

Embrace the Stink Bomb

Published June 16, 2017

Jeff Weniger, CFA

Head of Equity Strategy

Not many money management firms spend time talking about maligned asset classes, and most clients don't ask about them. To lose half of my readers right now, let me make a bull case for commodities. This one should be lonely.

We have a real stinker, a shunned exchange-traded fund (ETF), even though it shows up at the top of its category since its launch almost 10 years ago. The [WisdomTree Continuous Commodity Index Fund \(GCC\)](#) has lost an annualized 5.1% since its inception on January 25, 2008, or 38.7% cumulatively. Even that showing was enough to put it at the top of the heap among the five diversified commodity ETFs that have been around that long. Yet a relative performance like that can leave much to be desired.

Get ready for WisdomTree's "Stinker Study."

Contrarians: Grab the Stink Bomb

Using indexes representing U.S. large caps, U.S. mid-caps, U.S. small caps, international developed stocks, U.S. high-yield bonds, U.S. core bonds and commodities,¹ we assessed various asset class rotation strategies based on trailing five-year returns.

Each year, the investor could look back at the performance of the preceding five years and go "all in" on the index that had the best run, the second-best run and so on.

The truly independent-minded would look at the bottom of the list and allocate to the Stinker—the one that had the worst last five years of the lot. At the end of the year, the process is repeated. Figure 1 shows the results for January 31, 1997, through March 31, 2017.

Figure 1: Asset Class "Stinker" Study

		Return (%)	Std Dev (%)	Downside Risk (%)	Beta vs. Market*	Sharpe Ratio	Information Ratio vs. Market*	Tracking Error vs. Market (%)*	Correlation vs. Market*	Maximum Drawdown
Asset Classes	U.S. Large Caps	7.90%	15.21%	11.53%	1.00	0.38	0.00	0.00%	1.00	-50.95%
	U.S. Mid-Caps	10.12%	16.97%	12.91%	1.04	0.47	0.35	6.31%	0.93	-54.15%
	U.S. Small Caps	8.27%	19.95%	14.92%	1.07	0.31	0.03	11.53%	0.82	-52.89%
	International Developed ex-U.S. Equities	4.90%	16.84%	12.76%	0.93	0.16	-0.33	9.18%	0.84	-56.40%
	U.S. High-Yield Bonds	7.03%	9.03%	6.95%	0.37	0.54	-0.07	11.88%	0.63	-33.22%
	U.S. Aggregate Bonds	5.26%	3.43%	2.51%	-0.01	0.90	-0.17	15.74%	-0.04	-3.83%
	Commodities	0.38%	16.27%	11.91%	0.33	-0.11	-0.41	18.48%	0.31	-67.03%
Strategies	Best Performer in PrevioU.S. 5 Yrs.	4.49%	13.49%	10.53%	0.73	0.17	-0.39	8.69%	0.82	-49.21%
	2nd Best Performer in PrevioU.S. 5 Yrs.	6.46%	15.70%	11.84%	0.80	0.27	-0.14	10.46%	0.77	-44.80%
	3rd Best Performer in PrevioU.S. 5 Yrs.	6.61%	17.93%	13.69%	0.88	0.25	-0.11	12.14%	0.74	-49.64%
	4th Best Performer in PrevioU.S. 5 Yrs.	6.40%	14.48%	10.75%	0.61	0.29	-0.12	12.52%	0.65	-51.39%
	5th Best Performer in PrevioU.S. 5 Yrs.	6.59%	13.46%	9.90%	0.62	0.33	-0.12	11.21%	0.70	-39.22%
	6th Best Performer in PrevioU.S. 5 Yrs.	4.36%	14.60%	10.65%	0.64	0.15	-0.29	12.19%	0.67	-45.31%
	Worst Performer in PrevioU.S. 5 Yrs.	9.02%	11.96%	8.49%	0.43	0.57	0.08	13.29%	0.54	-36.27%
	EqualWeight, All Strategies	6.74%	11.17%	8.61%	0.67	0.41	-0.17	6.73%	0.91	-39.71%

Sources: Zephyr StyleADVISOR, WisdomTree, data from 01/31/1997 - 03/31/2017. *Beta, Information Ratio, Tracking error and Correlation are calculated relative to the S&P 500. Strategies are based on annual rebalancing based on performance from previous 5 years. For example, for calendar 1998, an investor in the "Best Performer in Previous 5 Years" would own the asset class with the highest return from 12/31/1992-12/31/1997. Past performance is not indicative of future results. You cannot invest directly in an index.

Loved Darlings vs. Stinkers

Woeful performance by the top performing "Loved Darling" is particularly notable. The investor who chased the darling of the previous five years every year witnessed subsequent annual returns of just 4.49%, more than 2 percentage points south of a strategy that simply put an equal allocation in all seven asset classes.

Contrast that with the experience of the investor who had the courage to buy the Stinker: returns came in at 9.02% annually for more than 20 years. That came with an annualized standard deviation of just 11.96%, lower than all of the equity indexes because aggregate bonds came up four times (at the end of 1996, 1997, 2006 and 2007). That also got some contrarians into bonds on December 31, 2007, a fortuitous move when Lehman collapsed in 2008.

The Stinker Strategy managed to have the lowest drawdown and downside risk with the highest Sharpe ratio and highest information ratio of any of the rotation strategies.

But the Stink Got Stinkier

The Stinker Strategy posted annual gains for 16 of 17 calendar years to the end of 2013, but unfortunately it picked up commodities for both 2014 and 2015—and those were woeful years for the asset class.²

In retrospect, we know that the Stinker Strategy made a series of great calls—for example, showing net gains during the 2000–2002 comeuppance in equity markets. The strategy also posted a 5.2% return during the year of Lehman's collapse because it liked bonds, while it transitioned to U.S. stocks for 2009, benefiting from the sharp rally (figure 2).

Figure 2: The Stinker Strategy through the Years

	YTD	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007
Best Performer in Previous 5 Yrs.	5.2%	12.0%	-2.4%	13.2%	7.4%	15.6%	4.4%	15.2%	5.9%	-43.1%	11.6%
2nd Best Performer in Previous 5 Yrs.	6.1%	13.8%	-4.4%	4.9%	-2.0%	4.2%	7.8%	23.7%	16.8%	-41.5%	17.2%
3rd Best Performer in Previous 5 Yrs.	2.5%	21.3%	1.4%	2.5%	34.8%	-5.0%	-10.5%	6.5%	32.5%	-33.8%	5.6%
4th Best Performer in Previous 5 Yrs.	2.7%	17.5%	-4.6%	13.7%	38.8%	17.3%	-1.6%	8.2%	40.5%	-28.6%	-1.6%
5th Best Performer in Previous 5 Yrs.	7.4%	1.5%	-0.4%	-4.5%	32.4%	16.4%	-4.2%	25.5%	57.5%	-37.0%	2.2%
6th Best Performer in Previous 5 Yrs.	0.8%	2.7%	0.6%	6.0%	-10.1%	16.0%	-11.7%	26.9%	27.2%	-26.4%	5.5%
Worst Performer in Previous 5 Yrs.	-0.3%	5.6%	-17.8%	-10.3%	23.3%	17.9%	2.1%	15.1%	26.5%	5.2%	7.0%

	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997
Best Performer in Previous 5 Yrs.	15.3%	2.4%	12.5%	4.1%	-16.2%	-11.9%	-9.1%	21.0%	28.6%	29.0%
2nd Best Performer in Previous 5 Yrs.	11.8%	12.7%	20.2%	40.1%	-22.1%	-5.6%	8.3%	18.2%	10.1%	22.4%
3rd Best Performer in Previous 5 Yrs.	9.2%	21.4%	18.3%	28.2%	-20.5%	2.5%	-3.0%	21.3%	-2.6%	33.4%
4th Best Performer in Previous 5 Yrs.	18.4%	2.7%	4.3%	11.3%	10.3%	-21.2%	-14.0%	27.3%	3.0%	13.3%
5th Best Performer in Previous 5 Yrs.	4.3%	4.6%	10.9%	28.7%	-1.9%	8.4%	-5.1%	2.4%	20.3%	-3.4%
6th Best Performer in Previous 5 Yrs.	26.9%	14.0%	20.7%	47.3%	-15.7%	4.5%	11.6%	-0.8%	-27.0%	2.1%
Worst Performer in Previous 5 Yrs.	15.8%	4.9%	10.9%	39.2%	18.4%	-17.2%	14.4%	21.3%	8.7%	9.7%

Sources: WisdomTree, Zephyr StyleADVISOR.

Now it gets philosophical. Either the Stinker Strategy itself is a stinker because it has given false hope to commodities in recent years or recent years of struggle have been an aberration, sure to come sooner or later in any two-decade run. Either way, the Stinker Strategy identified commodities as a contrarian play at the end of 2013, and the asset class just kept grinding lower. If the asset class was hated then, it may be hated more now.

GCC: If Ever There Was a Stinker

The WisdomTree Continuous Commodities Index ETF (GCC) has a simple strategy: it takes 17 commodities, everything from corn to platinum to lean hogs, and invests equally in each of them. There is no major exposure to any particular commodity, no riding oil from triple digits down to \$28 per barrel, at least not to the extent that oil represents anything more than 1/17th of the portfolio.

Aside from a brief bounce higher in the 2009–2010 recovery, commodities haven't had much love since the go-go years of the so-called "commodities supercycle," which ended a half generation ago. No surprise then that, as of March 31, 2017, the "order of finish," from Loved Darling to Stinker, was U.S. Large Caps, U.S. Mid-Caps, U.S. Small Caps, U.S. High Yield, International Developed Stocks, Aggregate Bonds and Commodities.

Few clients ask about GCC, and that's because it's a total stinker.

It's a true contrarian's dream.

Unless otherwise noted, data sources are WisdomTree, Zephyr StyleADVISOR and Bloomberg, as of March 31, 2017.

1S&P 500, Russell Midcap, Russell 2000, MSCI EAFE, BofA Merrill Lynch US High Yield, Bloomberg Barclays U.S. Aggregate indexes for the first six asset classes. Commodities are represented by the Bloomberg Commodity index through 8/31/99 and the Thomson Reuters Equal Weight Commodity Index thereafter.

2Sources: Zephyr StyleADVISOR, WisdomTree. Thomson Reuters Equal Weight Commodity Index, 2014 = -10.31%, 2015 = -17.76%.

Important Risks Related to this Article

There are risks associated with investing including possible loss of principal. An investment in this Fund is speculative, involves a substantial degree of risk, and should not constitute an investor's entire portfolio. One of the risks associated with the Fund is the complexity of the different factors which contribute to the Fund's performance. These factors include use of commodity futures contracts. Derivatives can be volatile and may be less liquid than other securities and more sensitive to the effects of varied economic conditions. The value of the shares of the Fund relate directly to the value of the futures contracts and other assets held by the Fund and any fluctuation in the value of these assets could adversely affect an investment in the Fund's shares. The Fund is not an Investment Company within the meaning of the Investment Company Act of 1940, as amended, and is not subject to the regulations thereunder. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

Investments in commodities may be affected by overall market movements, changes in interest rates and other factors such as weather, disease, embargoes and international economic and political developments.

Commodities and futures are generally volatile and are not suitable for all investors.

Performance is historical and does not guarantee future results. Current performance may be lower or higher than quoted. Investment returns and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost.

Performance data for the most recent month-end is available at www.wisdomtree.com.

WisdomTree shares are bought and sold at market price (not NAV) and are not individually redeemed from the Fund. Total returns are calculated using the daily 4:00 p.m. EST net asset value (NAV). Market price returns reflect the midpoint of the bid/ask spread as of the close of trading on the exchange where Fund shares are listed. Market price returns do not represent the returns you would receive if you traded shares at other times.