Herald Sun

SE Business

HD **How to hit paydirt**

BY Paul Gilder
WC 1,475 words
PD 20 September 2014
SN Herald-Sun
SC HERSUN
ED HeraldSun
PG 74
LA English

LP

Commodities are the bread and butter of the economy, but how can everyday investors trade in them? Paul Gilder takes a crash course

THE fortunes of iron ore this year have been hard to miss.

TD

A deep slide and now prolonged slump in the price of the commodity has captured plenty of headlines across the Australian media.

Iron ore — a key ingredient in steelmaking — is critical to the infrastructure programs of the world's developing nations. Chief among these is China, the top destination for our iron ore shipments.

Excessive stockpiling at China's ports and a ramp-up in production among Australian miners such as BHP Billiton and Rio Tinto have heaped downward pressure on the price of the commodity.

At $US83 a tonne yesterday, it is down almost 40 per cent this year. The flow-on effect of a weaker iron ore price can be seen in all parts of the Australian economy: BHP and Rio can move the wider sharemarket and in turn investor confidence due to their sheer size.

But despite the cloud over iron ore, not everyone is pessimistic about future prices.

At one end of the spectrum, Goldman Sachs is predicting prices to average $US79 a tonne next year, while at HSBC it's more like $US100.

For investors keen to do a little prospecting from the comfort of their armchairs, a good place to start is the London Metals Exchange website (lme.com), where any number of commodity prices are recorded. Historical charts for precious metals such as gold and silver can be found at Kitco (kitco.com).

But even once you've determined which commodity you would like exposure to, there are plenty of ways to invest.

Direct share investment WHITEHAVEN Coal chief Paul Flynn says he is hopeful the bottom of the price cycle has passed for thermal and metallurgical coal.

If you agree, then Whitehaven shares — which for much of this year traded at more than a 50 per cent discount to their five-year average — could be a handy addition to your portfolio.

Be mindful of China's attempt to tackle pollution with a proposed ban on low-quality coal into major economic regions. Analysts have flagged concerns about the proposal although the Australian coal industry has played down the likely impact.

In the broader commodities space, IG Markets analyst Stan Shamu says that, beyond the big names, miners are generally not known for their juicy dividends.

"Investors **buy** them for their growth prospects and their share price appreciation in times of rising commodity prices," Mr Shamu says.

"Commonly small to mid-cap miners don't issue dividends — in fact they're encouraged to keep money to fund their merger and **acquisition** strategies ... it's also about how well the **company** is managed." Exchange-traded funds and listed investment companies EXCHANGE traded funds are securities that track an index or a welter of assets and provide a quick and easy access point for a broad exposure to commodities.

BetaShares managing director Alex Vynokur says the beauty of an ETF lies in its flexibility. "Because different factors drive commodity prices as opposed to equities, these products have significant diversification characteristics and help investors diversify risks in their portfolios," Mr Vynokur says.

"They're quoted on the ASX, investors can **buy** or sell them like any **equity** and they're also currency hedged so that investors are exposed purely to the commodity, not the US dollar." BetaShares offers four commodity-specific ETFs, focusing on agriculture, crude **oil**, **gold** bullion and a broader commodities basket. The latter also features no exposure to **iron ore** — a deliberate move.

"Many indexes are often already overweight with **iron ore** through BHP and Rio; this provides an alternative," Mr Vynokur says.

The products have only been offered to Australian investors for the past two and a half years but Mr Vynokur says they're starting to get noticed for a range of investment strategies.

"Investors are tactically using the crude **oil** ETF to gain exposure to the **oil** prices inflated by the instability in the Middle East.

"Conversely, the agriculture ETF is more of a long-term play and taps into the story of the middle class in **China** consuming more protein." The Australian sharemarket also features a range of listed investment companies that offer some exposure to resources companies, including Argo Investments, Australian Foundation Investment **Company** and Djerriwarrh Investments.

Contracts for difference COMMONLY known as CFDs, these products allow investors to take up a position in a commodity, such as **gold**, and gain the same exposure as an ETF for a much smaller outlay. They do this by using leverage, or gearing — a technique that multiplies an investor's profits or losses.

"Leverage in the right hands is a very powerful tool. If you can harness it, it's a very strong bow in your armoury," IG Markets analyst Chris Weston says.

Also known as spread betting, investing with contracts for difference is not for the faint hearted.

The industry attracted fierce scrutiny in the wake of the financial crisis amid concerns that spread betting had fuelled market instability and left some investors nursing deep losses.

Brokers offering contracts for difference will set a market for a certain asset with a **buy** price above the price of the underlying asset, and a sell price below it. This range is known as the spread. It is where brokers make their money on CFD trading.

Investors choose to either **buy** more of the asset, known as going long, or sell the asset, called going short.

Should the asset appreciate or depreciate as the investor expects, they can then close their position and take a profit.

However, the reverse is also true, which is why many investors set up "stop-losses" — a price at which the contract will be closed, potentially mitigating much deeper losses. It's for this reason contracts for difference are often considered to be a more speculative investment and are definitely not a "set-and-forget" option, Mr Weston says.

He says the strength of a CFD is that the investor can gain exposure without needing to own the underlying asset, such as **gold**. They trade off the underlying market price and the contracts are held like shares. IG offers exposure to commodities as diverse as palladium, Brent crude **oil**, live cattle and even Arabica coffee.

Purchase physical **gold** THE classic defensive play, **gold** is turned to in times of global volatility because it is tangible, adds diversification to a portfolio and offers good leverage in cyclical down times for markets.

But while pleasing to behold, it’s a non-yielding asset and not easily stuffed into the mattress, independent fund manager George Boubouras says.

“**Gold** is a real store of wealth but it costs you to store and it yields you nothing,” Mr Boubouras says. “People **buy** it as a hedge against inflation or monetary debasing (sliding interest rates) and can sit on it for 10 years waiting for something to happen.

“I’**m** not a big proponent of **gold** stocks either. They’re not very good at adding value to the shareholder. When you **buy gold** stocks, I shouldn’t be expecting a dividend.” Mr Boubouras says **gold** stocks account for just 0.7 per cent of the benchmark ASX 200 index.

Much of that is to do with the inability of **gold** miners to turn a dollar when prices are depressed, he says.

“It’s very unprofitable for companies at $US1100 (a fine ounce), or even $US1300.

“There’s a high cost base to extract and deliver **gold**, and they’re extracting it from difficult to access areas, such as the side of an active volcano in Papua New Guinea.

“Many of these areas also carry a geopolitical risk, so shareholders are putting on **board** too much of that risk.” Other than scouring the stocks listings, investors eager to gain exposure to **gold** could take up any number of ETFs that are backed by vast physical stores of the metal.

One such is BetaShares’ **gold** bullion ETF. It trades on the ASX with its price updated daily and hedges all of its US dollar exposure back to the Australian dollar.

This product is backed by bullion held in the London vault of investment bank JP Morgan Chase.

There’s also a number of futures traders, such as CME **Group**, where investors trade for a theoretical settlement date, commonly three months ahead. However, these investments require considerable awareness as the level of exposure and potential losses are much greater than other options.

Eureka Report **mining** commentator Tim Treadgold says that, beyond these there is a much simpler way: “If you want to own **gold**, **buy gold**. Why **buy** someone’s else’s insurance policy?”paul.gilder@news.com.au

NS m14 : Commodity Markets | mcat : Commodity/Financial Market News | ncat : Content Types | nfact : Factiva Filters | nfce : FC&E Exclusion Filter

RE austr : Australia | apacz : Asia Pacific | ausnz : Australia/Oceania

PUB News Ltd.

AN Document HERSUN0020140919ea9k0005n

