

WHAT IF THE THING THAT “ROARS” IN THE 2020S IS COMMODITIES?

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01/25/2021

We recently completed the reorganization of the WisdomTree Continuous Commodity Index Fund (CCIF) into and with the [WisdomTree Enhanced Commodity Strategy Fund \(GCC\)](#). GCC is organized under the Investment Company Act of 1940, as amended, with no Schedule K-1 and an expense ratio of 0.55%.

There is an idea floating around that we are on the precipice of another Roaring '20s. By comparing Covid-19 to the Spanish Flu and adding in World War I to spice up the story, the thesis goes that a post-reopening build-out could set the stage for a booming economy and stock market.

Just one problem. The stock market in 1921 was in a very different state than the stock market of 2021. Take a look at the [cyclically adjusted price-to-earnings \(CAPE\) ratio](#), the measure that divides stock prices by 10-year average annual earnings, an effort to account for the market's earnings power across good and bad times.

With data from Yale's Robert Shiller, we know that December 1920 witnessed a CAPE ratio of 4.78, the absolute low of the 20th and 21st centuries. In the most recent reading, December 2020, the ratio was 33.44, higher than the [valuation](#) witnessed at the end of that decade-long [bull](#) market, in 1929 (figure 1).

Figure 1: S&P Composite Cyclically Adjusted Price-to-Earnings Ratio (CAPE)



Source: Robert Shiller, Stock Market Data Used in "Irrational Exuberance," Princeton University Press. 2000, 2005, 2015, updated.

With starting point valuations like that, the “60” in 60%/40% equity/fixed income portfolios may be on shaky ground—to say nothing of the current unprecedentedly low yields on offer in the “40.”

I do not want to deny some of the legitimate arguments put forth for justifying higher equity valuations in the modern era. For example, information availability has driven down [risk premia](#). [Diversification](#) is also easier. Think about the process of buying and selling in the 1920s. You had to get yourself physically to the broker's office. Once there, your guide was a chalkboard with quotes that could be hours old. Today, you can buy 500 companies from your iPhone while waiting in line at Starbucks.

Still, when the current CAPE ratio is exceeded only by the dot-com [bubble](#), investors may need to consider a contingency plan for a struggling stock market. When appropriate, commodities can take the role of portfolio diversifier as the Roaring 20s turn into something closer to the “Meowing 20s.”

Why a meow?

As bad as the 2020 experience was, I think comparing Covid-19 to the combination of WWI and the Spanish Flu is faulty. Back then, the global population was one-fifth the size of today's 7.8 billion. On that base, some historians estimate that as many as 100 million people perished. The current Covid-19 count is about 1/50th that amount.

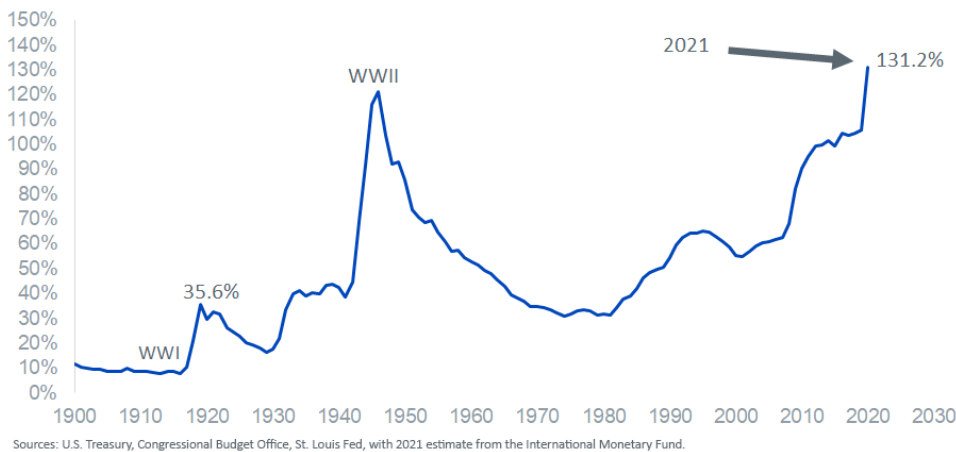
Also—and critically—the war lasted from July 1914 to November 1918, far longer than the year we have been dealing with Covid-19. It's hard *not* to rally after such devastation.

Another absent part of the comparison between the 1920s and the 2020s: entire swaths of Europe were destroyed, burned or bombed out from 1914 to 1918. *There was physically something to rebuild.* Today the buildings are still standing.

I know what you are thinking: a pending struggling economy, especially in commercial real estate, so why the bull case for commodities?

Because you know how officialdom plans to get out from underneath figure 2.

Figure 2: U.S. Debt-to-GDP Ratio



I believe the U.S. government's financial situation may be so out of control that it will counter natural [deflationary](#) forces such as declining office rents and labor's lack of bargaining power.

Consider that Fitch, the ratings agency, is penciling in a 2020 deficit-to-GDP ratio of 18.5%. For 2021, more red ink; Fitch expects a deficit equal to 11.3%. For context, that is a deeper deficit than in 2009, the worst year of the global financial crisis, when the federal government put up a \$787 billion stimulus package.

How does the U.S. escape the debt burden? The same way that many governments do when they get into a pinch: they liquefy it via money creation. After all, U.S. [M2](#) money supply has doubled in just the last nine years. It sets up a case for a rally in commodities, the asset class that may "find some love" in a [stagflation](#) scenario that witnesses stocks and bonds struggling.

Take a look at [GCC](#). If officialdom continues to seek a way out of the debt build-up via monetary expansion, and stocks and bonds decide to misbehave, GCC could buffer trouble.

Here is something that may be noteworthy: in our [Endowment Model Portfolios](#), which are available for financial professionals only, we recently began incorporating GCC. Please take a look to see how we work the strategy into an asset allocation.

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DEFINITIONS

Cyclically Adjusted Price to Earnings (CAPE) Ratio : a valuation measure of the S&P 500 Index that is adjusted for inflation and takes into account cyclical fluctuations in market earnings relative to longer term averages.

Valuation : Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

Bullish : a position that benefits when asset prices rise.

Risk premium : Equity investments are not risk free, but it is thought that investors buy stocks because the returns they expect are high enough to allow them to take the risk.

Diversification : A risk management strategy that mixes a wide variety of investments within a portfolio.

Bubble : when market participants drive stock prices above their "fair value" in relation to some system of stock valuation.

Debt to gross domestic product (GDP) : the debt-to-GDP ratio is the ratio between a country's government debt and its gross domestic product (GDP).

Deflation : The opposite of inflation, characterized by falling price levels.

M2 money supply : Contains all funds deposited in checking accounts as well as funds deposited in savings accounts and certificates of deposit. There are various ways to measure the money supply of an economy. This one is meant to broadly account for the majority of savings and checking accounts held by individuals and businesses across the economic landscape.

Stagflation : a situation in which the inflation rate is high, the economic growth rate slows.