Press Release
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Torbjörn Iwarson Makes the Case for Investing in Commodities

Stockholm (HedgeNordic) – The team at AQR has compiled a dataset of daily futures prices dating back to 1877, revealing that commodity futures indices have historically generated positive returns over the long term. This dataset highlights the potential of commodities as a valuable addition to diversified portfolios. Torbjörn Iwarson, a Swedish-born commodities markets expert based in Brazil, has conducted his own research supporting the benefits of incorporating commodities as a long-term portfolio allocation.

While commodities are widely seen as a hedge against inflation, "commodities are many things," explains Iwarson, who serves as a consultant for the recently launched Centaur Commodity Fund. Having begun his career on Handelsbanken's commodities desk, later serving as head of commodities at SEB, and managing a commodity futures portfolio at Skandia Investment Management, Iwarson explains that more than 20 different commodities typically form part of major indices. These range from energy, base and precious metals, and agricultural products, to soft commodities like coffee and cocoa, and livestock such as lean hogs and cattle. Each has its own distinct return drivers; some are linked to broader macroeconomic forces, while others respond to specific supply and demand dynamics, according to Iwarson.

Highlighting the cyclical nature of both commodities and other asset classes, Iwarson notes that assets such as equities, real estate and corporate bonds are closely tied to the business cycle, driven primarily by shifts in general demand. "It's demand, not supply, that drives these cycles," emphasizes Iwarson, who goes on to add that certain commodities such as energy and industrial metals are also tied to this business cycle. However, other commodities such as precious metals are more closely tied to inflation expectations, with gold, for instance, often acting as a hedge against currency debasement.

More interestingly, many commodities – particularly agricultural products like wheat, corn and soybeans – are primarily influenced by supply factors, especially supply shocks. "In the past, some 200 years ago, these supply shocks shaped macroeconomic trends, but in today's modern economy, they are not at all correlated with the macro drivers affecting traditional investment portfolios," says Iwarson. "Most commodities have a low correlation to macroeconomic factors and the global business cycle, because some of these commodities are affected by a different set of factors." Commodities, therefore, can serve as effective portfolio diversifiers.

Portfolio Benefits: Diversification, Inflation Hedge and Crisis-Alpha

In addition to diversification, commodities can provide protection against inflation, though their effectiveness varies by commodity and the type of inflation. Iwarson's analysis, looking back at data since 1996, shows that stocks and bonds generally exhibit negative inflation beta, meaning they tend to underperform during periods of rising inflation. Commodities, by contrast, exhibit positive inflation beta.

“If you analyze the monthly changes in the consumer price index, a common measure of inflation, and compare those to the monthly returns in stocks, bonds, and inflation-linked bonds, and commodities, you'll find that stocks and bonds have a negative inflation beta of about minus two,” says Iwarson. “This means that for every one percent increase in the consumer price index, the expected return on stocks and bonds falls by two percent.” Inflation-linked bonds, he notes, have a slightly negative inflation beta of minus 0.1, while commodities show a positive bet of between two and three. This positive beta indicates that commodities tend to perform well during inflationary periods, particularly during cost-push inflation when rising input prices drive up overall prices.

Beyond diversification and inflation protection, commodities offer a long-term return profile that sits between corporate bonds and equities, according to Iwarson. “The long-term return from commodity futures, including collateral returns from three-month T-bills – which is as low a return as you can get – has been between corporate bonds and stocks,” says Iwarson. “During inflationary periods, when inflation becomes a dominant market theme, the correlation between commodities and traditional assets like stocks and bonds turns negative as the inflation factor takes over,” he elaborates. “This makes commodities an effective tool for protecting other parts of the portfolio from inflation.”

Iwarson also suggests that commodities can offer “crisis-alpha” – the ability to generate positive returns during equity market downturns, particularly in the case of Swedish equities. When reviewing total returns from the OMX Stockholm exchange since 1901, he found that the average return during down years over 32 years was a negative 14 percent. By analyzing a basket of commodity prices, including copper, wheat, and corn – mirroring the Bloomberg Commodity Index's 1959 composition – Iwarson discovered that commodities returned an average of five percent during these down years, in Swedish kronor. “This shows that commodities, as an asset class, also have crisis-alpha characteristics,” he concludes.

Unlike equity indices, which are typically weighted by market capitalization, leading commodity indices often rely on more arbitrary construction methodologies, with production volume being a primary weighting method. This approach assigns greater weight to commodities produced in higher quantities, though investing in high-supply commodities does not necessarily guarantee long-term success in commodities investing. While Iwarson supports passive exposure to commodities, his own strategy leans toward active management, based on thorough fundamental analysis. This active strategy has enabled the Centaur Commodity Fund to be classified as an Article 8 fund, aiming to outperform the underlying market as represented by the Bloomberg Commodity Ex-Energy Total Return Index.