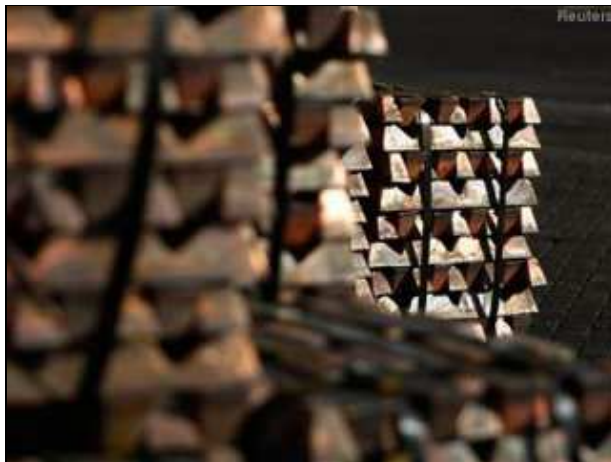




Commodity funds target pockets of tight supply in 2012

By: Reuters

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LONDON – Tight supply in grains and industrial metals such as copper along with further support for gold offer opportunities in what top commodities managers see as another challenging year in 2012.

"Our general feeling going into 2012 is that the trading environment is still a difficult one, and that markets will continue to be volatile with macro headwinds," said **Colin O'Shea**, head of commodities at Hermes.

The DB Platinum V Hermes Absolute Return Commodity fund was up about 10% in 2011 according to Lipper data.

The average actively-managed fund in the Lipper Global commodity sector was down over 9% as the majority of

managers struggled with whipsaw markets.

Kevin Baum, manager of the Oppenheimer Commodity Strategy Total Return Fund, which came third in the fourth quarter Lipper league tables, also expects volatility and correlations to remain elevated in the near term.

"In the latter part of 2012 and beyond, we look for demand from emerging economies and improved commodity futures curves to support commodities performance," he said.

The S&P GSCI, a popular commodity index, ended 2011 down 1.18%, with the year punctuated by sudden sell-offs and sharp reversals.

As a result, the best performers tended to be those that sought to make positive returns in both up and down markets through short positions, relative value trades, or market neutral trades.

Shorts in natural gas, US crude spread positions and wheat spreads helped in 2011, **Hermes' O'Shea** said.

Hermes remains friendly towards grains, particularly corn and soybeans, bearish on natural gas and positive on gold, he said.

"With natural gas we see continued supply increases in the US, and the abnormally warm weather in the northern hemisphere this winter is leading to year-on-year surpluses. As we head towards October we're going to play with storage congestion, putting downward pressure on prices," said O'Shea.

He maintains a positive gold bias, expecting a continuation of low real interest rates and potentially more quantitative easing. "Physical demand also remains strong," he added.

COPPER & URANIUM

There are also pockets of opportunity in copper, iron-ore, uranium and agriculture in 2012, according to managers who outperformed in the fourth quarter.

Basinvest's BI Basic Long Commodity Fund topped the performance tables in Q4 with a 15% return.

Ronald Wildmann, a fund manager at Basinvest, said big positions in copper stocks First Quantum and Copper Mountain had helped drive outperformance.

Wildmann noted China had run down its copper inventories in 2011, estimating it only has about two weeks' supply left.

"We expect the restocking phase to start in the next couple of months. But it depends on your outlook for China."

Basinvest expects a soft landing in China, and Wildmann was positive on iron-ore, arguing that a large part of the housing downturn would be levelled out by a social housing programme.

Current iron ore picks include Cliffs Natural Resources and Rio Tinto, which is trading on just six to seven times earnings despite being hugely cash generative, he said.

Like the Basinvest fund, the Tuma Commodities fund is a hybrid futures and equities product that struggled earlier in 2011 but came through more strongly at the end.

Thomas Meier, co-manager of the fund, said a heavy exposure to the meat sector had paid off in Q4, but a uranium position had hurt performance earlier in the year because of the Fukushima accident.

For 2012, he believes that a lot of the negative sentiment around the demand side is already priced in. But on the supply side, many projects, particularly in copper and uranium production, are in limbo.

"After the Fukushima shock, many uranium projects were postponed or even cancelled because it was almost impossible to get these properties financed," he said. This will impact the future supply of uranium and the price.

Meier also tipped certain agriculture plays for 2012, as the middle class in emerging markets grows and seeks to improve its diet. "Our focus is in increased production per acre. Therefore we concentrate on fertilisers, seeds and grain handling."

VOLATILITY & REVERSALS

Although hybrid funds enjoyed a turnaround in performance to close 2011, precious metals-focused funds, which had done well in the second and third quarters, lagged behind. Volatility and profit-taking by investors were thought to have contributed to the reversal.

The fund that had the poorest performance for the quarter, the Peak Capital Real Assets Fund, was hampered by the number of large intraday swings in commodity markets - especially where there was ultimately no daily price change.

Managing partner **Daniel Franc** said the fund follows a strict systematic approach with stop-loss levels for each position, so the persistence of high intraday volatility for months had taken its toll. "In such an environment we tend to get stopped out regularly and lose money even though on an index level there is not much change," he said.

"It has been a very frustrating period where we saw that a disciplined approach led to weaker results than a buy-and-hold approach, but are firmly of the belief that in the long run the main differentiation factor in risk-adjusted performance is to be systematic and disciplined."

The firm has made some adjustments to the approach and this has paid off in January, with a positive outperformance versus the fund's benchmark, he added.