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# LONG COMMODITIES, SHORT CONTANGO VIA COMMODITY CURRENCIES

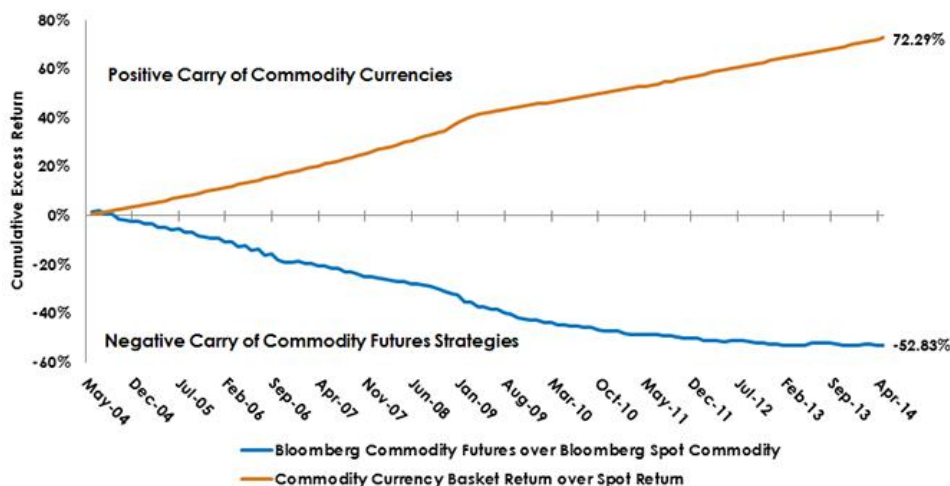
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On the back of a resurgence in Chinese economic data and rising geopolitical risk in Eastern Europe and the Middle East, increases in global commodity prices have reinvigorated investor interest in allocating to commodity-based investment strategies. However, a common complaint about commodity [futures](#)-based strategies stems from the drag on performance due to contango. In this blog post, we not only explain the potential costs of contango in commonly followed commodity strategies, we also explain how commodity currency strategies can provide a powerful alternative for commodity-focused investors.

**Contango Explained** Contango is a phenomenon in the futures market that simply means that the current [spot price](#) is lower than the futures price. While contango can occur for many reasons, the primary driver of contango has to do with storage and financing costs. If investors pay for and take delivery of a commodity today to resell it at some point in the future, they will likely incur costs associated with storage or insurance. Additionally, instead of buying the commodity, the investors could have simply bought a short-term fixed income investment and earned the time value of money. To break even on their investment, investors need to pass these costs on to future buyers. Since the costs of storage, financing and insurance are proportional to the amount of time the owner must hold the commodity for delivery, the futures curve is upward sloping (higher prices farther out into the future). Investors who are attempting to bet on higher commodity prices often will buy a futures contract. Unfortunately, if the spot price today is exactly the same as the spot price three months from now, they do not break even, given the upward slope in the futures curve. This drag on performance is often referred to as a negative roll yield because it is the cost that investors incur when they “roll” from one expiring futures contract to another to maintain their position.

**Commodity Currencies as an Alternative** We believe that currencies of commodity-producing countries can provide an attractive alternative to investing in commodity futures for investors hoping to profit from higher commodity prices. In this position, an investor goes [long](#) on a basket of currencies that have a significant amount of commodity exports. The logic and academic research supporting the trade reasons that, as demand for a commodity increases, the value of the currency will also increase as demand rises for that currency. Historically, countries with large amounts of commodity wealth have attracted foreign investment to extract their natural resources, thus increasing demand for their currencies. Additionally, interest rates in these countries tend to be higher than interest rates in the United States, and investors are typically able to capture this interest rate differential. As we show in the graph below, investors actually receive interest for putting on a position that is positively correlated to commodity prices, compared with the drag on performance experienced by positions in commodity futures contracts. The graph also shows that commodity currencies, due to their positive interest rate differentials, can have a significant impact on total returns of an investment in the same way that contango can significantly erode the return of a position over time.

**Cumulative Excess Return June 1, 2004- May 31, 2014**



Sources: WisdomTree, Bloomberg, Zephyr, as of 5/31/14. Past performance is not indicative of future results. You cannot invest in an index. Index performance does not represent actual fund or portfolio performance. A fund or portfolio may differ significantly from the securities included in the index.

For definitions of terms and indexes in the chart, please visit our [glossary](#). As one way to express a bullish view on commodities, we believe that the [WisdomTree Commodity Currency Strategy Fund \(CCX\)](#) can provide an attractive alternative to traditional commodity futures-based investing.

#### Important Risks Related to this Article

There are risks associated with investing, including possible loss of principal. Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty. The Fund focuses its investments in specific regions or countries, thereby increasing the impact of events and developments associated with the region or country, which can adversely affect performance. Investments in emerging or frontier markets are generally less liquid and less efficient than investments in developed markets and are subject to additional risks, such as risks of adverse governmental regulation and intervention or political developments. Fixed income investments are subject to interest rate risk; their value will normally decline as interest rates rise. In addition, when interest rates fall, income may decline. Investments in currency involve additional special risks, such as credit risk and interest rate fluctuations. Derivative investments can be volatile, and these investments may be less liquid than other securities and more sensitive to the effects of varied economic conditions. As this Fund can have a high concentration in some issuers, the Fund can be adversely impacted by changes affecting those issuers. Unlike typical exchange-traded funds, there are no indexes that the Fund attempts to track or replicate. Thus, the ability of the Fund to achieve its objectives will depend on the effectiveness of the portfolio manager. Due to the investment strategy of certain funds, they may make higher capital gain distributions than other ETFs. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

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You cannot invest directly in an index.

## **DEFINITIONS**

**Futures/Futures Contract** : Reflects the expected future value of a commodity, currency or Treasury security.

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

**Long (or Long Position)** : The buying of a security such as a stock, commodity or currency, with the expectation that the asset will rise in value, the opposite of Short (or Short Position).