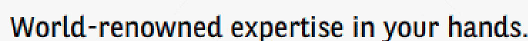

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Commodity managers argue tide of outflows is turning

By Chris Flood   Author alerts

Commodity markets have suffered massive financial outflows over the past 18 months as investors, disappointed with poor returns in recent years, headed for the exit.

Last year, investors withdrew a net $47.1bn from commodity markets, Barclays says. The bulk of the redemptions, some $40.7bn, were gold related but the base metal, agricultural and energy-related commodity sectors also saw withdrawals. Outflows have continued this year, albeit at a slower pace, with a further $8.6bn being withdrawn as of the end of May, $8bn of which was from gold.

Banks such as JPMorgan, Barclays and Deutsche have scaled back commodity-related operations and many hedge funds have been caught up in the exodus.

Clive Capital, once one of the world's biggest commodity hedge funds, closed last year, while Arbalet, BlueGold, Centaurus, Fortress and Higgs Capital wound up commodity vehicles and Schroders ' Opus fund, which managed $2.3bn at its peak, shut in June.

The top 10 commodity managers saw a 3 per cent decrease in pension fund assets under management to $40.4bn in 2014, according to Towers Watson.

However, commodity managers argue that an inflection point has been reached and improving fundamentals will draw investors back to the asset class.

Top 10 commodities managers ranked by pension fund

Management group	Pension AUM ($m) 2013	Pension AUM ($m) 2012	Pension AUM (as a % of total)
Pimco	8,788.0	11,775.7	34.9
Gresham Investment Mgmt	7,816.5	7,597.9	53.0
Schroders Investment Mgmt	4,457.3	4,678.2	59.4
BlackRock	3,413.3	3,330.9	6.4
CoreCommodity Mgmt	3,364.0	2,646.0	64.8
Wellington Management Company	3,281.0	2,273.0	53.0
Diapason Commodities Mgmt	3,108.4	3,235.0	51.8
Credit Suisse Asset Mgmt	3,029.5	2,897.8	28.8
TIAA-CREF	1,915.0	1,546.2	99.0
Investec Asset Mgmt	1,217.2	1,679.7	33.6

Source: Towers Watson

Robert Balan, senior market strategist at Diapason, says manufacturing surveys are pointing to stronger economic growth in the US, China, Japan and Europe, the first time these countries together are seeing more rapid economic activity since 2010.

"This should be positive for demand for cyclical commodities such as base metals and energy," says Mr Balan.

Diapason also expects to see real US interest rates and the dollar decline in the second half of 2014, factors which have historically provided support for commodity markets.

Hakan Kaya, who manages $400m in commodities for Neuberger Berman, says commodity markets now offer better relative value than stocks and bonds which are trading on expensive valuations.

The diversification benefits of commodities have also improved, according to Mr Kaya, who points out that commodity markets' correlations with stocks and bonds have fallen along with correlations between individual commodities such as gold and oil.

Supply has tightened in markets such as coffee, nickel, platinum and lean hogs that have not attracted sufficient investment over the past five years, says Mr Kaya, adding that investors only realise how tight these markets have become when there is a shock and prices react.

Jonathan Berland, managing director at Gresham, a specialist commodities manager with $15bn in assets, says investors realise that quantitative easing by the US Federal Reserve is approaching its conclusion and are positioning their portfolios accordingly, shifting from equities into commodities as an asset class that has performed well previously in this phase of the business cycle.

"In three out of the last four episodes of monetary tightening by the Fed, commodities have outperformed equities and bonds by more than 1,000 basis points," says Mr Berland.

But Alasdair MacDonald, head of investment strategy at Towers Watson, is much more cautious, arguing that prospects for future commodity price gains do not appear encouraging.

He says a lot of additional supply has come on stream in commodity markets even though economic growth globally remains weak. He

also maintains that the arguments for investing in commodities as a hedge against rising inflation have weakened as the world is moving through a disinflationary phase.

Index-linked bonds appear relatively more attractive as an inflation hedge as expected future returns from commodity markets have declined, says Mr MacDonald.

Mr Balan disagrees, arguing that multiple factors, including an upswing in global manufacturing activity, the resumption of strike action in South Africa's platinum industry, the high likelihood of an El Niño weather event and the crisis in Ukraine will provide support for commodity markets for the rest of the year.

He warns that investors are too blasé regarding the insurrection in Iraq and the possibility of fighting affecting the south of the country where the bulk of Iraqi oil assets are located.

Mr Kaya also warns that oil markets remain vulnerable with Opec operating with thin levels of spare capacity. US shale oil and gas production is not enough to keep pace with rising global demand.

"In this tight supply regime, geopolitical issues are likely to provide support for oil prices for some time to come," he says.

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