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THE GLOBAL PLAYER

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Commodities Enter Investment Mainstream

**Pension Funds, Universities
Jump Into the Asset Class;
High Returns, Low Risk**

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PARIS -- Hedge funds and other speculators have taken some criticism for the soaring price of oil and other commodities.

But amid the din of the blame game, a broader and more-significant trend in the global investment community has largely been overlooked: Mainstream investors such as pension funds, insurance companies and university endowments -- even Harvard's -- are pumping more money into commodities.

These long-term institutional investors hold, on average, investments in energy, industrial and precious metals, livestock, agriculture and other commodities that are twice those of hedge funds, estimates Jeffrey Currie, head of commodities research at a London office of Wall Street securities firm Goldman Sachs Group Inc.


Often, those investments aren't directly in physical commodities themselves but in commodity-related and energy-related companies and in indexes linked to the price of commodities.

¹Equally weighted index of commodity futures using data from the Commodity Research Bureau
²S&P 500 index ³Ibbotson corporate bond index

Source: Yale International Center for Finance

Market analysts conservatively figure that roughly 150 institutions have so-called passive investments pegged to the Goldman Sachs Commodity Index, up from fewer than 50 in 2000. Goldman estimates that more than \$25 billion (€21 billion) is tied to the index, compared with \$8 billion four years ago. American International Group Inc. estimates that an additional

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\$8 billion to \$10 billion in investments is pegged to the Dow Jones-AIG Commodity Index, up from about \$200 million a few years ago. (Dow Jones & Co. is also publisher of The Wall Street Journal.)

"Commodities have begun to emerge as a discrete asset class in their own right," says Stefan Weiser, London-based European head of investor sales for the Goldman index.

Of course, some commodities and metals, especially gold, have long had a dedicated following. But such investors typically have been few in number and have long been on the fringes of the global investment community. Until recently.

Part of commodities' recent appeal has to do with a bull market fueled by strong demand, especially from economies such as China's, and an underinvestment in production in the past 10 to 15 years. From its lows in mid-February 1999, the Goldman index is up 183% through Tuesday. "Commodities will be a bull market into early the next decade," predicts Felix Zulauf, principal partner of Zulauf Asset Management. In July 2003, the Zug, Switzerland, firm launched the Gondwana natural-resource fund. With more than \$605 million in assets, the fund is now closed to new investment.

Commodities' status as an acceptable investment for mainstream institutions could get a further boost from a recently published paper: "Facts and Fantasies about Commodity Futures" by Gary Gorton of the University of Pennsylvania's Wharton School and K. Geert Rouwenhorst of the Yale School of Management at Yale University. The two academics conclude that during the past 45 years, commodity futures have had roughly the same return as stocks with less risk, have way outperformed bonds and are a better hedge against inflation than either stocks or bonds.

"As this sinks in and as commodities do well, trustees, directors, portfolio managers, fiduciaries and others will no longer be able to dismiss commodities out of hand," says James Rogers, an independent investor and co-founder with financier George Soros of Quantum Fund. The Gorton-Rouwenhorst paper, predicts Mr. Rogers, "is going to change completely the investing world over the next decade."

The rush into commodities, in fact, already is well under way.

Take the Ontario Teachers' Pension Plan. More than 6% of its 79 billion Canadian dollars, or US\$61 billion, in assets is invested in commodity-related investments. Its biggest equity investment is in **Nexen Inc.**, a Canadian oil-and-gas concern. Its second biggest is in **Fording Canadian Coal Trust**. In partnership with **Sherritt International Corp.**, Ontario Teachers now owns 85% of Canada's coal reserves. Early this year, the fund also acquired a 50% stake in 25 U.S. power-generation facilities.

"We believe that demand for energy will increase in the years ahead, and this strategic investment in the energy sector will help us to pay many teachers' pensions in the future," Robert Bertram, Ontario's executive vice president for investments, recently told plan members in a Webcast.

At the start of the decade, Europe's two biggest pension funds had no commodity investments. Stichting Pensioenfond ABP, the €157 billion (\$190 billion) fund for Dutch government and educational-system employees, got into commodities in 2001 and has reached its target of having 2.5% of its assets, or close to \$5 billion, in commodities. A year earlier, the €5.7 billion PGGM fund for Holland's health-and-welfare sector waded into commodities. It now has 4.3%, or roughly \$3 billion, invested in them.

Harvard University has been investing in commodities for more than a decade, and its internal benchmark calls for allocating 13% of the university's \$19.3 billion endowment to oil, gas and other commodities. That's just two percentage points less than the weighting assigned to U.S. stocks and two points more than the allocation to U.S. bonds. Unlike many pension funds that passively follow a benchmark, Harvard actively manages its commodity investments, and 10 percentage points of the 13 allocated to commodities are invested in timber.

"Commodities, we think, are a diversifying asset class with no correlation -- and in some cases, negative correlation -- with other asset classes," says Jack Meyer, president and chief executive officer of Harvard Management Co. in Boston. In other words, commodities don't tend to rise and fall in lockstep with stocks and bonds, something that is also borne out in Harvard's performance. During the five years ended June 30, the Standard & Poor's 500-stock index averaged minus 2.2% a year. Over the same period, Harvard's average annual return from commodities was roughly 16%.

On the other hand, commodity prices tend to rise with inflation. And that, says Michel Meijs, a spokesman for ABP, "is very important for a pension fund."

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