

June 5, 2008

Economic Indicators Canada

	Dec. 2007	Apr. 2008	
GDP ⁽¹⁾	2.7	1.7 ⁽²⁾	↘
CPI ⁽¹⁾	2.4	1.7	↘
Unemployment	5.9	6.1	↗

United States

	Dec. 2007	Apr. 2008	
GDP ⁽¹⁾	2.2	2.5 ⁽²⁾	↗
CPI ⁽¹⁾	4.1	3.9	↘
Unemployment	5.0	5.0	-

(1) Year-over-year % variation
(2) March 2008

Sources: Statistics Canada, U.S. Dept. of Commerce, U.S. Dept. of Labor Statistics.

Equity Indices

% Change	2008 in local currency	2008 in C\$	
S&P/TSX	6.2	6.2	↗
S&P500	-6.2	-4.1	↘
Russell 2000	-2.9	-0.4	↘
Nikkei	-5.7	2.8	↘
S&P 350 Europe	-13.7	-6.3	↘

INVESTING IN COMMODITIES—PART 2

Last month, we reviewed some of the key reasons why so many institutions invest in commodities. They are attracted by their diversification characteristics, by the fact that commodities tend to perform well in high-inflation situations, and by the expectation that they will produce equity-like returns. This month, we will review how these investments are implemented in real life.

Typically, institutions will aim at investing in a diverse group of commodities. Obviously, most institutions don't have the means to warehouse precious metals, livestock, industrial metals, grains and crude oil. This is why they build their investment through “**collateralized commodity futures**” (CCF). A CCF is a combination of two components.

The first component is a group of positions in derivative products, called “**futures contracts**” on a variety of commodities. Futures contracts are commitments to buy (or sell) these commodities at a later date. These contracts are typically resold shortly prior to expiry and replaced by new, forward-dated futures contracts. By using these futures, institutions can closely mimic the value of the commodities without ever holding them physically.

The second component of a CCF is the **collateral**. Investing in futures contracts requires no disbursement of money in of itself, except to deliver ultra-safe securities, as required by futures exchanges to protect all transaction counterparties from a failure to honor the contracts. In a classic transaction, an institution will deposit 100% of the underlying value of the futures contracts in government Treasury bills as collateral to the transaction.

With the broad variety of commodities that routinely trade on the North American futures exchanges, managing a well-diversified CCF investment could be a complex task. But there are also **commodity index futures** available, which allow investors to invest in a wide group of commodities with a single transaction.

This article reviewed how most institutions implement their commodities investments. Next month, we will outline the desirable characteristics of a well-structured commodity investment.

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