

Biz Brain: The Best Way To Buy Commodities

By Karin Price Mueller | NJMoneyHelp.com for NJ.com
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Q. I hear I should have alternative investments. What are the best ways to buy commodities? I have no time to watch the market every day. — Needing Guidance

A. Alternative investments can be a good diversifier for your portfolio, and they've gained popularity in recent years.

It used to be that investors who bought alternatives hoped for hedge fund-like, high-powered performance. Not anymore.

In the wake of the 2008 financial crisis, there was a boom in new alternatives, said George Kiraly, a certified financial planner with LodeStar Advisory Group in Short Hills.

He said investors now turn to alternatives to diversify and improve the overall risk-return characteristics of their portfolios. They're also used to meet other critical investment goals, such as inflation protection and income generation, all with low or no correlation to the capital markets, Kiraly said.

Used appropriately, he said, alternative investments can be very useful in managing risk. But they can be complex and require more attention than your average fund.

Kiraly said there are more than 700 mutual and exchange-traded funds (ETFs) that embrace hedge fund-like strategies.

"Due diligence is more important than ever in the alternatives universe," Kiraly said. "Many of these products come with high fees, obscure risk and poor historical performance. If you're going to invest in alternatives, you'll need to weed out the poorer options and monitor your choices closely, post-investment."

Broadly speaking, Kiraly said, alternatives are investments in assets other than stocks, bonds and cash. Alternative fund managers also use strategies that go beyond traditional ways of investing, such as long/short, arbitrage or absolute return strategies, he said.

Alternatives, including commodities, tend to behave differently than typical stock and bond investments, he said. That's why adding them to a portfolio may provide broader diversification, reduce risk, and enhance returns.

Now to your specific question on commodities.

Commodities consist of four main categories: agriculture, livestock, precious metals and energy, Kiraly said.

"The commodities markets generally aren't for the faint of heart," he said. "They can be quite volatile. The best way to reduce volatility is to invest in commodity funds, either a mutual fund or exchange-traded fund."

On Morningstar.com, you can find a listing of commodity mutual funds and commodity ETFs.

As a potential commodity investor, Kiraly said, you should be aware that commodity funds have had long stretches of subpar performance.

He said according to the CFA Institute, from December 2004 to June 2015, the total return of the S&P GSCI commodity index was -4.6 percent a year, much lower than the +7.4 percent return of the S&P 500 Index and the +4.5 percent return of the Barclays US Aggregate Bond Index.

"Perhaps the next decade will be different. Who knows?" Kiraly said. "Commodity investments did rebound in 2016 to post their best year since 2010, returning over +11 percent."

Generally, allocating 10 to 20 percent of a portfolio to alternative investments, including commodities, may be considered appropriate, although it depends on your specific financial situation, Kiraly said.

Investors have, no doubt, become more intrigued with alternative-focused mutual and exchange-traded funds. Many top-tier firms have lowered annual fees and minimum investment requirements, which in the past, served as barriers to entry for those who wanted to invest in hedge-fund-like investments, Kiraly said.

"If you're considering the addition of an alternative fund or two in your portfolio, be sure to compare fees, liquidity, transparency and the manager's track record," he said. "Stick with very large, institutional-quality managers that have been around for a long time."

And remember, most alternative investments are designed to outperform over a long time horizon, so if you're a short-term investor, alternatives will probably disappoint you, he said, so be prepared to hold them for several years.

Email your questions to Ask@NJMoneyHelp.com.

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