Learning Module 5: Natural Resources

Q.1084 The sources of commodities futures return can be *best* described to be from:

A. Roll yield only.

B. Roll yield and collateral yield.

C. Roll yield, collateral yield, and change in spot prices.

The correct answer is **C.**

The three sources of commodities futures returns are roll yield, collateral yield, and change in spot prices.

Roll yield refers to the difference between a commodity’s spot price and the price specified by its futures contract. The collateral yield component of commodity index returns is the interest earned on the collateral posted as a good-faith deposit for the futures contracts. The change in spot prices is the relationship between current supply and demand.

A is incorrect. It suggests that roll yield is the only source of commodities futures return. While roll yield is a significant factor, it does not account for the other critical components like collateral yield and changes in spot prices, which can also significantly impact the overall return on a commodities futures investment.

B is incorrect. It includes roll yield and collateral yield but omits the change in spot prices as a source of return. This overlooks a fundamental aspect of commodities trading, where price movements based on supply and demand dynamics are a primary driver of profitability. By not considering the change in spot prices, this option fails to capture the full spectrum of factors that contribute to the returns from commodities futures.

CFA Level I, Alternative Investments, Learning Module 5: Natural Resources. LOS (b): Describe features of commodities and their investment characteristics.

Q.1248 Having physical commodities for use over the period of futures contracts is *most likely* called:

A. Backwardation.

B. Convenience yield.

C. Commodities yield.

The correct answer is **B.**

Convenience yield is the return or benefit derived from holding physical commodities in the short term, which includes the availability of the commodity when it is needed, storage convenience, and other factors that make holding the physical commodity more advantageous than holding a futures contract. This is in contrast to backwardation, which is a situation where the futures price is lower than the spot price, typically indicating a shortage in the market, and commodities yield, which is not a widely used term in commodity markets.

A is incorrect. Backwardation is a term used in futures markets to describe a situation where the futures price of a commodity is lower than the spot price. This typically occurs when there is a current shortage of the commodity in the market, leading to higher demand for the available physical product and, as a result, a higher spot price than the futures price.

C is incorrect. Commodities yield is not a commonly used term in commodity markets, and it is not a concept that is widely recognized or defined in the context of commodity trading.

CFA Level I, Alternative Investments, Learning Module 5: Natural Resources. LOS (b): Describe features of commodities and their investment characteristics.

Q.1249 A situation where futures prices are lower than the spot prices because of high convenience yields is *most likely* called:

A. Roll yield.

B. Contango.

C. Backwardation.

The correct answer is **C.**

In backwardation, the convenience yield is high, and futures prices are lower than the spot prices.

A is incorrect. Roll yield refers to the difference between a commodity's spot price and the price specified by its futures contract or the difference between two futures contracts with different expiration dates.

B is incorrect. Contango is when futures prices are higher than the spot price.

CFA Level I, Alternative Investments, Learning Module 5: Natural Resources. LOS (b): Describe features of commodities and their investment characteristics.

Q.3277 An analyst is writing a report on timberlands and farmlands. He includes the following statements in his report: Statement 1: “Unlike timberlands, the primary return driver of farmlands is land price changes only.” Statement 2: “A portfolio manager seeking to diversify his portfolio should seek to avoid timberlands.” Is the analyst correct?

A. No.

B. Only with respect to Statement 1.

C. Only with respect to Statement 2.

The correct answer is **A.**

The analyst is incorrect with respect to both statements. Both timberlands and farmlands have three primary return drivers: harvest quantities,commodity prices, and land price changes.

A portfolio manager seeking to diversify his portfolio should consider timberland as this asset class is not highly correlated with other asset classes.

B is incorrect. The primary return drivers for both timberlands and farmlands include more than just land price changes. For timberlands, the returns can be attributed to biological growth, timber prices, and land value appreciation. Biological growth increases the volume of timber available for harvest, which can lead to higher revenue when the timber is sold. Timber prices can fluctuate based on supply and demand dynamics in the market, affecting the revenue from timber sales. Land value appreciation can occur due to various factors, including changes in land use or improvements made to the land. Similarly, farmlands also benefit from crop yield (analogous to biological growth in timberlands), commodity prices, and land value appreciation. Crop yield depends on the farm's productivity, while commodity prices are influenced by global supply and demand for agricultural products. Therefore, stating that the primary return driver for farmlands is only land price changes overlooks the significant impact of crop yields and commodity prices on returns.

C is incorrect. Avoiding timberlands for portfolio diversification purposes is not advisable. Timberlands have been shown to have a low correlation with traditional financial assets like stocks and bonds, making them an excellent choice for diversification. The unique characteristics of timberlands, such as biological growth and the ability to delay harvests until market conditions are favorable, provide a hedge against inflation and market volatility. Including timberlands in a diversified portfolio can reduce overall risk and improve returns over the long term. The analyst's recommendation to avoid timberlands disregards the benefits they can offer in terms of diversification and risk management.

CFA Level I, Alternative Investments, Learning Module 5: Natural Resources. LOS (c): Analyze sources of risk, return, and diversification among natural resource investments.

Q.3279 An investor with a small asset base and moderate financial wealth would like to invest in an alternative asset class which is liquid, provides opportunities for diversification, and requires minimal active involvement. The investor will *most likely* select a:

A. Hedge fund.

B. Private equity fund.

C. Commodity-producing company's stocks.

The correct answer is **C.**

The investor will most likely select the common stock of a commodity-producing company for investment. Commodity investments provide the opportunity for diversification. Investments in commodity-producing companies allow small investors to invest little to moderate amounts of funds in these stocks. Furthermore, commodities are effective for portfolio diversification due to their low correlation with other asset classes. Also, publically traded common stocks can easily be sold and are relatively liquid.

A is incorrect. Hedge funds generally impose restrictions on redemptions. Investors may be required to keep their money in the hedge fund for a minimum period (lockup period) and may be charged a fee to redeem their shares. This makes hedge fund investments a relatively illiquid form of investment. Furthermore, hedge funds are restricted to large, wealthy investors who can invest substantial sums of money.

B is incorrect. Private equity funds require their investors to be patient. Private equity requires a long-term commitment from limited partners because of the long time lag between investments in and exits from portfolio companies. Thus, this is not a suitable investment alternative for investors averse to illiquidity.

CFA Level I, Alternative Investments, Learning Module 5: Natural Resources. LOS (b): Describe features of commodities and their investment characteristics.

Q.3900 When a future price is below the expected spot price for a particular commodity, the market is *most likely* in:

A. Contango.

B. Backwardation.

C. Premium buying.

The correct answer is **B.**

Backwardation is a term used in futures trading to describe a market where the price of a futures contract is trading below the expected spot price of the underlying asset at the contract's expiration date. This situation can occur when the market anticipates a shortage of the underlying asset in the future, causing the futures price to be bid up relative to the spot price. As a result, buyers of futures contracts are willing to pay a premium for the ability to lock in the lower price, rather than paying the expected higher spot price at a later date.

A is incorrect. Contango is the opposite of backwardation and occurs when the futures price of a commodity is higher than the expected spot price at the contract's expiration date. This situation can occur when the market expects an oversupply of the underlying asset in the future, causing the futures price to be bid down relative to the spot price.

C is incorrect. Premium buying is a term used in options trading to describe a situation where an investor purchases an option contract at a premium price in anticipation of a favorable price move in the underlying asset. It is not directly related to futures market conditions like backwardation or contango.

CFA Level I, Alternative Investments, Learning Module 5: Natural Resources. LOS (b): Describe features of commodities and their investment characteristics.

Q.4229 Returns from investing in commodities *most likely* arise from which of the following?

A. Price changes.

B. Regular income from interests and dividends.

C. Price changes and periodic income from interests and dividends.

The correct answer is **A.**

Returns from investing in commodities mainly come from the price changes of the commodity. Commodities are physical goods that have intrinsic value based on supply and demand dynamics, which can be affected by factors such as economic growth, geopolitical events, weather conditions, and technological advancements.

Investors buy commodities in the hope that the price will increase over time, allowing them to sell the commodity at a higher price than they bought it for and earn a profit.

B and C are incorrect. Unlike stocks or bonds, commodities typically do not generate regular income through interest or dividends. Commodities are physical assets that do not generate cash flows like interest or dividends, and therefore, investors in commodities do not usually receive regular income from holding commodities.

CFA Level I, Alternative Investments, Learning Module 5: Natural Resources. LOS (b): Describe features of commodities and their investment characteristics.

Q.4465 An investor is considering diversifying their portfolio by investing in land assets. They are particularly interested in timberland and are considering the United States, Central and Eastern Europe, Latin America, Australia, and New Zealand as potential locations. The investor is aware that these investments are unique and illiquid, and that the value of the resource is significantly influenced by its geographic location and features. However, they lack the specialized knowledge and understanding required to manage a forest over its life cycle.
Which of the following would be the *most likely* course of action for the investor?

A. Invest in a real estate property instead, as it offers a wide variety of financing alternatives and is not as illiquid as land assets.

B. Invest directly in timberland in the United States, as it is estimated that nearly half of private investable timberland globally is located there.

C. Rely on a timberland investment management organization (TIMO) to manage their investments in timberland and acquire suitable timberland holdings.

The correct answer is **C.**

Given the investor's lack of specialized knowledge and understanding required to manage a forest over its life cycle, the most suitable course of action would be to rely on a Timberland Investment Management Organization (TIMO). TIMOs are professional organizations that serve as intermediaries between institutional investors and the timberland market. They provide a range of services, including acquisition and disposition of timberland assets, forest management, and marketing of forest products.

By investing through a TIMO, the investor can leverage the organization's expertise in managing timberland assets and navigating the complexities of the timberland market. This can help the investor achieve their investment objectives while mitigating the risks associated with direct ownership of timberland assets. Furthermore, TIMOs can provide access to a diversified portfolio of timberland assets across different geographic locations, further enhancing the risk-return profile of the investment.

A is incorrect. While it is true that the United States holds a significant portion of private investable timberland globally, direct investment in timberland requires specialized knowledge and understanding of forest management, which the investor lacks. Therefore, direct investment in timberland, regardless of the location, may not be the most suitable course of action for the investor.

B is incorrect. While real estate property may offer a wide variety of financing alternatives and may not be as illiquid as land assets, it does not meet the investor's interest in diversifying their portfolio by investing in land assets, specifically timberland. Therefore, investing in a real estate property may not align with the investor's investment objectives.

CFA Level I, Alternative Investments, Learning Module 5: Natural Resources. LOS (c): Analyze sources of risk, return, and diversification among natural resource investments.

Q.4466 In the context of various aspects of farmland and timberland investments, which of the following statements is *least likely* true?

A. Farmland is immune to unexpected weather changes and climate developments, and these factors do not have any significant impact on the crop yield or revenue.

B. Farmland and timberland investments generate returns from selling crops and timber, and the value of the land may also change over time, contributing to the return on these investments.

C. Smaller investors typically invest in timber and farmland through investment funds, such as real estate investment trusts (REITs) in the United States, or administered privately through limited partnerships.

The correct answer is **A.**

The statement that "Farmland is immune to unexpected weather changes and climate developments, and these factors do not have any significant impact on the crop yield or revenue" is not true. Farmland and timberland investments are indeed subject to a variety of risks, and one of the most significant among them is the risk associated with weather changes and climate developments. Weather conditions and climate changes can have a profound impact on the yield of crops and timber, which in turn affects the revenue and returns from these investments.

Drought, floods, storms, and other extreme weather events can damage crops and timber, reducing their yield and quality. Changes in climate can also affect the suitability of land for certain types of crops or timber, potentially reducing its value. Therefore, investors in farmland and timberland need to carefully consider these risks and take appropriate measures to manage them.

B is incorrect. The statement that "Farmland and timberland investments generate returns from selling crops and timber, and the value of the land may also change over time, contributing to the return on these investments" is true. These investments generate income from the sale of crops and timber, and the value of the land can also appreciate over time, providing capital gains.

C is incorrect. The statement that "Smaller investors typically invest in timber and farmland through investment funds, such as real estate investment trusts (REITs) in the United States, or administered privately through limited partnerships" is also true. These investment vehicles provide a way for smaller investors to gain exposure to these asset classes without having to directly own and manage farmland or timberland.

CFA Level I, Alternative Investments, Learning Module 5: Natural Resources. LOS (c): Analyze sources of risk, return, and diversification among natural resource investments.

Q.4467 An investor is considering investing in commodities, and he is particularly interested in gold. In order to profit from this investment, the investor should wait for the gold's price to:

A. depreciate, which should ideally exceed the cost of carry.

B. appreciate, which should ideally exceed the cost of carry.

C. appreciate, which should ideally be less than the cost of carry.

The correct answer is **B.**

The investor should primarily aim for the gold's price to appreciate, which should ideally exceed the cost of carry. Investing in commodities, such as gold, is fundamentally different from investing in traditional assets like stocks and bonds. Commodities do not generate cash flows, and instead, they often incur costs associated with transportation, storage, and insurance. These costs are collectively referred to as the cost of carry. To profit from investing in commodities, an investor must hope for the price of the commodity to appreciate over time.

This price appreciation should ideally be greater than the cost of carry., as the cost of carry. represents a drain on the investor's potential returns. If the price appreciation is less than the cost of carry, the investor would incur a net loss on the investment. Therefore, the primary aim of an investor in commodities should be for the price of the commodity to appreciate by an amount that exceeds the cost of carry.

A is incorrect. If the investor aims for the gold's price to depreciate, they would incur a loss on their investment. This is because the investor would be selling the gold for less than what they initially paid for it, which is not a profitable strategy.

B is incorrect. If the gold's price appreciation is less than the cost of carry, the investor would not make a profit. The cost of carry represents a drain on the investor's potential returns, and if the price appreciation does not exceed this cost, the investor would incur a net loss on the investment.

CFA Level I, Alternative Investments, Learning Module 5: Natural Resources. LOS (b): Describe features of commodities and their investment characteristics.

Q.4468 Governments worldwide are implementing environmental safeguards to meet climate objectives and control activities with significant climate impacts, such as mining, agriculture, and energy extraction and production. The policy objective of reducing reliance on fossil fuels has led to a shift in focus towards electric vehicles and advances in battery technology.
Which of the following is the *most likely* potential impact of this shift on the demand for certain minerals and metals?

A. Lower demand for minerals and metals such as lithium, cobalt, and nickel.

B. Higher demand for minerals and metals such as lithium, cobalt, and nickel.

C. No effect on the demand for minerals and metals such as lithium, cobalt, and nickel.

The correct answer is **B.**

The shift towards electric vehicles and advances in battery technology can lead to higher demand for minerals and metals such as lithium, cobalt, and nickel. These minerals and metals are key components in the production of batteries for electric vehicles. Lithium is used in the production of lithium-ion batteries, which are commonly used in electric vehicles due to their high energy density and long life span. Cobalt and nickel are also used in these batteries to improve their performance and safety.
A is incorrect. The shift towards electric vehicles and advances in battery technology is not expected to lead to lower demand for minerals and metals such as lithium, cobalt, and nickel. On the contrary, as explained above, this shift is expected to increase the demand for these resources.

C is incorrect. The shift towards electric vehicles and advances in battery technology is expected to have a significant impact on the demand for minerals and metals such as lithium, cobalt, and nickel. As explained above, these resources are key components in the production of batteries for electric vehicles, and as such, their demand is expected to increase as the demand for electric vehicles increases.

Q.4469 Which of the following statements is most likely true regarding exchange-traded products (ETPs), commodity trading advisers (CTAs), and specialized funds as alternative methods of gaining commodity exposure?

A. Exchange-traded products (ETPs) cannot invest in commodities or commodity futures and do not charge fees included in their expense ratios.

B. Specialized funds investing involves direct or indirect claims to physical assets themselves and not claims on residual (equity) or fixed (debt) cash flows. This indirect approach comes with the added risks from financing and operations and, when privately held, the impact of additional illiquidity.

C. Commodity trading advisers (CTAs) are managed futures funds that make directional investments primarily in futures markets based on technical and fundamental strategies. Individual investors cannot establish accounts that are managed in accordance with their specific investment preferences and risk tolerance.

The correct answer is **B.**

Specialized funds investing in specific commodity sectors, such as private energy partnerships, enable institutional exposure to the energy sector. These investments usually involve direct or indirect claims to physical assets themselves and not claims on residual (equity) or fixed (debt) cash flows. However, this indirect approach comes with the added risks from financing and operations and, when privately held, the impact of additional illiquidity.
This statement is true because specialized funds allow investors to gain exposure to specific sectors of the commodity market. These funds often invest in physical assets, which can provide a more direct exposure to the commodity market. However, this approach also comes with additional risks, including financing and operational risks, as well as the risk of illiquidity, especially for privately held investments.

A is incorrect. Exchange-traded products (ETPs) can indeed invest in commodities or commodity futures. ETPs such as Exchange-Traded Funds (ETFs) and Exchange-Traded Notes (ETNs) can provide exposure to a wide range of asset classes, including commodities. They also charge fees, which are included in their expense ratios. Therefore, the statement is incorrect.

C is incorrect. Commodity trading advisers (CTAs) are managed futures funds that make directional investments primarily in futures markets based on technical and fundamental strategies. However, it is not true that individual investors cannot establish accounts that are managed in accordance with their specific investment preferences and risk tolerance. Many CTAs offer managed accounts, which can be tailored to the individual investor's risk tolerance and investment objectives. Therefore, this statement is incorrect.

CFA Level I, Alternative Investments, Learning Module 5: Natural Resources. LOS (b): Describe features of commodities and their investment characteristics.

Q.4470 An investor is considering investing in commodities using derivative instruments. They are particularly interested in a futures contract for gold, expecting the price of gold to rise in the future. If the investor expects a high convenience yield due to a preference for holding the physical commodity, how would this *most likely* impact the forward price?

A. No impact on the forward price.

B. Forward price would decrease.

C. Forward price would increase.

The correct answer is **B.**

The forward price would decrease due to the high convenience yield. The convenience yield is the non-monetary advantage or benefit that a holder of the physical commodity, in this case, gold, derives from the direct ownership of the commodity. It could be due to factors such as the ability to meet unexpected demand, avoiding costs of storage, or ensuring supply during times of shortages. The convenience yield represents the benefits of holding the physical commodity, which is foregone when holding a futures contract instead. Therefore, a higher convenience yield makes the futures contract less attractive, leading to a lower forward price.

A is incorrect. The convenience yield does have an impact on the forward price. It is a component of the formula for the forward price and represents the benefits of holding the physical commodity, which are foregone when holding a futures contract. Therefore, a change in the convenience yield would affect the forward price.

C is incorrect. The forward price would not increase due to the high convenience yield. As explained above, the convenience yield is subtracted from the risk-free rate in the formula for the forward price. Therefore, an increase in the convenience yield would decrease, not increase, the forward price.

CFA Level I, Alternative Investments, Learning Module 5: Natural Resources. LOS (b): Describe features of commodities and their investment characteristics.

Q.4471 Which of the following *best* describes the difference between soft and hard commodities?

A. Soft commodities are less volatile in price than hard commodities.

B. Soft commodities are traded more frequently than hard commodities.

C. Soft commodities are agricultural products, while hard commodities include energy and minerals.

The correct answer is **C.**

Soft commodities specifically refer to agricultural products such as crops and livestock, known for being grown and harvested. In contrast, hard commodities include mined or extracted resources like oil, gas, and metals. This fundamental difference in nature and source is what primarily distinguishes the two categories, with soft commodities being renewable and hard commodities generally being non-renewable.

B is incorrect. The trading frequency of commodities is not the primary factor distinguishing soft and hard commodities. Instead, it's their nature and source that set them apart.

A is incorrect. While price volatility can vary between soft and hard commodities, it's not the defining characteristic that differentiates them. Both categories can experience significant price fluctuations based on market conditions.

CFA Level I, Alternative Investments, Learning Module 5: Natural Resources. LOS (b): Describe features of commodities and their investment characteristics.

Q.4472 Which of the following is *most likely* a benefit of farmland investment?

A. High liquidity and low return.

B. Suitable for speculative purposes rather than a long-term investment.

C. There is a potential for regular income through crop sales and lease payments.

The correct answer is **C.**

Farmland can be a valuable component of an investment portfolio, particularly due to its potential for regular income generation. This income can come from the sale of crops grown on the land or through lease payments from farmers. Additionally, farmland can appreciate in value over time, potentially offering capital gains. The nature of farmland as a tangible asset with a fundamental role in food production can make it a stable investment, especially during times of economic uncertainty.

A is incorrect. Farmland investments are typically illiquid, meaning they cannot be quickly converted into cash without a significant loss in value. They are also seen as long-term investments rather than quick, high-return opportunities.

B is incorrect. While all investments carry some level of speculation, farmland is often valued for its long-term investment potential rather than for speculative trading.

CFA Level I, Alternative Investments, Learning Module 5: Natural Resources. LOS (c): Analyze sources of risk, return, and diversification among natural resource investments.

Q.4473 Which of the following is *most likely* a unique characteristic of timberland as an investment?

A. Offer immediate returns due to the fast growth of trees.

B. Timberland is primarily valued for its underlying land rather than the timber it produces.

C. Timberland functions as both a production site and storage, allowing for harvest timing based on market conditions.

The correct answer is **C.**

One of the unique features of timberland as an investment is its dual role as both a production site and a form of storage. The growth of trees, a biological process, continues regardless of market conditions, giving investors the flexibility to harvest timber when prices are favorable. This characteristic can help stabilize returns over time and reduce the impact of short-term market fluctuations. It makes timberland an attractive option for investors seeking long-term, stable returns.

A is incorrect. Timberland investments do not typically offer immediate returns, as the growth of trees is a long-term process.

B is incorrect. While the value of the underlying land is a factor, the timber produced on timberland is a significant source of its value.

Q.4474 In the context of farmland and timberland investments, which of the following is *most likely* a feature that is considered a primary risk factor?

A. Fixed returns on investment.

B. Weather patterns and climate change.

C. Guaranteed price appreciation over time.

The correct answer is **B.**

One of the primary risks in farmland and timberland investments is the impact of weather patterns and climate change, which can significantly affect crop yields and timber growth. These environmental factors are unpredictable and can lead to variability in investment returns. For instance, adverse weather conditions can damage crops or slow timber growth, leading to reduced yields and financial losses.

A is incorrect. Farmland and timberland investments do not typically offer fixed returns; instead, their returns can fluctuate based on a variety of factors, including environmental conditions.

C is incorrect. Price appreciation in farmland and timberland is not guaranteed and can be influenced by a range of market and environmental factors.

CFA Level I, Alternative Investments, Learning Module 5: Natural Resources. LOS (c): Analyze sources of risk, return, and diversification among natural resource investments.

Q.4475 Which of the following *most likely* outlines the importance of Timberland Investment Management Organizations (TIMOs) to institutional investors?

A. TIMOs provide immediate liquidity in timberland investments.

B. TIMOs primarily focus on residential development on timberland.

C. They offer forest investment expertise for managing timberland portfolios.

The correct answer is **C.**

TIMOs are crucial for institutional investors because they provide the necessary forest investment expertise to manage timberland portfolios effectively. This includes selecting appropriate timberland properties, managing them for sustainable yield, and making informed decisions about when to harvest or sell the timber. Their expertise is vital for maximizing the returns from timberland investments.

A is incorrect. TIMOs do not typically provide immediate liquidity in timberland investments, which are generally considered long-term investments.

B is incorrect. TIMOs do not primarily focus on residential development; their main focus is on timberland investment and management.

CFA Level I, Alternative Investments, Learning Module 5: Natural Resources. LOS (c): Analyze sources of risk, return, and diversification among natural resource investments.

Q.4476 Which of the following is *most likely* an investment characteristic of farmland and timberland?

A. They offer guaranteed returns with minimal risk.

B. They investments are highly liquid and easily tradable.

C. The requirement for high technical knowledge for investment.

The correct answer is **C.**

A significant challenge in direct investments in farmland and timberland is the requirement for high technical knowledge and expertise. Investors need to understand the nuances of agricultural and timber markets, soil quality, environmental factors, and sustainable land management practices. This complexity can be a barrier for investors who lack the necessary expertise.

A is incorrect. Direct investments in farmland and timberland do not offer guaranteed returns and can carry significant risks.

B is incorrect. These assets are typically illiquid and not easily tradable, unlike more conventional investment assets like stocks and bonds.

CFA Level I, Alternative Investments, Learning Module 5: Natural Resources. LOS (c): Analyze sources of risk, return, and diversification among natural resource investments.

Q.4477 Which of the following statements is *most likely* accurate about the factors influencing the returns and cycles of a portfolio that includes commodities, farmland, and timberland?

A. Commodity prices, farmland returns, and timberland returns are all primarily driven by global supply and demand dynamics.

B. Commodity prices, farmland returns, and timberland returns each have distinct factors influencing their returns and cycles.

C. Farmland returns are primarily influenced by global supply and demand dynamics, while timberland returns are driven by geopolitical events.

The correct answer is **B.**

Commodity prices, farmland returns, and timberland returns each have distinct factors influencing their returns and cycles. While there may be some overlap in the factors that influence these asset classes, each has unique drivers and cycles.

Commodity prices are influenced by global supply and demand dynamics, geopolitical events, and currency fluctuations. Farmland returns are influenced by factors such as crop yields, land value appreciation, and government policies.

Timberland returns can be impacted by timber growth rates, timber prices, and land value appreciation. Therefore, it is not accurate to say that all three asset classes are primarily driven by the same factors or that only two of the asset classes are influenced by the same factors. Understanding the unique drivers and cycles of each asset class can help investors make informed decisions about portfolio diversification and risk management.

A is incorrect. While global supply and demand dynamics can influence commodity prices, farmland returns, and timberland returns, they are not the primary driver for all three asset classes. As mentioned above, farmland returns and timberland returns are influenced by a variety of other factors, including crop yields, land value appreciation, government policies, timber growth rates, and timber prices.

C is incorrect. This statement incorrectly suggests that farmland returns are primarily influenced by global supply and demand dynamics and that timberland returns are driven by geopolitical events. While these factors can influence the returns of these asset classes, they are not the primary drivers. Farmland returns are influenced by factors such as crop yields, land value appreciation, and government policies, while timberland returns can be impacted by timber growth rates, timber prices, and land value appreciation.

CFA Level I, Alternative Investments, Learning Module 5: Natural Resources. LOS (c): Analyze sources of risk, return, and diversification among natural resource investments.

Q.4478 Which of the following statements is *most likely* accurate about the pricing mechanisms for commodities and land?

A. Land prices fluctuate more rapidly throughout the trading day than commodity prices.

B. Commodities and land are both priced on a second-by-second basis on public exchanges.

C. Commodity prices are constantly changing on public exchanges, while land prices are updated less frequently.

The correct answer is **C.**

Commodity prices are constantly changing on public exchanges, while land prices are updated less frequently. Commodities like crude oil are traded on public exchanges, where their prices can fluctuate rapidly throughout the trading day. This is due to the high liquidity and high volume of trading in commodity markets.

On the other hand, assets like farmland have an infrequent pricing mechanism, with prices only updated when a transaction occurs. This is because land is an illiquid asset, and transactions occur less frequently. Therefore, the pricing mechanism for land is less dynamic and more infrequent compared to commodities. This difference in pricing mechanisms reflects the different characteristics of these asset classes, including their liquidity, transaction frequency, and market structure.

A is incorrect. Land prices do not fluctuate more rapidly throughout the trading day than commodity prices. In fact, the opposite is true. Commodity prices fluctuate more rapidly due to the high liquidity and high volume of trading in commodity markets, while land prices are updated less frequently due to the infrequent nature of land transactions.

B is incorrect. Commodities and land are not both priced on a second-by-second basis on public exchanges. While commodities are traded on public exchanges and their prices can fluctuate rapidly, land is not traded on public exchanges and its prices are updated less frequently.

CFA Level I, Alternative Investments, Learning Module 5: Natural Resources. LOS (b): Describe features of commodities and their investment characteristics.

Q.4479 Which of the following is *most likely* a potential advantage of investing in commodities and a potential disadvantage of investing in farmland and timberland?

A. Commodities offer stable cash flows and potential for value appreciation, while farmland and timberland offer high liquidity and price transparency.

B. Commodities offer high liquidity and price transparency, while farmland and timberland can be illiquid and subject to various risks, such as changes in government policies.

C. Commodities are subject to various risks, such as weather events and changes in government policies, while farmland and timberland offer high liquidity and price transparency.

The correct answer is **B.**

Commodities, such as gold, oil, and agricultural products, are traded on global exchanges and offer high liquidity and price transparency. This means that investors can easily buy and sell these assets at any time, and the prices are readily available and updated in real time. This is a significant advantage for investors who need flexibility and want to be able to react quickly to market changes.
On the other hand, farmland and timberland are real assets that can be illiquid, meaning they can be difficult to sell quickly without potentially incurring a significant loss. They are also subject to various risks, such as weather events and changes in government policies. For example, a severe drought or a change in agricultural subsidies could significantly impact the value of these assets. Therefore, while they can provide diversification benefits and potential for long-term returns, they also come with certain challenges that investors need to consider.

A is incorrect. Commodities do not typically offer stable cash flows as their prices can be highly volatile and influenced by a wide range of factors, including supply and demand dynamics, geopolitical events, and macroeconomic conditions. On the other hand, farmland and timberland do not generally offer high liquidity and price transparency. These assets are not traded on exchanges, and their prices can be difficult to determine, especially in the absence of recent comparable sales.

C is incorrect. While it is true that commodities are subject to various risks, such as weather events and changes in government policies, these are not advantages but rather challenges associated with investing in these assets. Similarly, farmland and timberland do not typically offer high liquidity and price transparency, which are considered disadvantages rather than benefits of investing in these assets.

CFA Level I, Alternative Investments, Learning Module 5: Natural Resources. LOS (b): Describe features of commodities and their investment characteristics.

Q.4480 Consider a scenario where you are an investor looking to diversify your portfolio. You decide to invest in commodities, specifically wheat, due to its potential for returns and inflation protection. Given this information, which of the following actions would *most likely* show you that there is an imminent increase in the price of wheat in the short term?

A. A large number of investors buy wheat futures contracts.

B. There is an unexpected increase in the production of wheat due to favorable weather conditions.

C. There is a sudden decrease in the demand for wheat from bakeries and food processing companies.

The correct answer is **A.**

When a large number of investors decide to buy wheat futures contracts, it is likely to increase the price of wheat in the short term. When investors buy futures contracts, they are essentially betting that the price of the commodity will rise in the future.

This increased demand for futures contracts can drive up the price of the underlying commodity, in this case, wheat. This is due to the fact that futures prices are often used as a benchmark for spot prices in the physical market.

B is incorrect. An unexpected increase in the production of wheat due to favorable weather conditions would most likely lead to a decrease in the price of wheat, not an increase. This is because when the supply of a commodity increases, its price tends to fall, assuming that demand remains constant. This is yet another basic principle of supply and demand.

C is incorrect. A sudden decrease in the demand for wheat from bakeries and food processing companies would most likely lead to a decrease in the price of wheat, not an increase. This is because when demand for a commodity decreases, its price tends to fall, assuming that supply remains constant. This is another basic principle of supply and demand.

CFA Level I, Alternative Investments, Learning Module 5: Natural Resources. LOS (b): Describe features of commodities and their investment characteristics.

Q.4481 Which of the following events would *most likely* lead to the worst performance for both global stocks and commodities?

A. A global economic recovery following a financial crisis.

B. A global financial crisis leading to economic uncertainty.

C. A sudden increase in the demand for oil outpacing supply.

The correct answer is **B.**

A global financial crisis leading to economic uncertainty would most likely lead to the worst performance for both global stocks and commodities. During a financial crisis, investors tend to move away from riskier assets such as stocks and commodities and towards safer assets such as government bonds. This can lead to a decrease in the prices of both stocks and commodities.
Furthermore, a financial crisis often leads to a decrease in economic activity, which can reduce the demand for commodities, leading to a further decrease in their prices. In addition, during times of economic uncertainty, companies may cut back on their production and investment activities, which can lead to a decrease in their stock prices.

A is incorrect. A global economic recovery following a financial crisis would likely lead to an increase in the prices of both global stocks and commodities. During an economic recovery, companies' earnings typically increase, which can lead to an increase in their stock prices. Furthermore, an economic recovery often leads to an increase in demand for commodities, which can lead to an increase in their prices.

C is incorrect. A sudden increase in the demand for oil outpacing supply would likely lead to an increase in the price of oil, a commodity. This could potentially have a positive impact on the performance of commodities as an asset class. However, the impact on global stocks is less clear. While companies in the oil and gas sector may benefit from higher oil prices, companies in other sectors may face higher costs, which could negatively impact their earnings and stock prices.

CFA Level I, Alternative Investments, Learning Module 5: Natural Resources. LOS (b): Describe features of commodities and their investment characteristics.

Q.4482 Which of the following statements is *most likely* accurate regarding the relationship between inflation and natural resource performance?

A. Commodities, particularly gold, tend to perform better during periods of high inflation, regardless of other market conditions.

B. In stable inflation environments, commodity returns have generally been low but positive, as the real return on commodities tends to be lower.

C. The investment performance of farmland or timberland significantly varies in different inflation environments due to factors such as weather conditions, supply and demand dynamics, and government policies.

The correct answer is **C.**

The statement that the investment performance of farmland or timberland significantly varies in different inflation environments due to factors such as weather conditions, supply and demand dynamics, and government policies is the most accurate. The performance of these types of commodities is influenced by a variety of factors, including inflation, but also other factors that can have a significant impact on their value.

For example, weather conditions can affect crop yields, which in turn can affect the price of farmland. Similarly, supply and demand dynamics can have a significant impact on the price of timberland. Government policies can also play a role, as they can affect the cost of production, the availability of subsidies, and the demand for certain types of commodities. Therefore, while inflation is an important factor to consider when investing in these types of commodities, it is not the only factor that can affect their performance.

A is incorrect. While it is true that commodities, particularly gold, can perform well during periods of high inflation, this is not always the case. The performance of commodities can be influenced by a variety of other factors, including supply and demand dynamics, geopolitical events, and changes in technology. Therefore, it is not accurate to say that commodities always perform better during periods of high inflation, regardless of other market conditions.

B is incorrect. While it is true that commodity returns can be low in stable inflation environments, this is not always the case. The performance of commodities can be influenced by a variety of factors, including supply and demand dynamics, geopolitical events, and changes in technology. Therefore, it is not accurate to say that commodity returns are always low but positive in stable inflation environments.

CFA Level I, Alternative Investments, Learning Module 5: Natural Resources. LOS (c): Analyze sources of risk, return, and diversification among natural resource investments.

Q.4483 Which of the following statements is *most likely* to be correct? Alternative asset classes such as farmland, timberland, and commodities have

A. no correlation with traditional assets like stocks and bonds.

B. high correlations with traditional assets like stocks and bonds.

C. historically shown low correlations with traditional assets like stocks and bonds.

The correct answer is **C.**

Historically, alternative asset classes such as farmland, timberland, and commodities have shown low correlations with traditional assets like stocks and bonds. This is one of the main reasons why financial advisors consider these alternative asset classes for diversification purposes. The low correlation means that these assets do not move in tandem with traditional assets. Therefore, when stocks and bonds are performing poorly, these alternative assets may perform well, and vice versa.

A is incorrect. It is not accurate to say that alternative asset classes such as farmland, timberland, and commodities have no correlation with traditional assets like stocks and bonds. While the correlation is typically low, it is not zero. There can be periods when these asset classes move in the same direction as traditional assets, even if the overall long-term correlation is low.

B is incorrect. Alternative asset classes such as farmland, timberland, and commodities do not have high correlations with traditional assets like stocks and bonds. While there may be periods when these asset classes move in the same direction as traditional assets, over the long term, they have shown low correlations. This is due to the unique factors that drive the returns of these alternative assets, which are different from the factors that drive the returns of stocks and bonds.

CFA Level I, Alternative Investments, Learning Module 5: Natural Resources. LOS (c): Analyze sources of risk, return, and diversification among natural resource investments.
