



Press Release

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EDHEC-Risk Institute study sheds new light on commodity investment and financialisation of commodity markets

A number of policy-makers have blamed the decade-long rise in commodity prices and recent market volatility on the growing influence of financial investors and called for new regulation restricting their participation in commodity markets. Market financialisation has also led investors to worry about higher integration between commodity and traditional financial markets weakening the portfolio benefits of commodity investment.

EDHEC-Risk Institute Professor Joëlle Miffre addresses these concerns in a study released today entitled “Long-Short Commodity Investing: Implications for Portfolio Risk and Market Regulation”, produced with market data and support from CME Group.ⁱ

The study first examines the performance and risk characteristics of long-only commodity index investments favoured by passive investors and of long/short commodity strategies of the kind implemented by hedge fund managers.

Over 1992-2011, strategies involving going long and short in commodity futures based on signals such as momentum, term structure or hedging pressure are found to dominate investment in long-only commodity indices, in terms of raw as well as risk-adjusted performance.ⁱⁱ

The low correlations of long-only and long/short commodity portfolios with equities and bonds confirm the strategic role of commodity investments as diversifiers of both equity and fixed income risks. While the correlation between long-only commodity portfolios and equities has risen sharply since the downfall of Lehman Brothers, long/short investing continues to offer excellent diversification benefits.ⁱⁱⁱ Overall, long/short investing is found to be a better diversifier of equity risk and long-only investing a better diversifier of fixed income risk. However, the diversification benefits of long-only investing are unequivocally reduced in times of financial stress (correlations with equities and bonds rise), while long-short commodity portfolios are found to provide a partial hedge against extreme risks in equity markets (correlations fall when the volatility of equities rises) and to better withstand turbulence in fixed income markets.

The study then confirms the financialisation of commodity markets and investigates whether the increased participation of long/short investors has caused changes in the volatility of their portfolios or in the correlation between their returns and those of traditional assets. The tests performed find very little to no evidence to suggest that these investors have had such a destabilising role.^{iv}

These results on the performance and risk characteristics of long-only and long/short commodity investing have important practical consequences for investors that are considering or have implemented commodity investment programmes. The new evidence on the financialisation of commodity futures market and the impact of long/short investing challenges the assumptions of a politically charged debate and will be of relevance not only to regulators and industry associations but also to investors that need to factor social responsibility considerations into their investment decisions.

Download: [“Long-Short Commodity Investing: Implications for Portfolio Risk and Market Regulation”](#)

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ⁱ The extant academic literature has focused on the conditional correlations between long-only commodity portfolios and traditional assets; its overwhelming conclusion is that it is not possible to empirically link investments in commodity futures and commodity futures prices. This study extends the literature by looking at the potentially unsettling role of long-short investors on price volatility and cross-market correlation.

ⁱⁱ Over the period, the mean excess return of the Standard and Poor's Goldman Sachs Commodity Index (S&P-GSCI) equals 0.64% per year, that of the long-only equally-weighted portfolio of the twenty seven commodities in the study is 4.28% and the average mean excess return of the long-short portfolios equals 7.99% when only one type of signal is used and 9.03% when two signals are used in combination. The Sharpe ratios of the long-short portfolios range from 0.2711 to 0.6302 and average out at 0.5093. The equally-weighted portfolio has a Sharpe ratio of 0.0529 and the S&P-GSCI a Sharpe ratio of 0.1965.

ⁱⁱⁱ The mean in the average conditional correlations of the S&P500 index relative to long-short indices stands at a mere 0.0559, while that relative to long-only indices equals 0.5402.

^{iv} This conclusion is based on Granger-causality tests and holds irrespective of whether investors are labelled as "non-commercial" in the CFTC Commitment of Traders report or "professional money managers" (i.e., CTAs, CPOs and hedge funds) in the CFTC disaggregated Commitment of Traders report.