There Is (Still) No Such Thing As Commodities

Maybe if I keep repeating "There's no such thing as commodities," like Dorothy kept repeating "There's no place like home," I could be transported to some magical land where everyone would run the numbers before reaching conclusions.

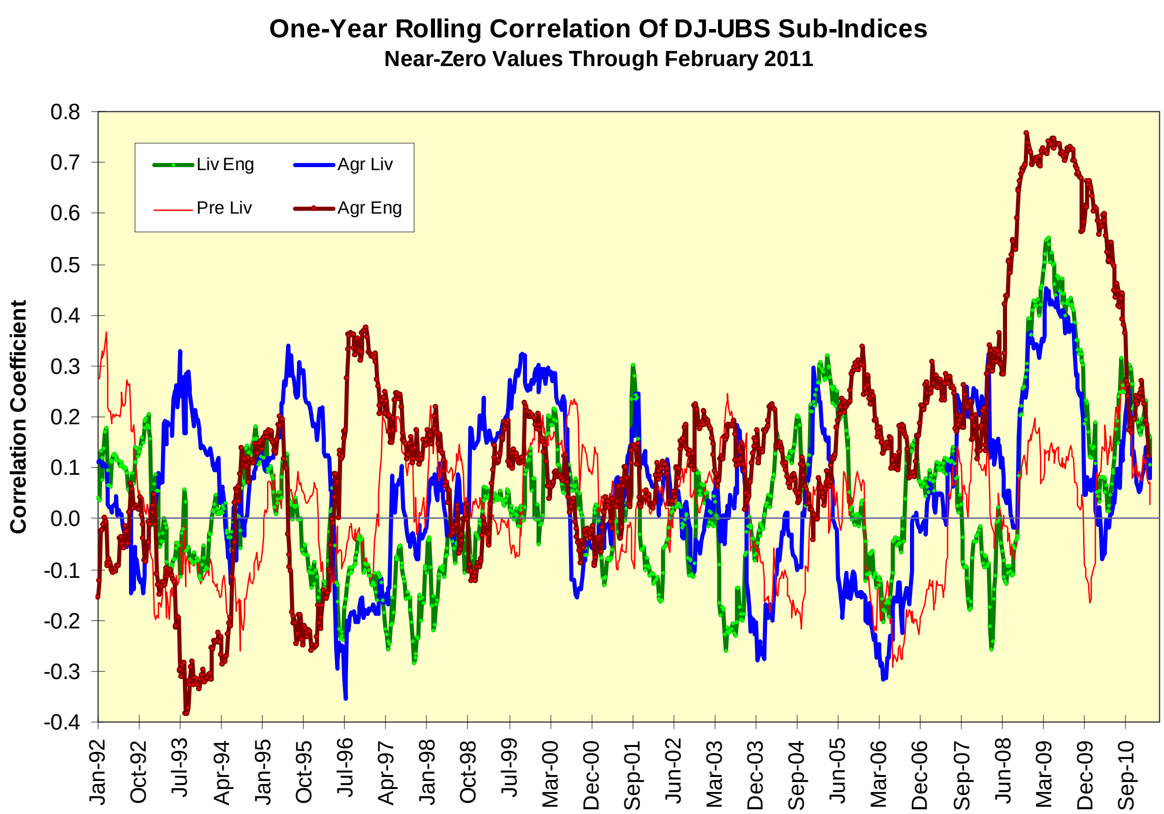
Let's take the current situation, please. It seems as if every commodity save natural gas has been on a tear to the upside. Grains, petroleum, precious metals, industrial metals, cotton; it matters not, they all seem en route to the moon. We have food riots going on globally, we have central bankers sending poison-pen letters to Benny's Boys asking them to put a cork in the monetary jug, we have preemptive excuse-making coming out of Washington, and even Janet Yellen, the monetary *dove di tutti dovi*, knows the game will be over soon.

In this environment of rising global growth, rising inflation and a Federal Reserve balance sheet you can see from space, surely my conclusion from last March that inter-subindex correlations of returns for the Dow Jones-UBS total return indices must be obsolete, right?

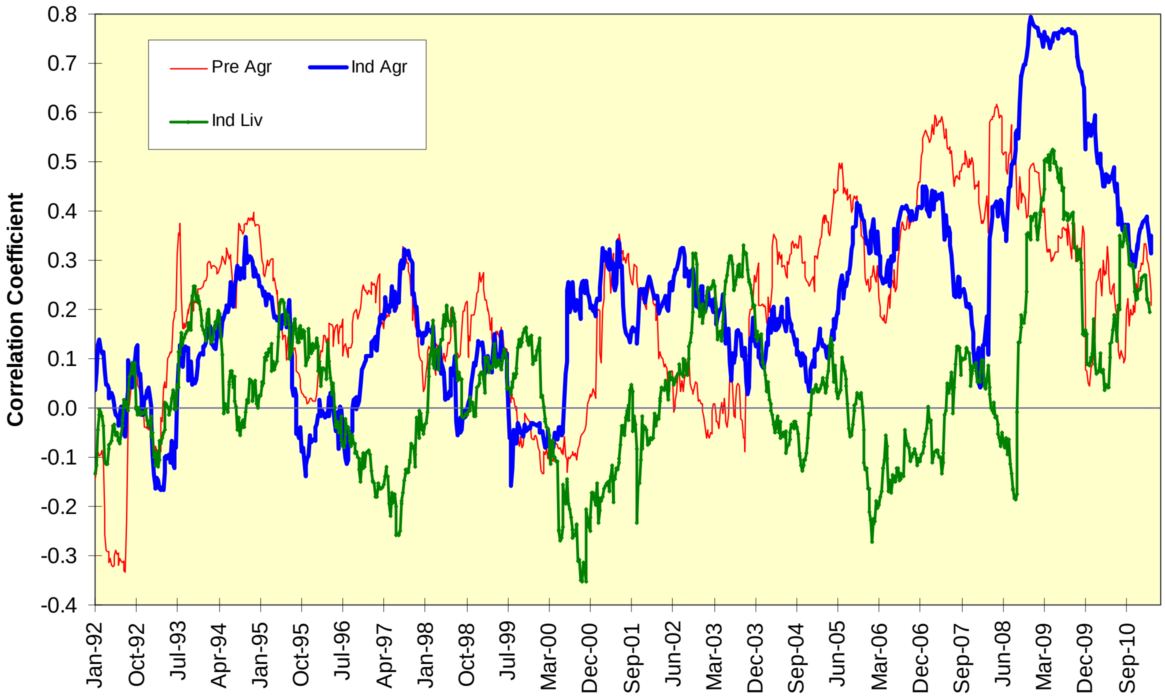
Think real hard before answering; would I pose this rhetorical question if it was?

The Results

The charts below update the rolling one-year correlations of returns between five Dow Jones-UBS commodity total return indices: Livestock (LIV), Precious Metals (PRE), Energy (ENG), Agriculture (AGR) and Industrial (IND).



One-Year Rolling Correlation Of DJ-UBS Sub-Indices
Weakly Positive Values Through February 2011



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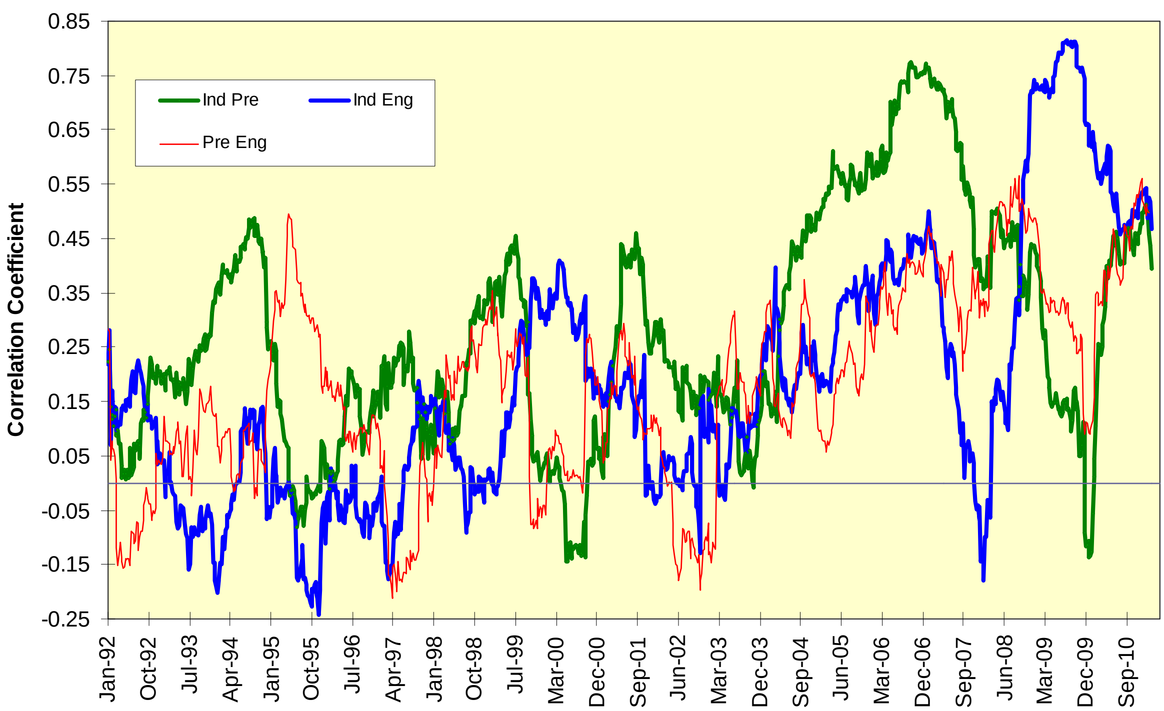

If it appears the correlations of returns have been declining over the past year, you are correct. If we take the period beginning with the Jackson Hole speech and continue through the execution of QE2 and into last week, we find five of the ten index pairs' correlations of returns actually declined, while two rose and three treaded water.

One-Year Correlation Of Returns
For Week Ending

Groups		27-Aug-10	5-Nov-10	25-Feb-11
Pre	Liv	**0.251**	**0.083**	**0.036**
Liv	Eng	**0.251**	**0.223**	**0.103**
Agr	Liv	**0.135**	**0.133**	**0.094**
Agr	Eng	**0.431**	**0.168**	**0.149**
Ind	Liv	**0.327**	**0.292**	**0.184**
Pre	Agr	**0.093**	**0.195**	**0.233**
Ind	Agr	0.361	0.287	0.334
Ind	Pre	0.405	0.424	0.406
Ind	Eng	0.471	0.494	0.473
Pre	Eng	**0.371**	**0.467**	**0.488**

It turns out the "commodity" space is not so monolithic at all. Not only are the spot returns different, but the investable total return indices are quite different as well; each is subject to the vagaries of its members' forward curves. If these forward curves are in deep carries or contango, a spot market gain can turn into a futures market loss.

The lesson is, or should be, you cannot throw money at this group and expect the commonality of return and index effects you can in, say, stocks where actively managed funds struggle to beat passive indices. The conclusion reached in a recent analysis of agricultural commodity trading advisors, that they can add value, is affirmed.