



# SPECIAL COMMODITIES REPORT



## A Case for Commodities in a Rising Rate Environment

Commodities are one of the most unappreciated areas of the market today, with fund managers holding an extremely underweight position that hasn't been seen since late 2008. Compiled data suggest that as expectations of an economic recovery grow, rates will rise, and in this environment, portfolios without an allocation to commodities and energy and material stocks risk missing out on the potential rally.

### KEY POINTS:

- Growth and rising rates have historically been a powerful combination for countries that are proxies for global growth.
- Timing is an important consideration. Materials and energy stocks have moved higher before the Federal Reserve begins raising interest rates.
- Of three scenarios for rising bond yields, basic resources outperformed in two.
- The 1970s inflationary environment provides historical perspective on the outperformance of real assets.
- Investors' current underweight in commodities bears striking resemblance to late 2008 and early 2009, shortly before commodities and commodities stocks experienced a huge rally.
- With uncertainty today, we suggest diversifying across commodities.

## As Economy Heats Up, Research Shows that Commodities Should Too

Following an injection of \$12 trillion and 515 rate cuts by the world's central banks since March 2009, the global economy's heart is beginning to beat again. A robust economic recovery is underway and expectations are climbing that this growth will continue. As a result, interest rates have been increasing.

According to Goldman Sachs, higher U.S. rates do not hurt Asian equities. Since 1990, there were 35 periods in which U.S. rates rose 50 basis points or more, and 75 percent of the time, the MSCI All Country Asia Pacific (excluding Japan) Index (MXAPJ) climbed higher, says Goldman.

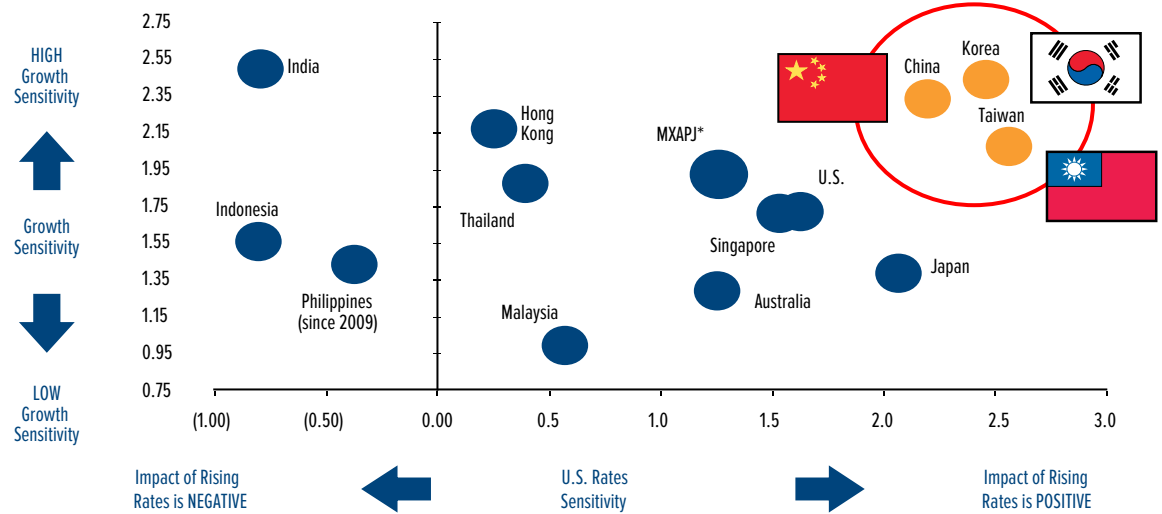
The research firm plotted Asian countries and Australia according to their growth sensitivity compared to their U.S. rate sensitivity. You can see

the graph shows the MXAPJ tends to be positively impacted by rising rates in the U.S. and is relatively growth sensitive.

Across Asia, China, Korea and Taiwan are the most positively affected by rising rates. These three countries are also the highest growth-sensitive areas of the world. That makes today's situation of economic growth with rising rates a powerful combination for commodity investors. When economies such as China and Korea are growing, their use of commodities tends to expand as well.

On the opposite end of the spectrum, countries such as India, Indonesia and the Philippines are negatively impacted by rising rates, as their economies are domestically driven and do not benefit from rising growth expectations in the U.S.

### Rising Rates and Better Growth Positively Affected Countries that are Proxies for Global Growth



\*MSCI All Country Asia Pacific (excluding Japan) Index

Source: FactSet, MSCI, GS Global ECS Research

Past performance does not guarantee future results.

## The Key is to Take Action

Don't wait for the Fed to officially raise rates, as research shows that investors historically benefited most from materials and energy stocks by getting in before rates increased. Take a look at William O'Neil & Co.'s table below, which illustrates how critical it was to be invested in commodities before rates increased.

The firm looked at individual sectors, such as retail, technology, and utilities, along with broad

indices, including the S&P 500 Index, the Dow Jones Industrial Average and the Nasdaq over four decades. It calculated the gains not only received during the period of the rate increases, but also six months prior to the initiation of rate increases.

In every instance, the energy sector performed "extremely well during these periods," with basic materials also outperforming, says William O'Neil.

### Energy and Materials Have Shown Most Outperformance During Rate Increase Periods

Percent Gain by Sector and Index

| Period of Rising Rates         | Best-Performing Sector | Sector Gain | Best-Performing Index     | Index Gain |
|--------------------------------|------------------------|-------------|---------------------------|------------|
| August 1971 - March 1974       | Materials              | 27%         | S&P 500                   | 0%         |
| July 1976 to February 1980     | Energy                 | 62%         | Nasdaq                    | 59%        |
| February 1987 to March 1989    | Energy                 | 16%         | Dow Jones Industrial Ave. | 5%         |
| November 1993 to February 1995 | Health Care            | 22%         | Dow Jones Industrial Ave. | 8%         |
| February 1999 to May 2000      | Energy                 | 46%         | Nasdaq                    | 45%        |
| January 2004 to July 2006      | Energy                 | 82%         | S&P 500                   | 11%        |

Source: William O'Neil & Co.

Past performance does not guarantee future results, and it is possible to lose capital invested.

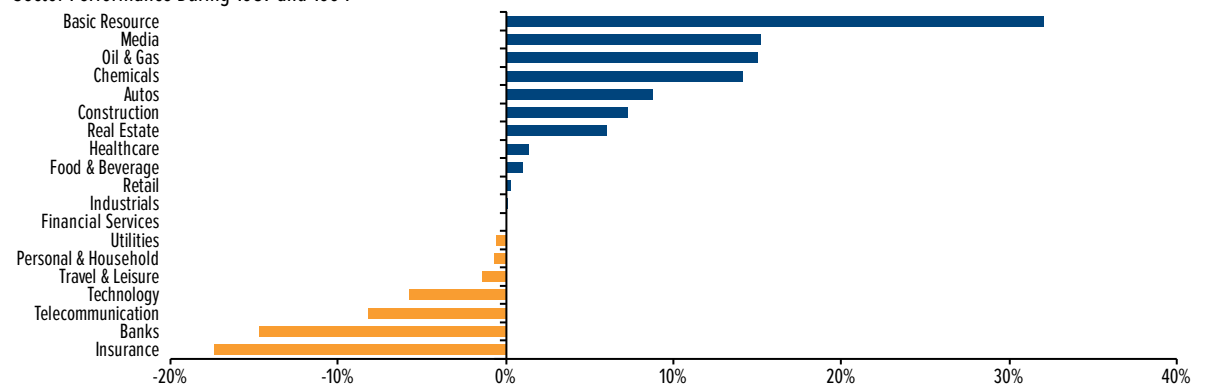
## Basic Resources Have Outperformed When Bond Yields Spiked

An allocation to commodities becomes even more significant if the market sees bond yields spike. Of three scenarios for rising bond yields, Bank of America Merrill Lynch (BofA-ML) found that when there were "disorderly spikes," basic resources were "extreme outperformers."

There were two times this occurred: in 1987 and again in 1994. Yields increased more than 200 basis points, representing an extreme 2 standard deviation move over three months. In addition, employment was improving in the U.S. and there was an expectation of rising inflation. In this environment, basic resources rose more than 30 percent, followed by oil & gas stocks and chemicals.

### Basic Resources Have Outperformed When Bond Yields Spiked

Sector Performance During 1987 and 1994



Source: BofA Merrill Lynch Global Research estimates

## A Rerun of That '70s Show?

While the market is not expecting steep inflation today, do not dismiss the possibility given the global excess liquidity and rising labor costs around the world. After two decades of an ever-increasing supply of global labor due to the collapse of communism and the opening up of China, India and Eastern Europe, salaries are now beginning to rise. In 2012, the minimum wage in China increased 13.7 percent, while wages overall grew about 11 percent. In addition, China's 5-year plan includes increasing minimum wages by at least 13 percent each year.

Food and energy costs will likely rise for many emerging consumers, which should lift global inflation, and in this case, history shows it makes sense to hold real assets.

A decade ago, Investment Advisers Stephen Leeb and Donna Leeb wrote a very informative book on how to profit from the "turbulent post-technology market boom." The book, *Defying the Market*, discussed how to protect against deflationary and inflationary scares, comparing investment ideas that were likely novel to many people in their day, including energy, food, gold, and small-cap stocks.

One of their tables listed the performance of these investments during an earlier era when Americans faced high inflation — the 1970s.

In that decade, gold, silver and oil outperformed many other areas of the market. Gold stocks rose 28 percent on an annualized basis and oil companies grew 14 percent. The S&P 500 Index, on the other

hand, grew 8.4 percent on a nominal basis. After factoring in sky-high inflation of 8.10 percent, gold and oil still added significant real returns. The real return of the overall stock market, on the other hand, was nearly zero.

### Will Commodity Investors See a Rerun of That '70s Show?

| Nominal Annualized Returns |        |
|----------------------------|--------|
| Gold/Silver                | 33.10% |
| Gold Stocks                | 28.00% |
| Oil                        | 26.40% |
| Oil stocks                 | 14.20% |
| Equity REITs               | 12.10% |
| Commodities                | 11.00% |
| Real Estate                | 10.10% |
| S&P 500 Index              | 8.40%  |
| CPI                        | 8.10%  |
| T-Bills                    | 6.80%  |
| Government Bonds           | 3.90%  |

Source: *Defying the Market*, Stephen Leeb and Donna Leeb, Leeb Investment Advisors

*"Stocks leveraged to growth, such as the oils and oil drillers, did splendidly. But the big-cap stocks [i.e. the general market] ... were complete duds,"* wrote the Leebes.

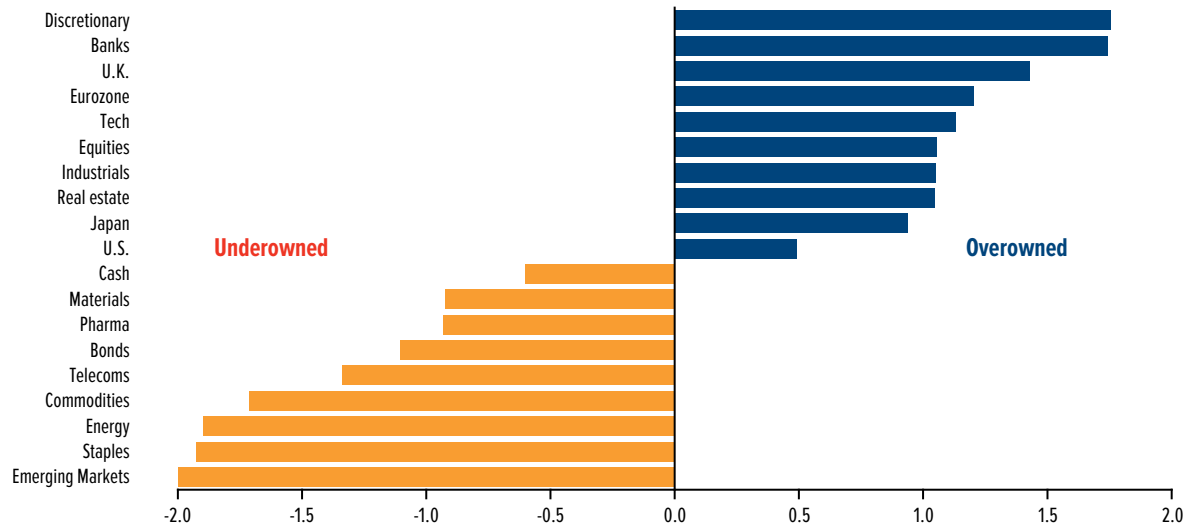
While it is still too early to tell whether investors will see "That '70s Show" again, one valid consideration to protect from inflationary measures is an allocation to real assets, such as commodities.

## Commodities are Underowned by Investors

U.S. Global research has shown that portfolios have been maintaining a persistent underweight in the commodity area for some time and recent monthly survey data from BofA-ML has been reinforcing this analysis. We believe a reversion to the mean is overdue.

According to BofA-ML's Global Fund Manager Survey of around 250 participants who collectively manage between \$600 and \$700 billion, energy, materials and commodities are among the most underowned asset classes in a comparison of the global asset class positioning to historical data.

### Global Asset Class Positioning Compared to Historical Data



Source: Bank of America Merrill Lynch, historical data for commodities and real estate since 2006; for equities, bonds and cash since 2001

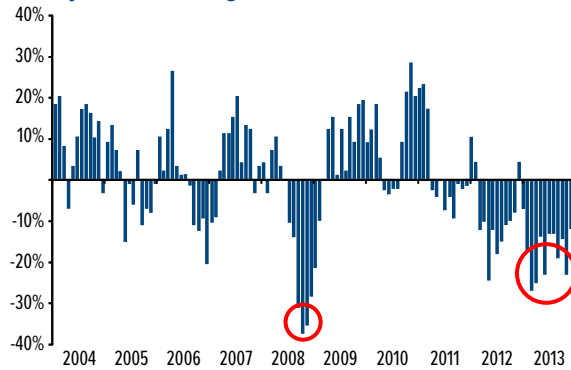
The previous (and nearly only) time fund managers had such a significant underweight in global energy was at the end of 2008 and the beginning of 2009. In materials, there were many more times in the last decade that managers chose to have an underweight allocation. But again, the magnitude of today's allocation decision matches what we saw in the 2008–2009 timeframe. A similar trend emerges

for commodities, as an asset allocation indicating an overweighting in commodities hasn't been this negative since 2008–2009.

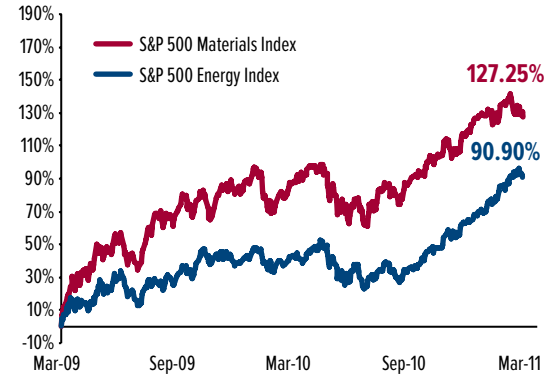
Given the historical trend in late 2008 and early 2009 when managers were invested in other areas of the market, many likely missed the huge rally in energy and materials stocks and commodities.

**Underweights are Similar to 2008, Shortly Before Energy Stocks, Materials Stocks and Commodities Took Off**

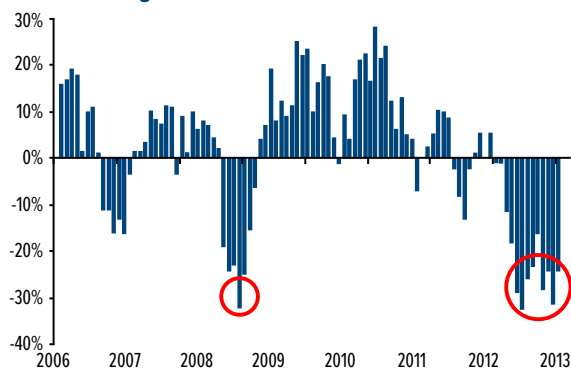
**Survey of Fund Managers Allocation to Global Materials**



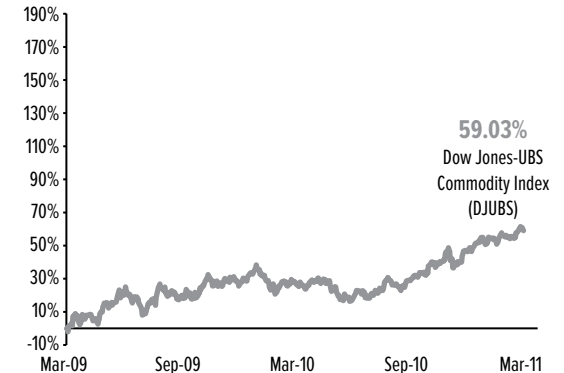
**Two-Year Cumulative Total Return**



**Net Overweight Allocation to Commodities**



**Two-Year Cumulative Total Return**

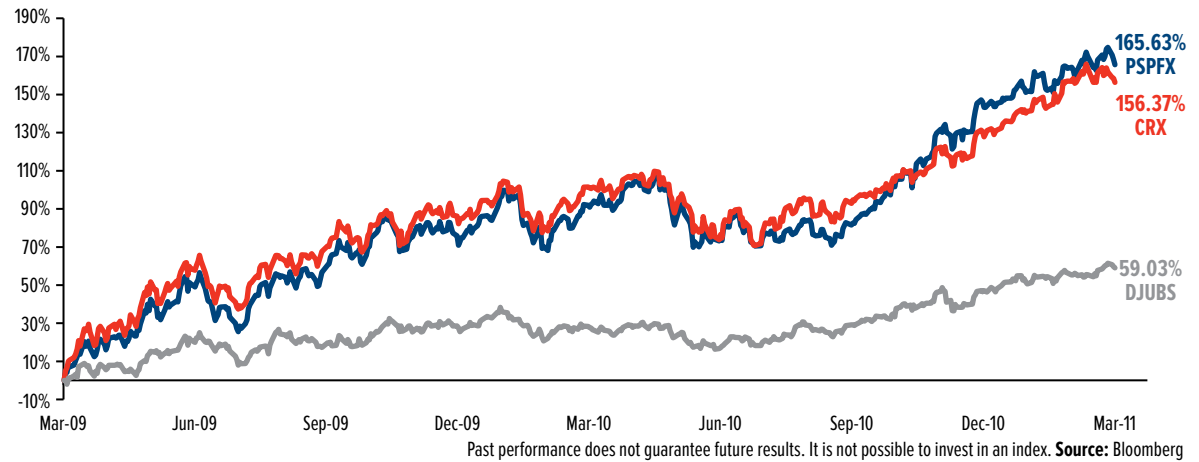


Past performance does not guarantee future results. It is not possible to invest in an index. **Source:** Bank of America Merrill Lynch, Bloomberg

It's important to note that the rally in commodity stocks was even more significant than commodities futures. In the same time frame, the Morgan Stanley Commodity Related Equity Index (CRX) grew 156 percent on a cumulative basis over the next

two years. This is more than twice the return of commodities futures. The Global Resources Fund (PSPFX) grew even more than the CRX, rising 166 percent over that same period.

### Global Resources Fund (PSPFX) Grew Even More than the CRX, Rising 166 Percent Over the Same Period



### Total Annualized Returns as of 12/31/2013

|                                               | One-Year | Five-Year | Ten-Year | Gross Expense Ratio |
|-----------------------------------------------|----------|-----------|----------|---------------------|
| Global Resources Fund (PSPFX)                 | -0.72%   | 14.91%    | 9.68%    | 1.57%               |
| Morgan Stanley Commodity Related Equity Index | 11.95%   | 14.73%    | 12.40%   | n/a                 |
| Dow Jones-UBS Commodity Index                 | -9.58%   | 1.41%     | -0.73%   | n/a                 |

Expense ratios as stated in the most recent prospectus. Performance data quoted above is historical. Past performance is no guarantee of future results. Results reflect the reinvestment of dividends and other earnings. Current performance may be higher or lower than the performance data quoted. The principal value and investment return of an investment will fluctuate so that your shares, when redeemed, may be worth more or less than their original cost. Performance does not include the effect of any direct fees described in the fund's prospectus (e.g., short-term trading fees of 0.05%) which, if applicable, would lower your total returns. Performance quoted for periods of one year or less is cumulative and not annualized. Obtain performance data current to the most recent month-end at [www.usfunds.com](http://www.usfunds.com) or 1-800-US-FUNDS.

Please consider carefully a fund's investment objectives, risks, charges and expenses. For this and other important information, obtain a fund prospectus by visiting [www.usfunds.com](http://www.usfunds.com) or by calling 1-800-US-FUNDS (1-800-873-8637). Read it carefully before investing. Distributed by U.S. Global Brokerage, Inc.

Foreign and emerging market investing involves special risks such as currency fluctuation and less public disclosure, as well as economic and political risk. Because the Global Resources Fund concentrates its investments in specific industries, the fund may be subject to greater risks and fluctuations than a portfolio representing a broader range of industries.

All opinions expressed and data provided are subject to change without notice. Some of these opinions may not be appropriate to every investor.

The Dow Jones UBS Commodity Index is composed of futures contracts on physical commodities, and includes commodities traded on U.S. exchanges, with the exception of aluminum, nickel and zinc, which trade on the London Metal Exchange (LME). The Morgan Stanley Commodity Related Index (CRX) is an equal-dollar weighted index of 20 stocks involved in commodity related industries such as energy, non-ferrous metals, agriculture, and forest products. The index was developed with a base value of 200 as of March 15, 1996. Standard deviation is a measure of the dispersion of a set of data from its mean. The more spread apart the data, the higher the deviation. Standard deviation is also known as historical volatility. Diversification does not protect an investor from market risks and does not assure a profit.

The MSCI All Country Asia Pacific (excluding Japan) Index captures large and mid cap representation across 4 of 5 Developed Markets countries (excluding Japan) and 8 emerging markets countries in the Asia Pacific region. The Dow Jones Industrial Average is a price-weighted average of 30 blue chip stocks that are generally leaders in their industry. The S&P 500 Stock Index is a widely recognized capitalization-weighted index of 500 common stock prices in U.S. companies. The Nasdaq Composite Index is a capitalization-weighted index of all Nasdaq National Market and SmallCap stocks. 14-029

Don't Miss the Potential Rally. Learn More About the Global Resources Fund

## The Importance of Diversification

We believe the commodity supercycle continues, driven by emerging countries experiencing rising urbanization, increasing wealth and healthy GDP growth rates. What's important for investors to remember is to build a diversified basket of natural resources companies actively managed by professionals who understand the seasonal and cyclical trends of these specialized assets.

An investment that covers all the commodity bases is the Global Resources Fund (PSPFX), which selects commodity stocks across 12 themes, including oil services, exploration and production companies, as well as precious metals stocks. We believe this approach offers investors the possibility for better growth with lower volatility.

### A Multi-Faceted Approach—12 Themes



Bulk Commodities



Base & Industrial Metals



Precious Metals



Venture Stage Exploration



Oil/Gas Exploration & Production



Resource Transportation



Oil Services



Energy Infrastructure



Agriculture



Food



Forest & Lumber



Renewable Energy

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