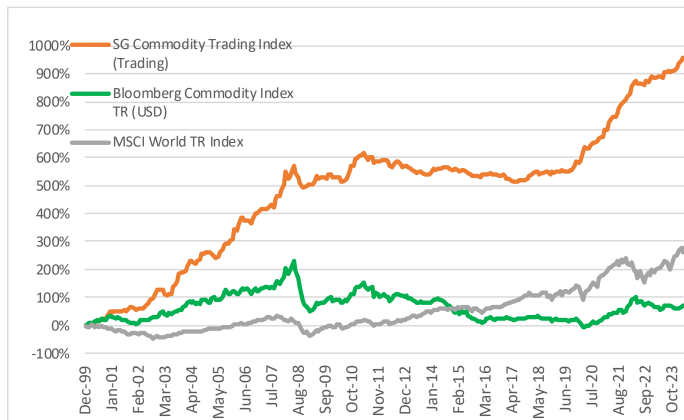
Crossbow Partners
Experience & Discipline

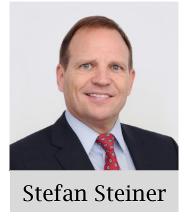
Market Update July 2024

Commodity investments for portfolio diversification

Commodities had a strong price movement in the 2000s and were abruptly stopped by the 2008 financial crisis. After a brief rebound, a 10-year bear market followed until the summer of 2020. The Bloomberg Commodity Index was thus back at its starting point after 20 years. The situation looks better for commodity trading strategies (represented by the SG Commodity Trading Index) that were able to take long and short positions. Here, capital was largely preserved in the bear market and the total return over the 24 years is significantly better than long-only commodity investments or stock market investments measured by the MSCI World TR Index as shown in the chart.

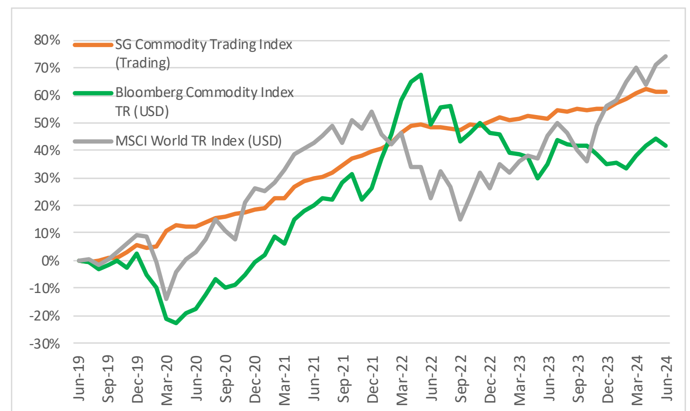


For the past 4 years, commodity markets have turned and prices have risen significantly. This is due to a lack of investment during the bear market and the global shift towards renewable energies. Added to this was Russia's war of aggression against Ukraine, which triggered shortages. We believe that this commodity cycle will continue for some time and commodity traders will benefit from large price movements in both directions. Commodity prices are still record low compared to stock prices, which makes a shift from equity to commodity strategies attractive and significantly reduces the risk of the overall portfolio through diversification effects.



Stefan Steiner

The chart below illustrates how commodity markets turned around after the Covid pandemic and achieved similar returns to equity markets since the summer of 2020. The commodity trend should continue, while consolidation in equities is becoming increasingly likely.



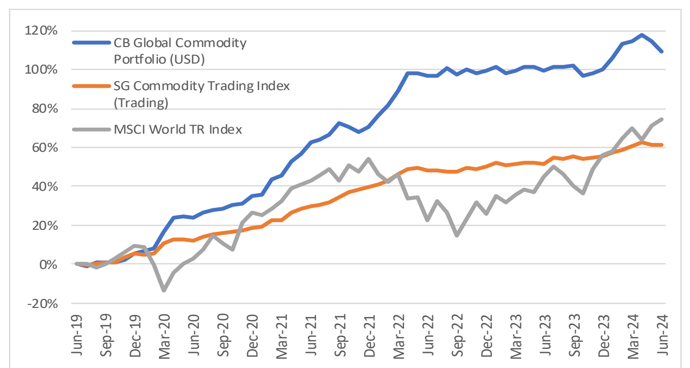
For a more detail discussion or more information by e-mail, please contact ss@cb-partners.com.

In the spotlight

The CB Global Commodity Portfolio (USD) has outperformed the SG Commodity Trading Index over the past five years and has also outperformed global equities. In addition, the correlation with equities and bonds was even slightly negative thanks to a double-digit positive return that was achieved in the 2022 correction.

	CB Global Commodity Portfolio	SG Commodity Trading	MSCI World TR Index (USD)	FTSE WGBI USD hedged
CB Global Commodity Portfolio (USD)	1.00	0.80	-0.07	-0.16
SG Commodity Trading Index (Trading)	0.80	1.00	-0.03	-0.17
MSCI World TR Index (USD)	-0.07	-0.03	1.00	0.43
FTSE WGBI USD hedged	-0.16	-0.17	0.43	1.00

The next chart shows the portfolio performance in comparison with the SG Trading Index and the MSCI World TR Index since July 2019.



The Commodity Portfolio currently consists of seven underlying managers who are specialists in their niches and together manage a global and diversified exposure. We have other very interesting funds in the pipeline and will expand to 10 managers, which will further increase the stability of the Commodity Portfolio.

The Case for Commodity Hedge Funds

Commodities should be part of an investor's portfolio, as they provide many attractive features: Potential strong performance (although volatile), low correlation to other asset classes, differentiated return drivers (supply & demand, weather, etc.) than other financial markets.

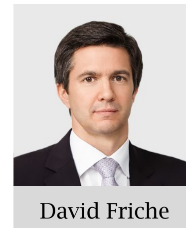
However, investing passively and/or long-only in commodities can bring several drawbacks, including the possible negative impact of roll yields when investing through commodity futures contracts, and long periods of negative returns (see first chart on previous page).

The benefits of active trading strategies

Commodity hedge funds, through their active investment approach, can mitigate and even benefit from those situations. They can indeed take advantage of rising and declining markets through long, short and relative value trades, reduce downside through active risk management, and reduce or avoid negative roll yields. Specialist commodity managers can thus capitalize on price moves in specific markets driven by e.g. supply & demand or weather shocks, as it was the case recently with extreme moves in the cocoa market.

The opportunity set

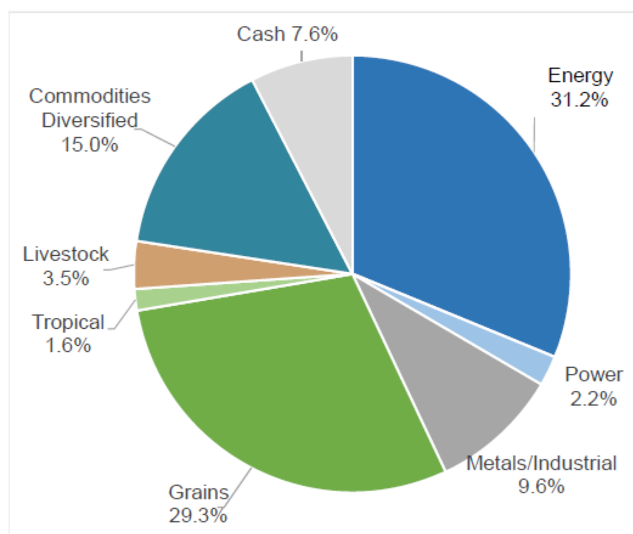
Commodity prices are currently influenced by a variety of factors, including energy transition, growing commodity consumers (e.g. India), prolonged lack of investments in commodity extraction and production, weather changes. This can cause large supply & demand imbalances and corresponding price moves. Moreover, on a long-term historical basis, commodities look deeply undervalued compared to other risk assets such as equities.


David Friche

Portfolio of commodity specialists

Given the specific investment opportunities within commodities, which can be very different from energy to metals and agriculture, we favour investing in sector specialists, who benefit from extensive experience in the markets they trade.

We also recommend to diversify across investment strategies (which can span from directional to relative value), investment process (discretionary or systematic), and time horizons (from short-term to long-term), in order to build a robust portfolio of commodity managers providing uncorrelated alpha sources.



The pie chart shows a recent snapshot of the sector exposure of the CB Global Commodity Portfolio advised by Crossbow Partners. Positions within sectors will change over time, examples could be long crude oil, short copper, time spreads in soybeans. The managers implement positions through liquid, listed commodity derivative contracts (the portfolio has no or only limited equity exposure).

The above sector allocation is also dynamic, as we constantly seek to optimize the portfolio by adding alpha (rather than beta) oriented commodity managers in order to further improve the portfolio's risk/return profile. We are currently working on compelling managers in the energy and metals sectors.

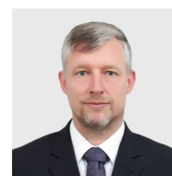
Source:s Crossbow Partners, Quest Partners, Bloomberg

For more information please an e-mail to David Friche at df@cb-partners.com.

Ten Common Mistakes Investors Make When Allocating to Hedge Funds

In a paper, Francois-Serge Lhabitant identifies the "ten most common mistakes" that investors make when allocating to hedge funds:

1) **Targeting Decorrelation**: Investors often seek hedge funds that are uncorrelated with traditional assets. However, this can be misleading as correlations are often misunderstood and do not necessarily predict future returns.
2) **Using Hedge Fund Indices**: Many investors rely on hedge fund indices, which are often distorted and unrepresentative. These indices often do not offer true alpha and are over-diversified.
3) **Minimizing Fees**: While high fees are criticized, low fees often result in less qualified managers. It is more important to focus on net returns rather than the level of fees.
4) **Choosing High Sharpe Ratio Funds**: The Sharpe Ratio measures risk-adjusted return, but focusing solely on high Sharpe Ratios can be misleading. A combination of funds with high Sharpe Ratios does not necessarily result in a better portfolio.
5) **Behaving Like a Hedge Fund Manager**: Investors should not try to time hedge fund managers or choose managers who share their own market views. Instead, they should select high-quality hedge funds and leave tactical decisions to the managers.
6) **Over-Diversifying:** Too many hedge funds in a portfolio can lead to alpha dilution and increased market risk. A targeted selection of hedge funds is more effective.
7) **Underestimating Short Volatility Strategies**: Some hedge fund strategies resemble selling put options and involve significant risks. These risks must be recognized and, if necessary, hedged.
8) **Neglecting Operational Due Diligence**: Many investors skimp on operational due diligence, leading to avoidable losses. Thorough scrutiny is essential.
9) **Using Static Linear Models:** Linear regression models do not capture the complexity of hedge fund strategies. Alpha calculations are often misleading as they do not reflect actual risk profiles.
10) **The Power of Pie Charts**: Traditional asset allocation charts are not suitable for hedge funds. A flexible and differentiated approach is required to consider the unique strategies and risks.


Armin Vogel

By avoiding these mistakes and conducting thorough due diligence, investors can improve their chances of successful hedge fund investments.

Are Crypto Hedge Funds the Rising Star?

In their work, authors Chen and Huang compare the performance of crypto hedge funds with conventional strategies. The study employs a non-parametric and utility-based measure known as "Almost Stochastic Dominance" (ASD), a criterion for evaluating distributions, allowing minor deviations from perfect dominance to reflect realistic investor preferences. Two new performance indices consistent with this measure are proposed.

The analysis of data from July 2013 to July 2022 reveals that crypto hedge funds outperform other funds over one-, two-, and three-year investment horizons. The indices suggest that equity hedge, risk parity, and relative value strategies outperform event-driven, fund of funds, and macro strategies over these investment periods.

These results highlight the performance of crypto hedge funds and underscore their potential role as a leading investment strategy in the hedge fund industry. Given the exponential growth of the digital asset market and the increasing acceptance of cryptocurrencies, this development could have significant implications for investors and hedge fund managers.

Furthermore, the study highlights the impact of integrating digital assets into traditional portfolios. As the financial landscape evolves, crypto hedge funds' ability to adapt and innovate positions them as key players. This growth attracts high-net-worth individuals and institutional investors, signaling a transformative shift in investment approaches.

If you would like to receive the above mentioned papers, please contact Armin Vogel at av@cb-partners.com.