

real opportunities?

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Angus Murray, founder of alternative investments specialist Castlestone Management, makes the case for allocating to 'real' assets.



As the market torment continues, the need to provide your clients with the very best opportunities and maximum peace of mind becomes more important – and more demanding. Our mantra has always been that the best portfolio is a diversified one. A sensibly apportioned mix of asset classes, containing investments in which prices are not closely correlated, can help to smooth out volatility while keeping long-term returns buoyant.

The right mix is the key: stocks tend to be highly correlated with other stocks. Whether they are Japanese, American or European, all equity indexes show correlation – that is they tend to both rise and fall together. True diversification is not achieved through a mix of different assets,

but through a mix of different asset classes. We view a balanced portfolio as one containing a mix of financial assets such as stocks and bonds alongside 'real assets', where we consider commodities to form the core.

It is in achieving diversification that real assets can truly shine. The prices of real commodities act very differently from stocks; even a gold equity fund shows far more correlation to other stock indexes than the price of gold. The Financial Times noted last month that in the long term commodities show the least price correlation to stocks of any asset class. Even in the market mayhem of 2008 when investors saw a simultaneous liquidation of all asset classes, commodities showed the least associated price moves, making them the ideal counterbalance.

accessing the right assets

When we first began managing real assets in 2002, it was immediately clear to us that there were few funds offering this choice. The majority of commodity-styled funds offered exposure to commodity-related stocks, such as

mining companies, oil firms and such like, rather than actual real assets. Indeed, for many years, the UCITS regulations prohibited investment in assets of this kind – only with the development of the more sophisticated UCITS III framework could asset managers look to create mutual funds offering investors any exposure to real asset prices at all.

Castlestone Management's Aliquot Commodity (UCITS) and Aliquot Agriculture (UCITS) Funds use a groundbreaking structure to give investors direct exposure to individual commodity and agriculture prices within a UCITS framework. Our aim was not to give investors exposure just to indices, which in terms of commodities are heavily weighted to volatile oil and gas (these assets make up a third of the Dow Jones AIG Index, and three quarters of the GSCI Index), but instead to offer investment in attractively-priced commodities while minimising exposure to those which look vulnerable to a fall.

now is the time

The fallout of the credit crunch devastated markets in 2008, triggering a slump in



agriculture prices – the figures behind the facts

- It is estimated that food supply will have to grow by 50% by 2030 to meet projected demand.
- The GSCI agriculture and livestock index has already bounced 12% from its December lows.
- Combined global inventories for corn, wheat and soybeans have shrunk to 2008 levels only once in the past 35 years.
- The US Department of Agriculture (USDA) estimates that seed prices rose 27% in 2008.
- The USDA estimates that fertilizer costs rose 68% in 2008.

almost every asset class. We believe this resulted a significant amount of ‘forced selling’ – by which we mean the need to liquidate assets regardless of whether the price was right. This led to staggering declines in the prices of commodities and agriculture, and we would argue that any sense of fair value was all but forgotten.

Agriculture, and in particular the grains sector, is a case in point. Credit has been tight for more than a year and even those with good repayment records have struggled to borrow. Globally, this includes farmers – who typically borrow to fund the cost of seeds, pesticides and fertiliser. At the same time, these growers are facing crushingly low prices for their goods. Many of the grains, for example, are trading at prices far below their costs of production. Faced with insufficient funds and the prospect of selling at a loss, farmers are scrapping expansion plans and even leaving fields fallow. Many are cutting back on expensive fertiliser, which will reduce yields at harvest time. Supply and demand were finely balanced even before the credit crunch struck; now the imbalance will be worse and may take a long time to reverse. A field left fallow may not return to full productivity for many seasons. Such a shortage of supply means that when demand returns, prices will be forced up. And return it will – people do not stop eating just because there is a recession.

The same applies to many other commodities such as industrial metals.

no single asset class is always a winner

Best performer ↑ Worst performer	Commodities	Global Real Estate	Global Real Estate	Commodities	Global Real Estate	Commodities	Global Bonds
	+28.84%	+31.13%	+33.28%	+21.61%	+36.44%	+26.79%	+8.85%
	Global Bonds	Global Equity	Commodities	Global Real Estate	Global Equity	Global Equity	Cash
	+7.92%	+28.68%	+15.64%	+11.42%	+15.79%	+5.49%	+1.37%
	Hedge Funds	Commodities	Global Equity	Global Equity	Hedge Funds	Cash	Hedge Funds
	+4.41%	+19.49%	+10.88%	+4.91%	+9.25%	+4.44%	-23.25%
Cash	Hedge Funds	Global Bonds	Global Bonds	Cash	Hedge Funds	Global Equity	
+1.33%	+12.60%	+4.83%	+3.60%	+4.83%	+4.24%	-36.99%	
Global Real Estate	Global Bonds	Hedge Funds	Cash	Global Bonds	Global Bonds	Commodities	
-11.05%	+2.18%	+2.68%	+3.19%	+0.88%	+3.93%	-47.29%	
Global Equity	Cash	Cash	Hedge Funds	Commodities	Global Real Estate	Global Real Estate	
-19.39%	+1.02%	+1.38%	+2.72%	-19.08%	-7.68%	-49.87%	
	2002	2003	2004	2005	2006	2007	2008*

* Note: 2008 data runs up to and includes 31st December 2008. Past performance is not a guide to future performance.
Source: Bloomberg & Castlestone Management. Sectors defined by Bloomberg.

Plans for new smelters and mines have largely been put on hold and companies are struggling to find funding for such plans, especially given the current low prices of most base metals. Some existing mines and plants have already been mothballed, and that process will take a long time to reverse. It can take months or even years just to rebuild a skilled labour force. At the same time, there is likely to be huge growth in demand for these assets as the infrastructure-heavy government stimulus plans take effect.

As demand returns to a supply-depleted sector, all of this points to a very strong revival in commodity prices in the months and years ahead. We are very positive on the outlook for commodity prices both in the medium and long term. For those looking to construct a well-diversified portfolio, we believe commodities are at their most attractive prices in years. ●

exclusive availability

The Castlestone Aliquot Active Commodity Index (UCITS) and Aliquot Agriculture (UCITS) Funds are now available through Skandia's Selestia Investment Solutions platform.

When accessed through Skandia, investment in these funds will not incur a performance-related fee. This offer is currently exclusive to Skandia.

www.skandia.co.uk

Calls may be monitored and recorded for training purposes and to avoid misunderstandings.

Selestia Investment Solutions investment platform gives you access to an ISA and Collective Investment Account provided by Skandia MultiFUNDS Limited, a Collective Retirement Account and Collective Investment Bond provided by Selestia Life & Pensions Limited and an Offshore Collective Investment Bond distributed by Skandia MultiFUNDS Limited for Old Mutual International (Guernsey) Limited.

Skandia fund platform gives you access to MultiISA and MultiFUND provided by Skandia MultiFUNDS Limited and to products provided by Skandia Life Assurance Company Limited.

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