



Commodities may have portfolio future

Kathleen Gallagher
kgallagher@journalsentinel.com



Natural gas, aluminum, soybeans and hog bellies aren't the hottest topics around the office water cooler.

Indeed, many individual investors

would rather talk about stocks and bonds. But don't discount those pork bellies, a local investment pro says.

"History has shown time and time again there are periods - often lengthy periods - where (stocks and bonds) don't do well," said Michael J. Francis, senior consultant at Francis Investment Counsel LLC. The Hartland investment consulting firm provides advice to retirement plans.

There have been extended periods during the last 150 years when commodities have provided better returns than stocks and bonds, according to data collected by Van Eck Global, a New York investment firm.

Before the bull market that began in 1982, there were more than 15 years during which commodities outperformed those financial assets, according to Van Eck.

The average duration of such cycles - where either commodities or financial assets are outperforming - has been 18 years, Francis said.

"When I started in the business in 1984, all people wanted to talk about was oil and gas deals and real estate limited partnerships," Francis said. "Dial the clock ahead 20 years, and now all people want to talk about is their stock and bond holdings."

Francis isn't recommending investors get out of their other investments completely, but since the summer of 2003 he says that he's been encouraging his retirement plan

clients to add so-called hard assets to their portfolio mix.

Any professionally managed pool of money - where the portfolio has \$1 billion or more of assets - probably has 5% to 15% of that money in hard assets, Francis said.

"I'm not recommending clients load up on hard assets, but for long-term equity investors, this should be a component of their portfolio. Period," said Francis, who recommends individual investors put 10% or less of their portfolio into this category.

The average investor, and even many a small retirement plan, doesn't have enough money to go out and buy a room full of gold bars or a carload of soybeans and still maintain a diversified portfolio. Those investors who in recent years have gotten exposure to commodities typically buy mutual funds focused on investing in either energy or precious metals, but Francis says he's not a fan of either.

"In my opinion, they introduce additional execution risk to the process," he said. "The fund manager can be absolutely right about the price of gold, but if he owns a Canadian gold mine that goes belly up, it won't help him."

Francis said he favors funds that invest in securities that tie returns to the swings in commodities prices, rather than those that invest in the stocks of companies that produce natural resources. These funds, which are a lot like index funds, can be extremely volatile. But their performance often goes in the opposite direction of the U.S. stock market, so they help investors smooth the ups and downs of holding only financial assets, Francis said.

There are only three such funds, although Francis said Dreyfus will probably start one soon.

The **Merrill Lynch Real Investment Fund (MDCDX)**, started in March, is still too new for Francis. But he has been recommending the other two such funds for clients.

The **Oppenheimer Real Asset Fund (QRAAX)** invests in securities whose return is linked to the Goldman Sachs Commodity Index. About two-thirds of that index is in energy, such as oil and gas; and the other one-third is split between metals, such as gold and aluminum, and soft commodities, such as wheat and hog bellies, Francis said. Consequently, changes in energy prices can have much more influence than changes in other commodity prices.

The fund also holds futures contracts on commodities such as oil, wheat, metals and hogs to keep the fund balanced to the index.

The **PIMCO Commodity Real Return Fund (PCRAX)** invests in securities whose return is linked to the performance of the Dow Jones-AIG Commodity Index. About one-third of that index is in each of three categories: Energy, metals and soft commodities. The fund puts the money it doesn't need to use to get full exposure to the index into TIPS, or Treasury Inflation Protected Securities.

Francis would buy both funds at current prices. He recommends investors buy them to diversify their portfolios and reduce risk, rather than to get a predetermined return.