

# Steinhilber: Sticking With Commodities

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*J.D. Steinhilber is the founder and CEO of [AgileInvesting](#), an investment advisory firm that develops all-ETF portfolios using an active asset allocation strategy driven by valuation fundamentals and risk reduction.*

*Steinhilber, who has been investing in commodities since they were first made available in an ETF format, spoke with the editors of [HardAssetsInvestor.com](#) about how commodities fared in 2008 ... and what role they should play in investors' portfolios in 2009.*

**HardAssetsInvestor.com (HAI): The downturn in 2008 for commodities was awful. I thought they were supposed to protect portfolios during market downturns. What happened?**

**J.D. Steinhilber, founder, AgileInvesting (Steinhilber):** Other than gold, I don't think commodities protect you in a deflationary/deep recessionary bust like we had recently. I don't think they are a good hedge in that kind of environment.

Also, given the fact that commodities ran up so much in the first half of 2008, primarily due to the extreme weakness in the dollar, they were set up for a ferocious correction. They were severely stretched to the upside by midsummer, so when the financial crisis hit and it became clear that we were entering a deep global recession, they faced very, very powerful headwinds.

The other factor at work was the deleveraging of the Financials sector. Investors were long commodities on a leveraged basis and needed to unwind those positions. I also think, however, that there were a lot of uncommitted retail investors who had just gotten into commodities, and I think they started to rethink their commitment to the asset class.

Commodities are an unconventional asset class, and it has only been in the relatively recent past that investors have gotten comfortable with the idea of allocating a percentage of their portfolio on a long-term basis to commodities. Just as many abandoned stocks in the fall, a greater percentage probably abandoned commodities.

**HAI: But still ... the violent nature of the fall was surprising.**

**Steinhilber:** Well, if you take a step back and just look at the magnitude of the overall decline, it's less shocking. Commodity indexes got cut in half over six months, while equity indexes got cut in half over 12 months. Both lost the same in value; it was just more intense and dramatic in commodities.

The people who really got hurt were the latecomers to the commodities party; the ones who invested at the worst possible times. But if you go back and look at how commodities have performed versus equities over a multiyear time frame, you cannot make the argument that equities have been a significantly better investment. Gold in particular has been a much better investment than stocks, but even diversified commodities, if you go back over five years, I'm pretty sure were still leading the stock market over that time.

They weren't a good hedge recently, clearly. Very few things are in this kind of environment. You have cash, Treasuries and gold, and that's about it.

**HAI: How do you use commodities in client portfolios?**

**Steinhilber:** I've gotten it down to three positions: DJP (the iPath Dow Jones AIG ETN (NYSE Arca: DJP)), DBC (the PowerShares DB Commodity Index Fund (NYSE Arca: DBC)) and GLD (the SPDR Gold Shares {NYSE Arca: GLD}).

Every account has a position in GLD, and some accounts will have DJP by itself or a combo of DJP and DBC. It's hard to decide which of those two products I prefer, because there are certain things that are attractive about DBC. I think their optimized roll yield mechanism - even though it doesn't produce a *lot* of incremental return - does have a

history of returning 100 bps versus a plain front-month roll strategy. On the other hand, DBC is highly weighted to Energy, and it's nice to have more commodities than are included in DBC's focused portfolio. DJP has things like natural gas, sugar, etc.

Both DBC and DJP meet standards in terms of the overall assets and spreads; you can get in and out of those products for less than 10 bps. So both work in the portfolios.

**HAI: What kind of weights do you use? How much of each should the average investor hold?**

**Steinhilber:** In a typical account, I will invest about 8% of the portfolio in those three ETFs. That's up from probably around 5% because the extreme weakness in commodity prices has allowed me to move back to a more neutral allocation in a growth-oriented account. In a conservative account, I would pull back on this.

I had recently been in the 5% range in those three funds together, but I bumped that to 8% recently. It's worth noting that I pulled that extra 3% from cash - I had cash reserves, thankfully. That's not a reduction in my equity exposure.

**HAI: So you think commodities are attractive here?**

**Steinhilber:** They're really cheap. They look very cheap. Even though the economy is creating a headwind for commodities, you have big tailwinds from the government spending and other factors. There is the infrastructure spending, and people still need to eat. Add in questions about the dollar and that is bullish for commodities.

**HAI: That covers DBC and DJP. But what role does gold have in a portfolio?**

**Steinhilber:** That's kind of an insurance policy. Gold is an unusual asset in that its pure economic utility value is significantly less than its price, because it retains a monetary role.

I hope this doesn't happen, but there is a scenario ... and there are plenty of smart people who point to this risk - George Soros, for instance ... where the U.S. dollar doesn't remain the reserve currency in the world. It's also not out of the realm of possibility that there could be a greater global monetary disruption than we've already seen.

I think you need to have some exposure to gold as an insurance policy.

**HAI: And what if that scenario doesn't play out?**

**Steinhilber:** Well, I think gold is fairly valued in the status quo. People say you can't value gold, but there are long-term studies that compare the price of gold to the monetary supply over the long term.

Using those, we're in the realm of fair value. Could gold go down to \$600/ounce if there's a big dollar rally? Sure. Could it go to \$1,000/ounce? I wouldn't be surprised at all.

I don't think there's any more downside in gold than in the market in general, and it's sure nice to have that insurance. I'd also add: With the Fed making it so that there is no yield on cash, the opportunity cost of holding gold right now is negligible. So why not?

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