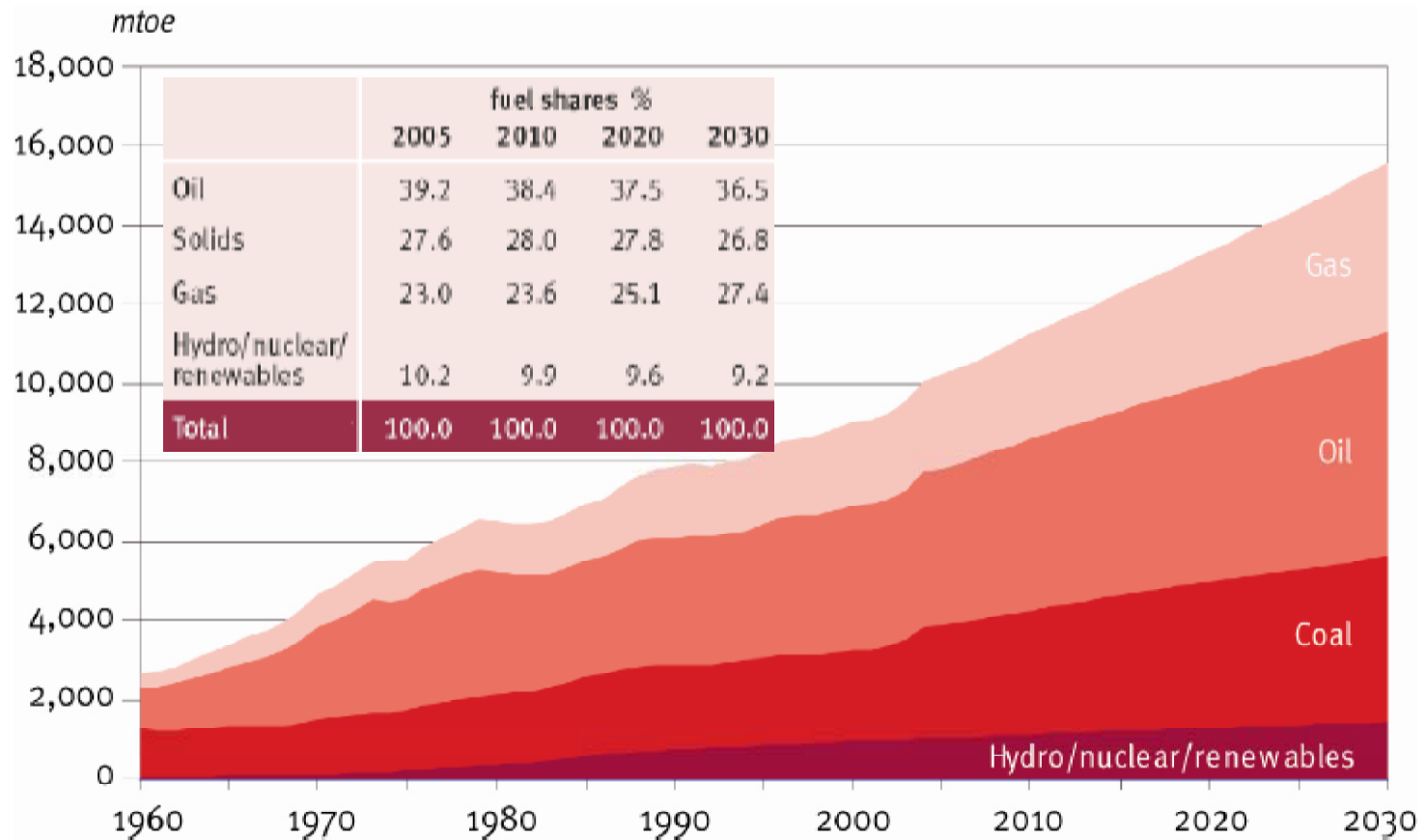


Goodbye, cheap oil!





Energy & oil demand by type



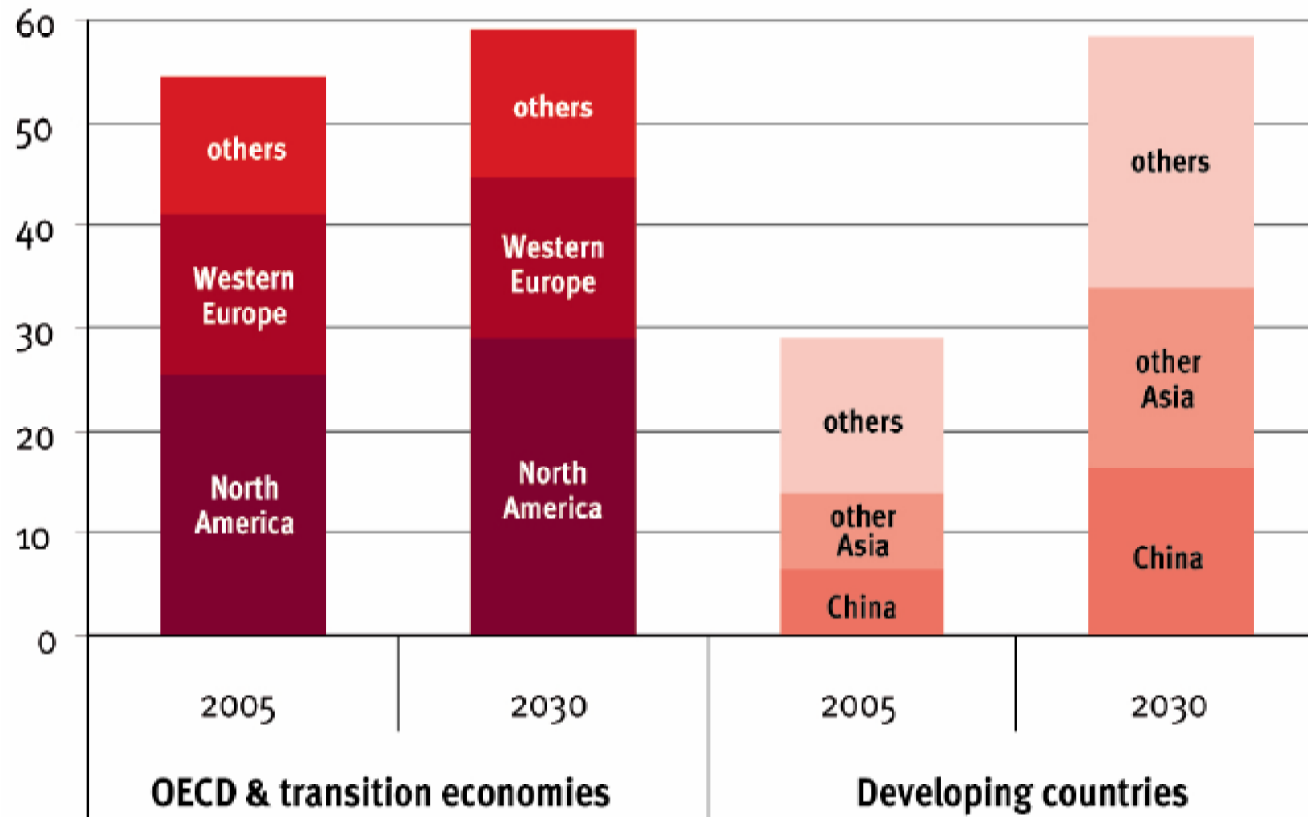
Source: OPEC World Oil Outlook 2007





World oil demand outlook

mb/d



● ● ● | But what about the supply?

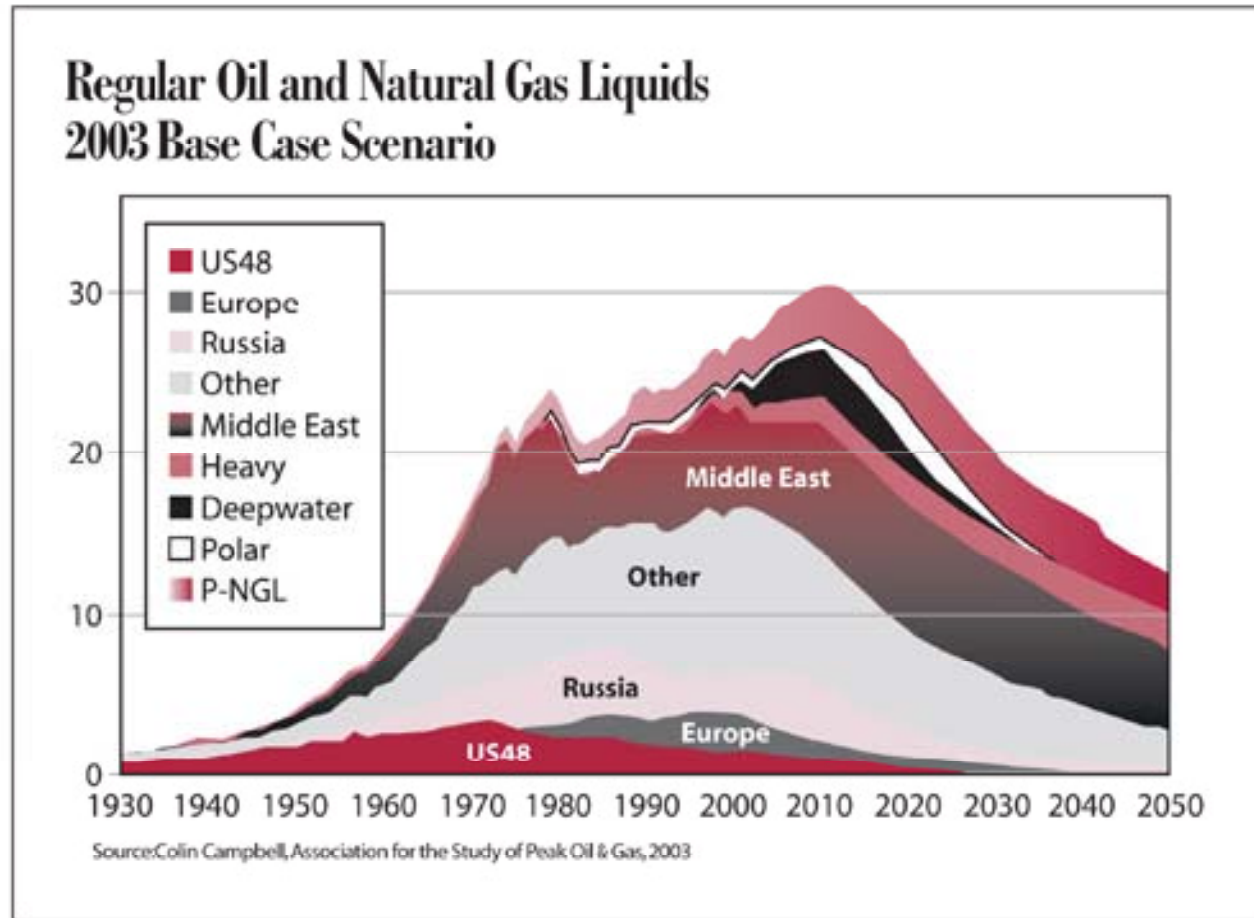


Source: images.google.com



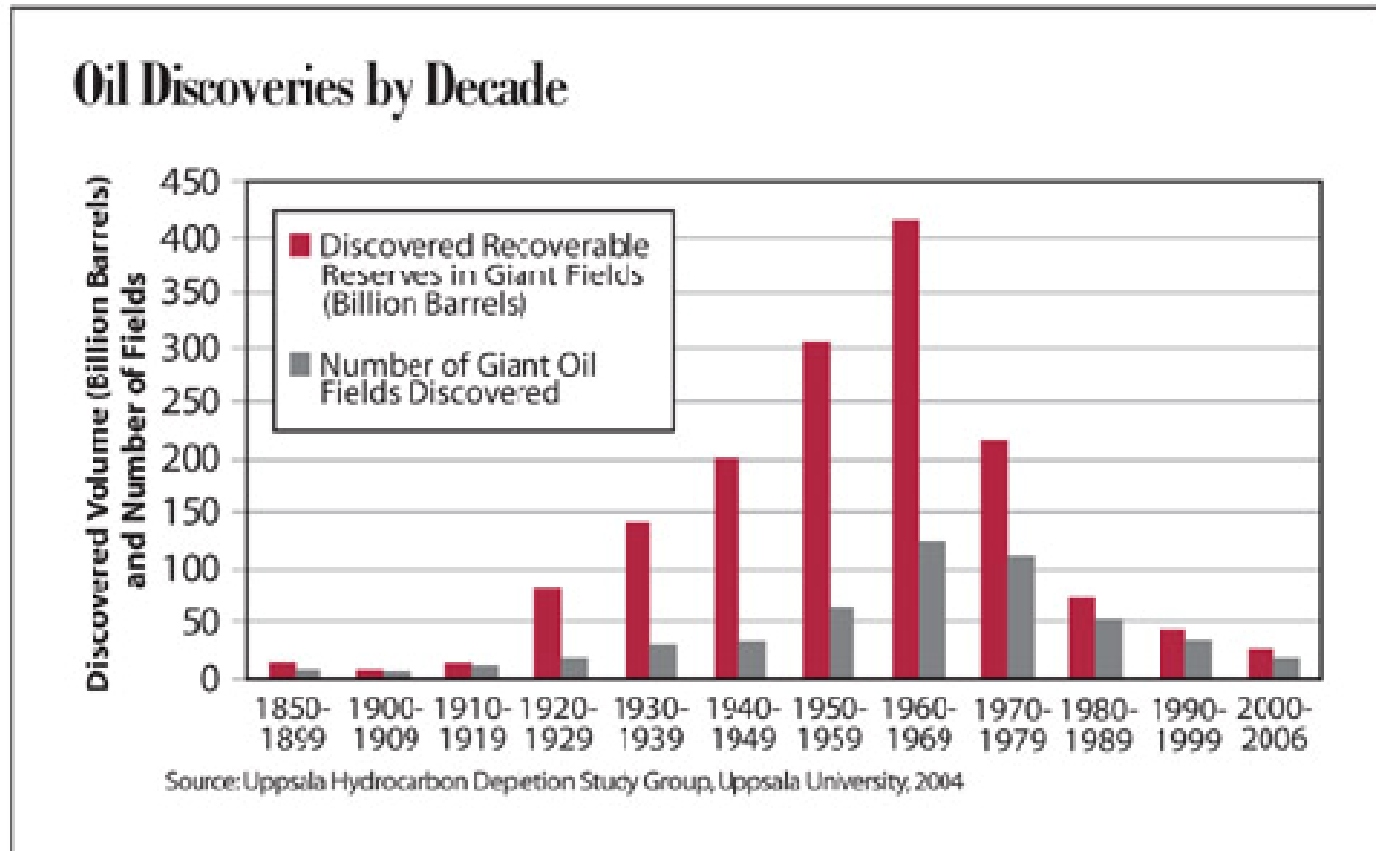


Heard of 'Peak Oil'?

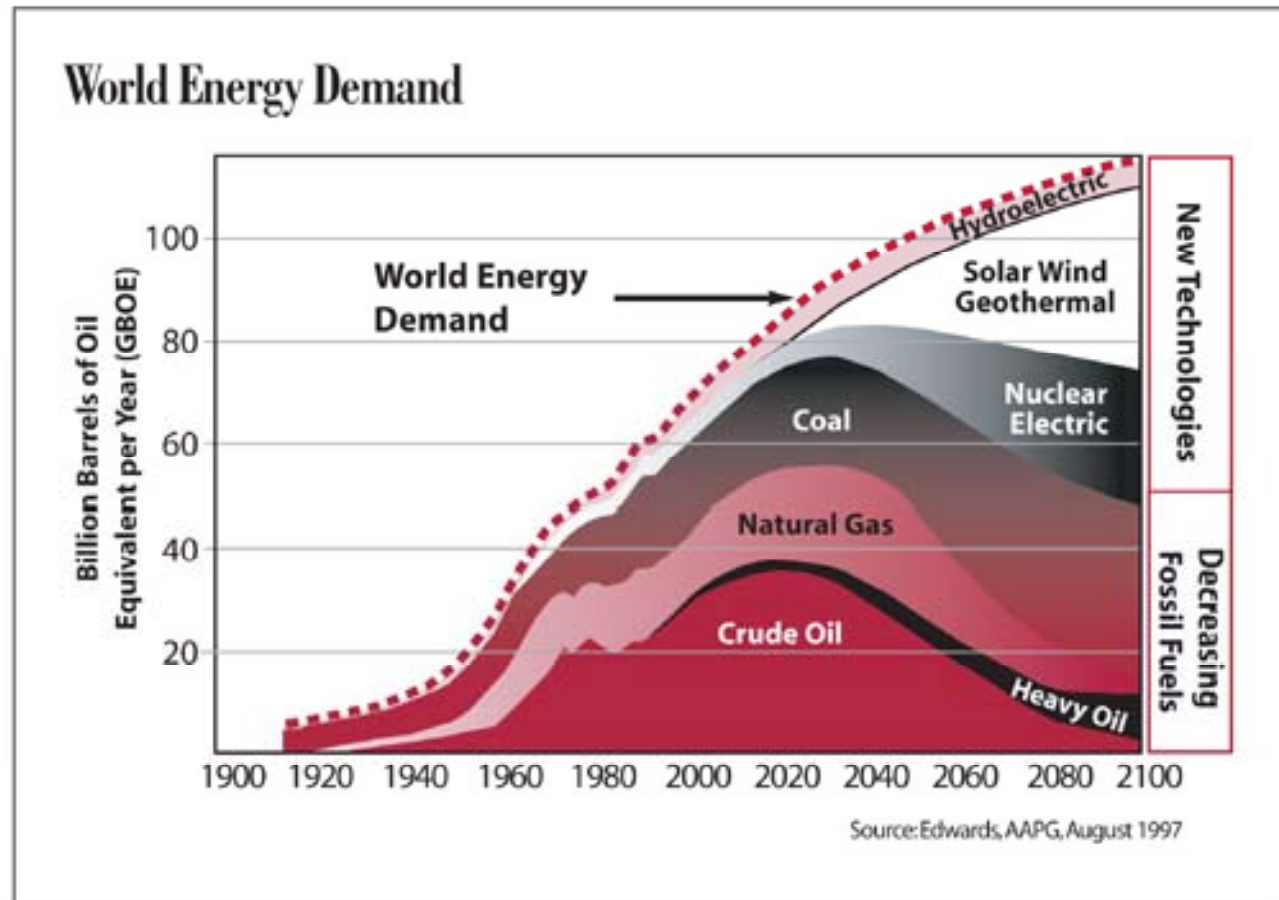




We're not finding oil any more...



● ● ● More coal & uranium in future



Source: Casey Research, Casey Energy Speculator





Time is short

- Oil used since 1850 – about 1,000 billion barrels
- World reserves remaining – about the same...
- Amount of oil currently in production that was discovered before 1973 – 70%
- Time left if the whole world used oil at the same rate as the US currently does – 6 years
- Price implications?
 - ❖ US\$100+/bbl not out of the question even in 2008/09



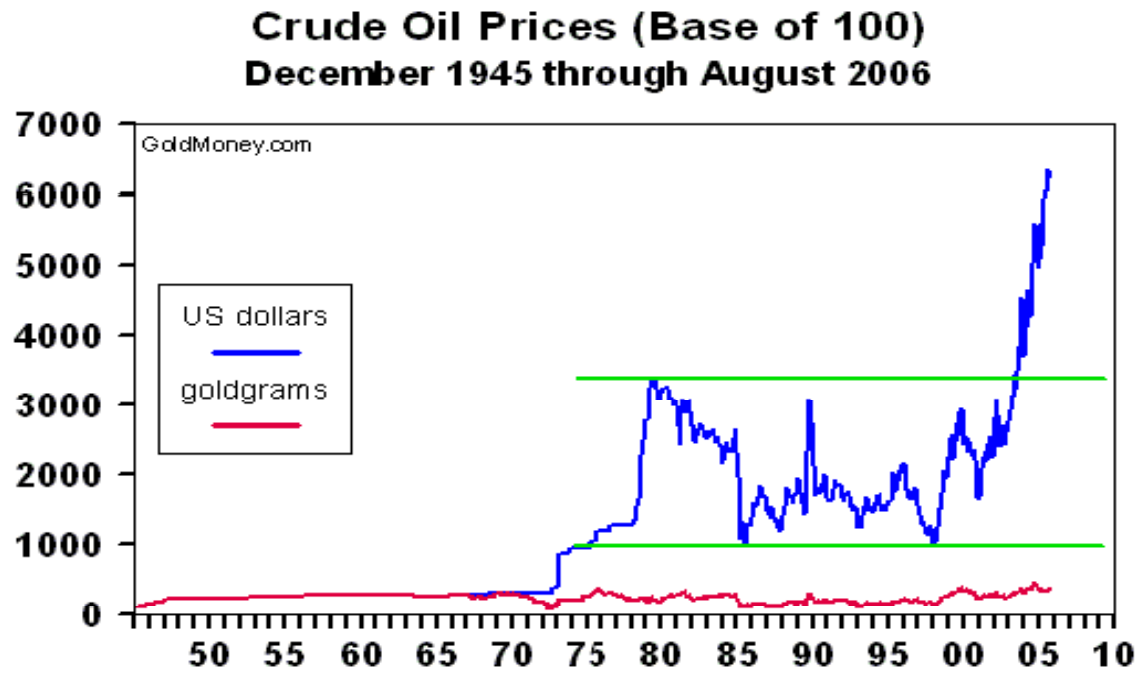


Gold – a barbarous relic?





I don't think so...



Source: James Turk, Founder of GoldMoney (www.goldmoney.com)



● ● ● | What you should know about gold

- Gold is one of the world's most misunderstood assets
 - ❖ Powerful 'enemies' (esp. US Fed & Treas. since 1971)
 - ❖ Despite hostile environment, gold remains valued RTW
 - ❖ Why? Because it is useful as a monetary commodity
- “Gold is money and nothing else” J P Morgan, 1913
 - ❖ It cannot be debased by creating it 'out of thin air' by government fiat – like all currencies today inc. USD
- Gold is nobody's liability (unlike any other asset)





What you should know about USD

\$US Index Fut-Weekly 10/05/2007 C=78.235 +.610 Mov Avg 2 lines 80.688 81.998
HIGH: 121.29 - Week ending July 6, 2001



Source: The Privateer (www.the-privateer.com)





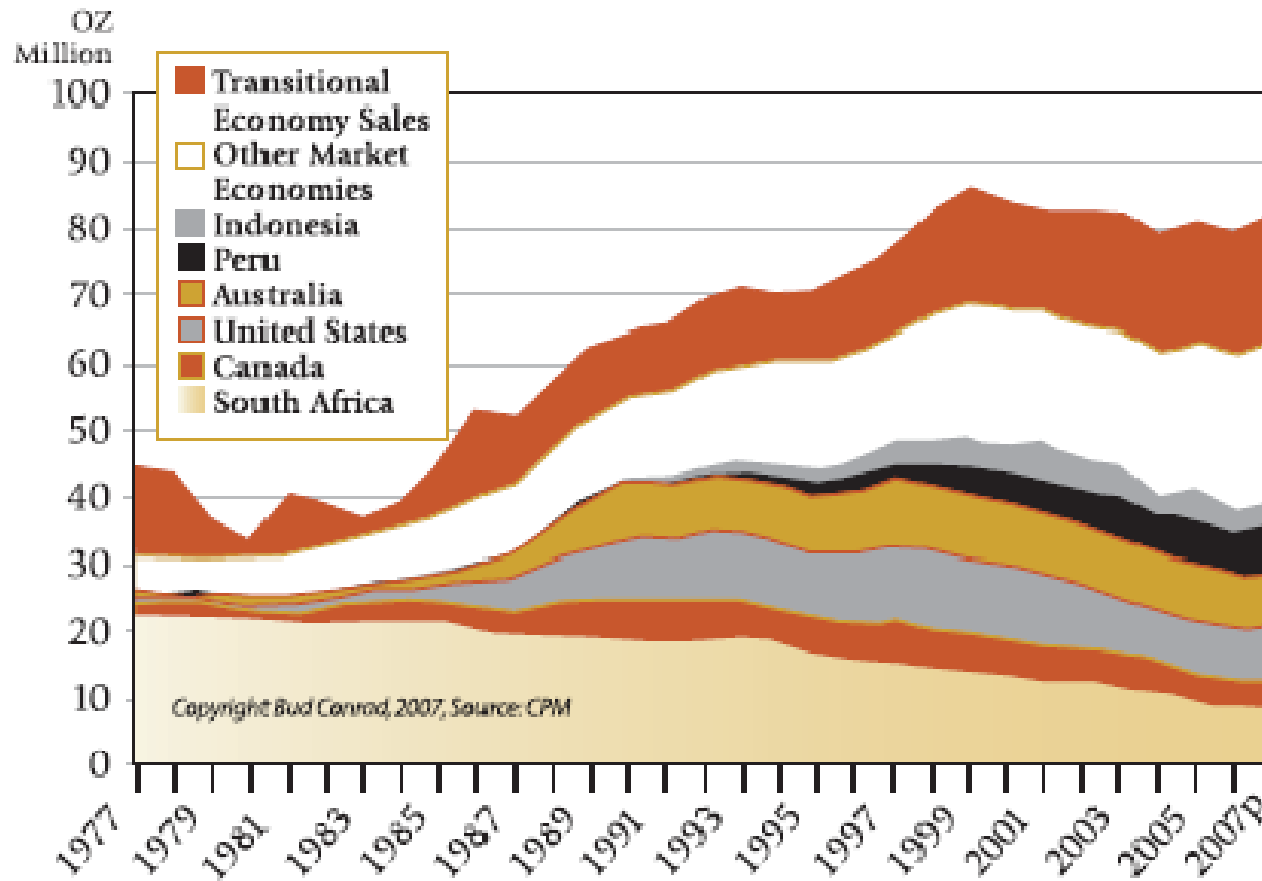
Gold is special and unique

- The only commodity produced for accumulation
- The entire aboveground gold stock is only about 155,000 tonnes (8,000 cubic meters)
- Gold's supply is its aboveground stock
 - ❖ This is crucial to understand how to analyze gold
 - ❖ Amount of gold mined each year only increases aboveground stock year after year by about 1.7% p. a.
 - ❖ A gram of gold mined today is no different from a gram of gold mined by the Romans two-thousand years ago
- So...gold price is principally a function of **demand**





Mine supply is NOT rising...

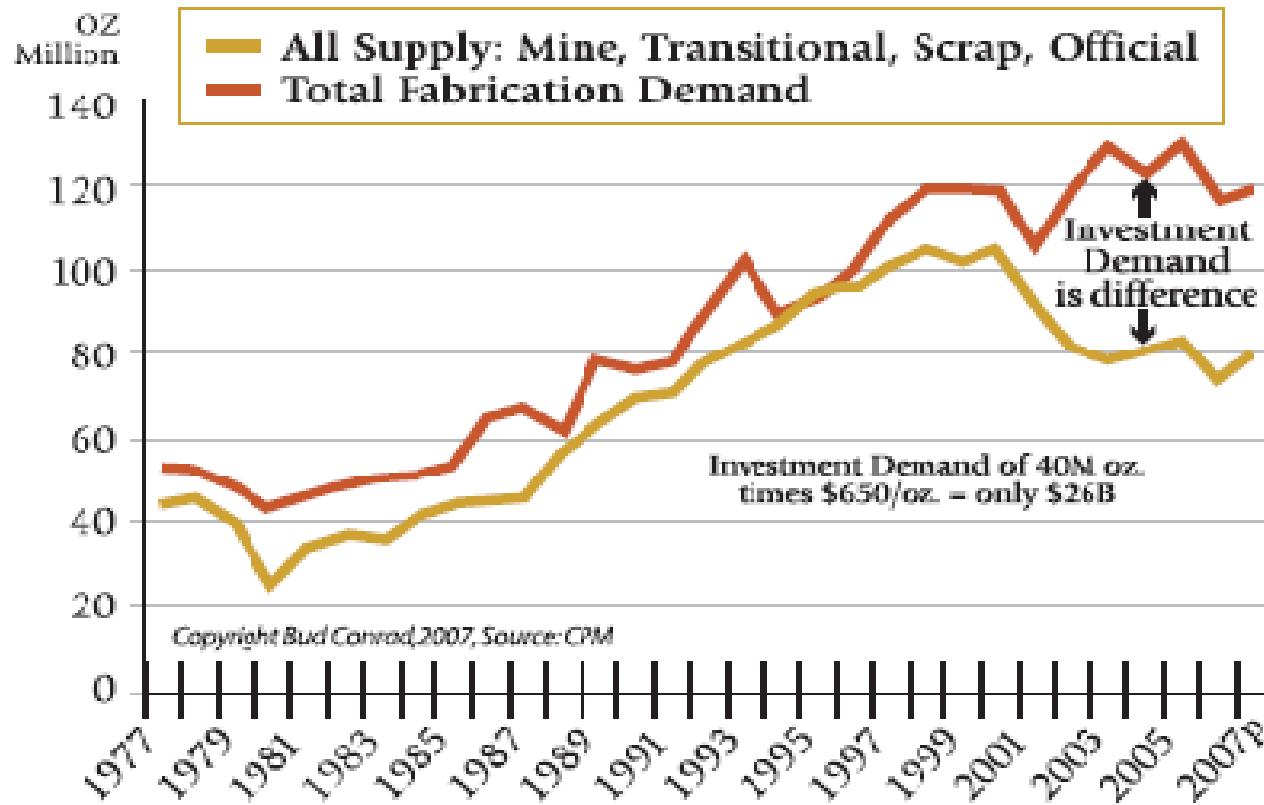


Source: Casey Research, LLC



...but investment demand IS!

Gold: *Supply Minus Fabrication = Investment Demand*



Source: Casey Research, LLC





How to invest in...



=Real Stuff!

● ● ● Remember... ‘as an asset class’

- This presentation is not about *speculating* on any single commodity or raw material
- It's about exposing your investment portfolio to the overall **price action** of all commodities
- It's about recognizing the role of commodities as part of a portfolio's strategic asset allocation
- Focus: PRUDENT DIVERSIFICATION
- Simplest: Fully collateralized total return index



● ● ● | Was complex : Now it's 'simple'

- Thanks to:
 - ❖ Modernization of commodity futures markets
 - ❖ Financial engineering (it's not all bad)
 - ❖ Dramatic growth in recent investment demand (underpinned by long-lasting fundamentals)
- Many indices & index funds now to choose from:
 - ❖ Reuters-CRB Continuous Futures Index (CRB®)
 - ❖ Dow Jones-AIG Commodity Index (DJ-AIGI®)
 - ❖ Goldman Sachs Commodity Index (GSCI®)
 - ❖ Rogers International Commodity Index® (RICI®)



● ● ● | Range of investment solutions

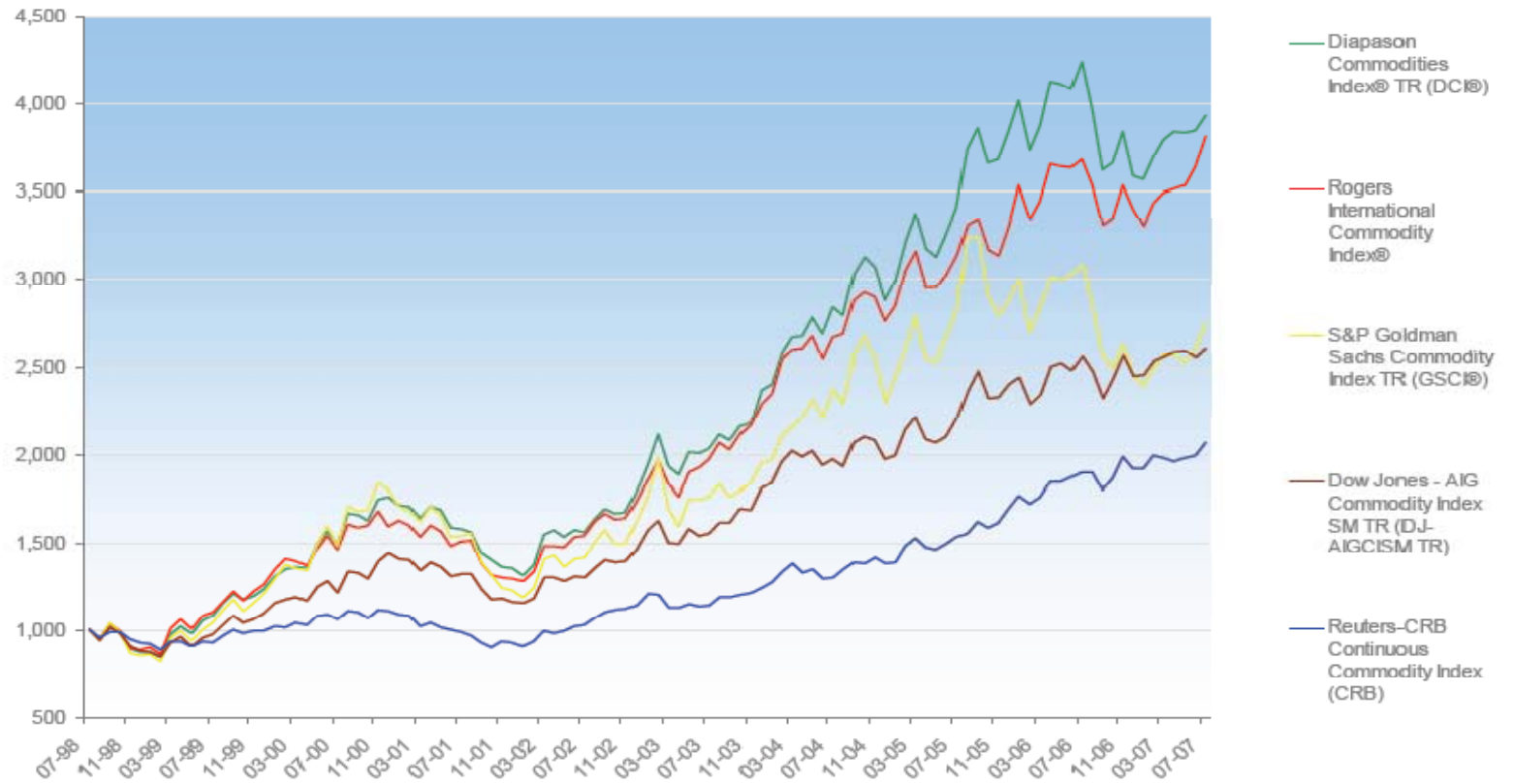
- Global indices (CRB[®] --- RICI[®])
- Sector indices (agriculture, metals, energy)
- Thematic (non GMO, biofuel...)
- Long-Only funds (actively managed)
- Long/Short funds (with leverage)
- Structured products (dedicated portfolios)





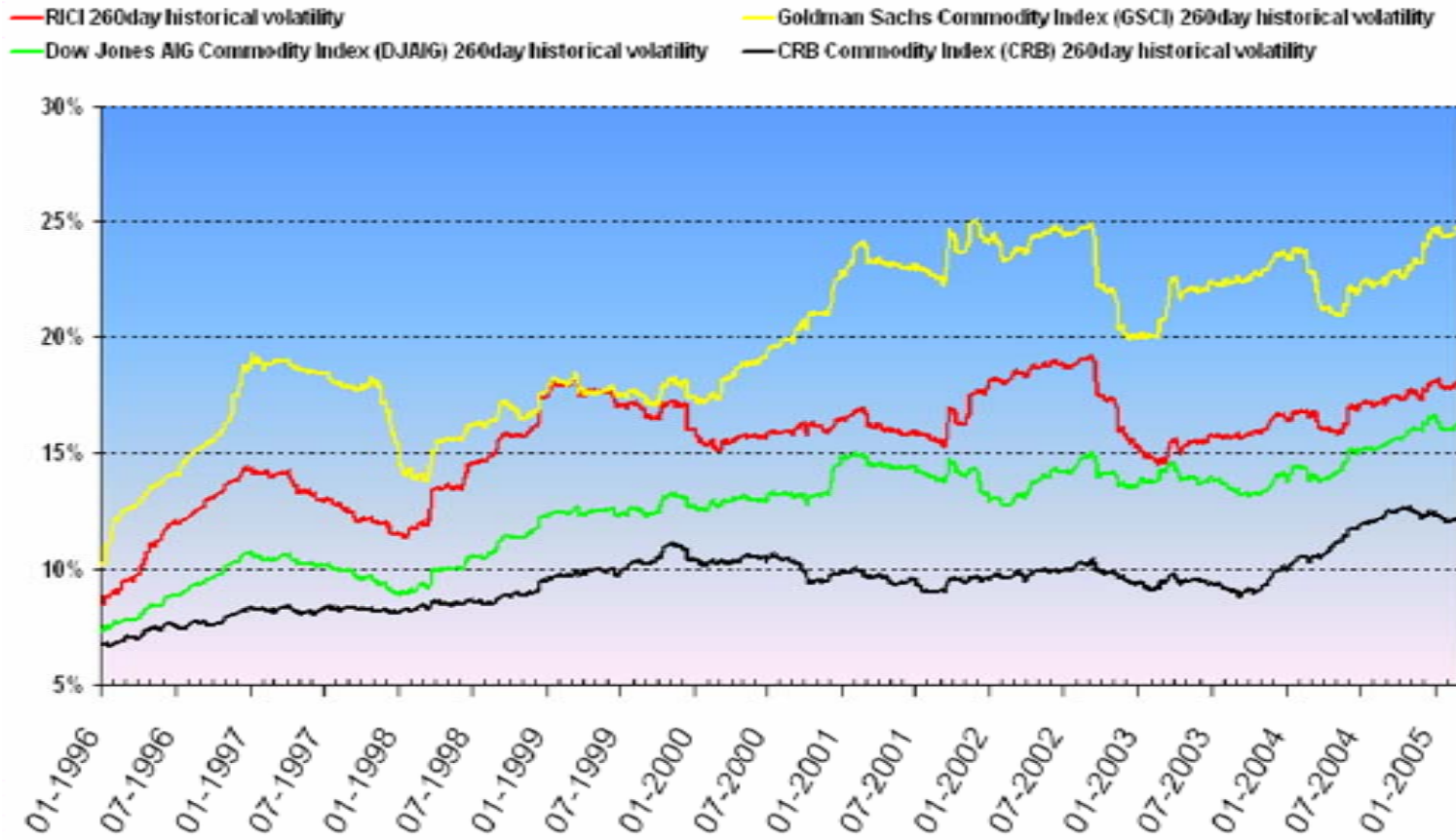
Let's compare indices

Commodity Indexes Performances - monthly data July 1998 – July 2007





What about volatility?



Source: Diapason Commodities Management LLP



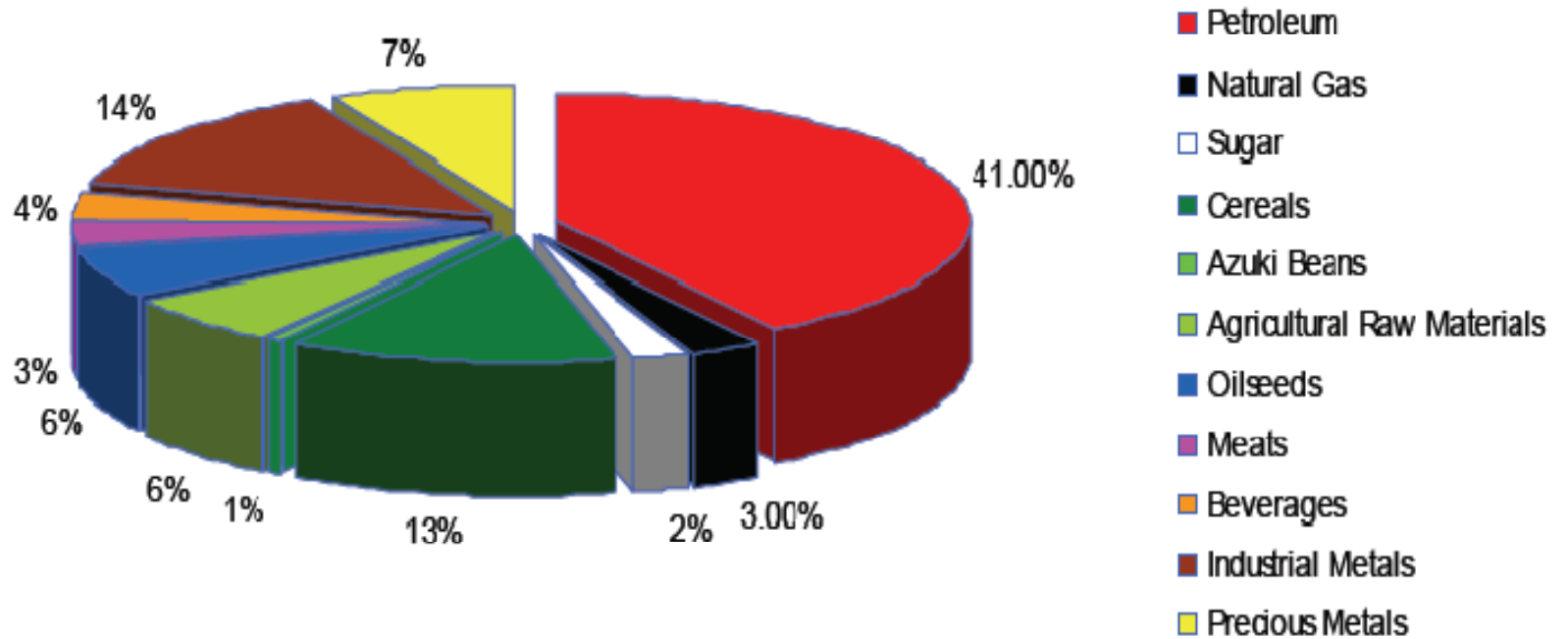


Distinctive RIC[®]

- Solely RIC[®] is an index dedicated to mirror actual international (not US) consumption
- Uniquely conditioned to reflect changes in global demand patterns and supply shocks
- Highest compound annual return/risk of all current commodity indices (Sharpe ratio 0.77)
- 36 commodities (not 17 or 19 or 24)
- 10 exchanges (not just 1 in US); 5 countries



● ● ● | RIC I[®] composition

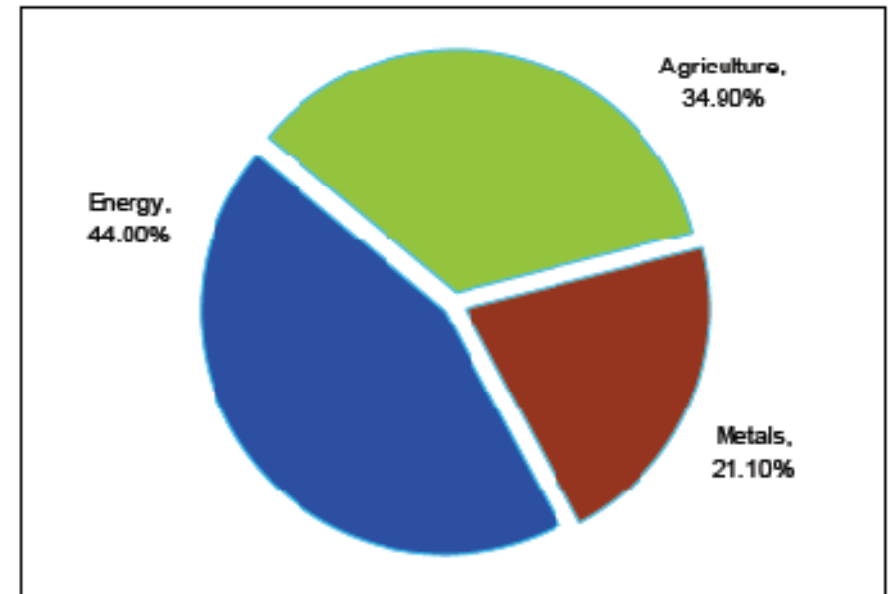


Source: Diapason Commodities Management LLP (www.diapason-cm.com)



RICI[®] composition (cont'd)

Crude Oil	21.00%	Soybean Oil	2.00%
Brent	14.00%	Sugar	2.00%
Wheat	7.00%	Platinum	1.80%
Corn	4.75%	Lean Hogs	1.00%
Aluminum	4.00%	Cocoa	1.00%
Copper	4.00%	Nickel	1.00%
Cotton	4.05%	Tin	1.00%
Heating Oil	1.80%	Rubber	1.00%
Gas Oil	1.20%	Lumber	1.00%
RBOB Gasoline	3.00%	Soybean Meal	0.75%
Natural Gas	3.00%	Canola	0.67%
Soybeans	3.00%	Orange Juice	0.66%
Gold	3.00%	Rice	0.50%
Live Cattle	2.00%	Oats	0.50%
Coffee	2.00%	Azuki Beans	0.50%
Zinc	2.00%	Palladium	0.30%
Silver	2.00%	Barley	0.27%
Lead	2.00%	Greasy Wool	0.25%
		TOTAL	100.00%



● ● ● | Why the RICI[®]?

- Effective and logical measure of the **price action** of raw materials on a *worldwide* basis

Broadest exposure to the asset class



Reflecting the current state of international trade & commerce



Obtaining the true benefits of global diversification

Return since inception (31/07/98): 306.6% or 16.6%pa



● ● ● | How to invest in the RIC1®?

- Diapason Commodity Management LLP manages many index funds including 5 that aim to replicate the RIC1 as closely as possible
- 8 more funds aim to replicate only one segment or another of the RIC1 (i.e. agric., energy, metals)
- All mutual funds are registered in the Cayman Islands and listed on the Irish Stock Exchange
- Choice of base currency (€, US\$ or CHF) and of hedging or not that currency against the US\$





Want to know more?



Some of my sources...

- Casey Research, LLC (www.caseyresearch.com), USA
- Commodities Now (www.commodities-now.com), London, UK
- CPM Group (www.cpmgroup.com), New York, USA
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Lausanne, Switzerland (www.diapason-cm.com)
- Ferdinand Lips, Gold Wars, FAME (www.fame.org), 2001
- Ibbotson Associates' Study for PIMCO; *Chicago, USA*
www.pimco.com/LeftNav/Viewpoints/2006/Ibbotson+Commodity+Study.htm
- Jim Rogers, Hot Commodities, J Wiley & Sons, 2004
- OPEC (World Oil Outlook 2007); *Vienna, Austria*
www.opec.org/library/World%20Oil%20Outlook/WorldOilOutlook07.htm
- The Financial Services Authority (FSA), *London, UK*
(www.fsa.gov.uk/pubs/other/commodity_invest.pdf)
- Yale ICF Working Paper No. 04-20: *Facts and Fantasies about Commodity Futures* (ssrn.com/abstract=560042)





Thank You.

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Freethinking Investment Strategies

Any questions?



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