A NEW REGIME FOR COMMODITIES

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Commodity markets were one of the toughest places to invest for much of the last 14 years since oil peaked out around $150 in 2008.

On top of disappointing spot prices, the commodities futures curve was priced in a way that the rolling of futures led to a drag in returns that caused commodity futures investors to experience something quite disappointing and below the general move in commodity prices (known as spot prices).

High Cost to Roll

If we go back to 1999, the average cost to roll futures (measured as the difference between the Bloomberg Commodity Spot Index and the Excess Return Index of the futures) was more than 7% a year.

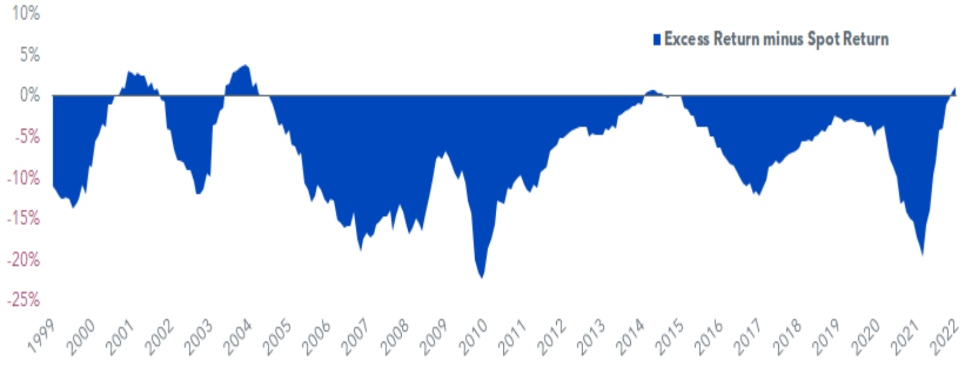
The blue line in the chart below shows that there were many years when the cost was well north of double digits, even as much as 20% in the 2008–2009 period.

But the trend has changed. In 2021, enough commodities had moved from being in "contango" (where futures prices are higher than spot prices) to being in backwardation (where futures prices are below current prices), which means there was a net "benefit" to rolling the futures instead of being a drag/cost.

Rolling 12-Month Return on the Bloomberg Commodity Index | Excess vs. Spot Return

Source: WisdomTree. You cannot invest in an index, and past performance does not guarantee future results.

Rolling 12-Month Return Difference | Excess vs. Spot Return



Source: WisdomTree. You cannot invest in an index, and past performance does not guarantee future results.

Historically, commodity futures investors could think of return sources as coming from three components:

1. Return on collateral that backs the futures
2. The spot commodity return
3. The futures roll component

In the past, these three components of returns were thought to be equal contributors—or at least that is what I recall from my CFA textbooks a decade ago.

Then you had a period when collateral returns went to zero, and the cost to roll futures became increasingly high.

It is understandable why many investors avoided commodities.

But those dynamics are changing.

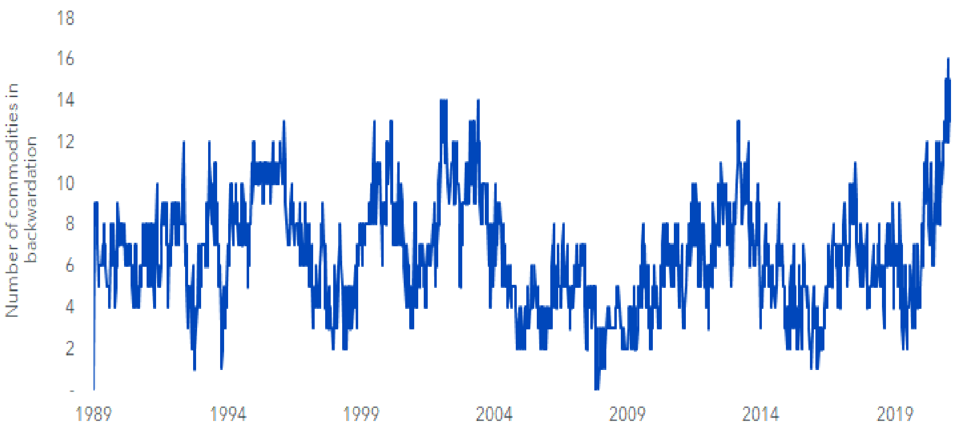
First, we have the Fed set to embark on a rate hiking program that should help increase the returns on collateral over the coming years.

Second, a lack of capital expenditures in mining and exploration has constrained the supply of many different commodities, compounded by supply chain issues and infrastructure spending. This gave us a cocktail for strong commodity price trends over the last 12 months that has many looking for a new super cycle of commodity prices.

But now you also have segments where the futures roll can start to meaningfully contribute more positively to returns.

Out of a universe of 25 commodities in the Bloomberg Commodity Index, more than half are now priced to be in backwardation.

These are the highest levels of commodities in backwardation in the last three decades.



Sources: WisdomTree, CME Group. You cannot invest in an index, and past performance does not guarantee future results.

For the WisdomTree Enhanced Commodity Strategy ETF (GCC), this can translate to meaningful contributors to returns. GCC had an average implied roll yield of 9.5% over the last year, and it currently is around 10%.

The energy complex has some of the highest roll yields but so too do aluminum, nickel, cotton and sugar.

Annualized Weighted Implied Roll Yield

Source: WisdomTree, CME Group. You cannot invest in an index and past performance does not guarantee future results.

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You cannot invest directly in an index.

DEFINITIONS

Commodity : A raw material or primary agricultural product that can be bought and sold.

Spot price : The current price at which a particular security can be bought or sold at a specified time and place.

Commodity Future Curve : A futures lcurve is a curve made by connecting prices of futures contracts of the same underlying, but different expiration dates. Commodity future curve is based on commodity future contract prices.

Bloomberg Commodity Spot Index : formerly known as Dow Jones-UBS Commodity Spot Index (DJUBSSP), tracks the spot prices of a broadly diversified basket of commodities that comprise the total return index.

Excess Return Index : Refers to an Index with the index type "Excess Return"

Contango : A scenario when the futures price is above the spot price. .

Futures price : the price of a futures contract.

Backwardation : A scenario when the futures price is below the spot price.

Collateral : something pledged as security for repayment in the event of a loss.

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Rate Hike : refers to an increase in the policy rate set by a central bank. In the U.S., this generally refers to the Federal Funds Target Rate.

Capital expenditures : Spending by a company typically made to enhance longer-term productive capacity.

Roll Yield : The yield that an investor in futures receives as the long position converges to spot. .