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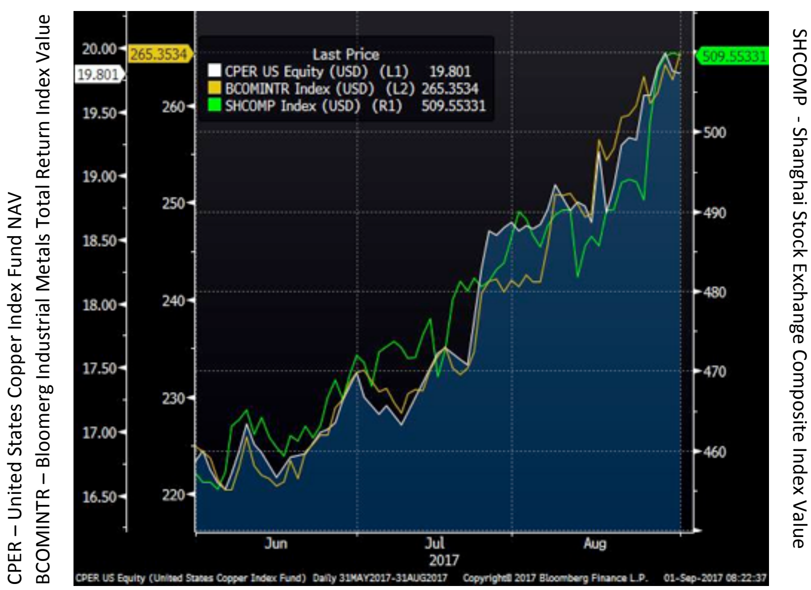
Commodities Insights – Return Dispersion August 2017

Key Takeaways

- **U.S. dollar weakness largely ignored by commodities.**
- **Return dispersion among commodities was notable.**
- **Are catalysts emerging in the oil market?**

The three month period from May 31 to August 31 was marked by notable return dispersion across commodities. This dispersion occurred despite a broadly weaker U.S. dollar. The negative correlation between the U.S. dollar and commodities is typically evident on big dollar moves. The dollar's -4.4% decline ranks near the bottom decile of three-month returns over the last ten years; however, the broad basket Bloomberg Commodity Index, and all sectors except industrial metals, were within +/- 3% of unchanged. The outlier was an 18% increase in industrial metals. The chart below highlights one factor supporting copper and industrial metals prices over the period – strong Chinese markets.



Source: Bloomberg As of 8/31/2017

Another key factor driving copper and industrial metals prices has been declining inventories. Of the six industrial metals most commonly included in broad basket commodity indexes, the average drop in London Metal Exchange warehouse stocks is -30% for twelve month period ending August 31. Another data point demonstrating the recent decline is the following chart of a weighted basket of industrial metals inventories.

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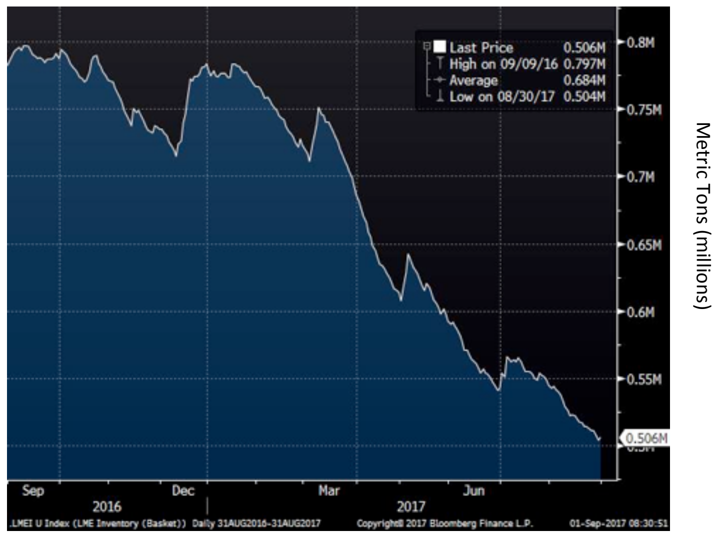
London Metal Exchange Warehouse Stocks
(Industrial Metals)



Source: Bloomberg As of 8/31/2017

The aforementioned sector return dispersion highlights the importance of the implementation decision in commodity investing. Rather than a static component mix, the United States Commodity Index Fund (USCI) tracks an index, the SummerHaven Dynamic Commodity Index, which dynamically allocates to commodities with the strongest inventory fundamentals as measured by forward curves. As a result, USCI's 40+% recent allocation to industrial metals has contributed to stronger three-month and year-to-date returns than traditional commodity indexes using production and/or liquidity weightings.

Turning to the oil market, we're seeing catalysts emerge which could lift 4Q17 prices from current levels. West Texas Intermediate Crude Oil (WTI) closed August 31st at $47.23/bbl near the bottom of the $43 to $54 twelve month trading range. Among the factors weighing on price has been rising rig counts, rising U.S. production, and historically high inventories. Recent data suggests changes to these factors. The number of U.S. oil rigs drilling new wells rose sharply from 316 on May 31, 2016 to 765 on July 14, 2017 – an increase of almost 8 rigs per week. However, producer inquiries to drillers has fallen consistent with the rig count declining in recent weeks. While U.S. oil production continues to edge closer to the 9.61 million barrels per day high from June 2015, the rate of increase should begin to moderate in coming months. More broadly, the global supply and demand balance has improved as reflected in U.S. inventory data. Summer is seasonally a time of U.S. inventory reductions but 2017's draw has been notably larger than normal. For the five years ending 2016, the spring crude oil storage peak to end-of-summer storage trough is a 39mill barrel reduction. With several weeks remaining, this year's oil stocks have already declined by 78mill barrels.

Additional factors heavily influencing energy prices in coming months will be geopolitical developments in Venezuela, production levels in Libya, and dislocations caused by Hurricane Harvey.

Kevin Baum, Chief Investment Officer

Definitions:
Bloomberg Commodity Index - is an index that tracks the performance of 22 broadly diversified commodity futures contracts. Prior to July 1, 2014, BCOM was known as the Dow Jones-UBS Commodity Index.

Bloomberg Industrial Metals Total Return Index – Formerly known as Dow Jones-UBS Industrial Metals Subindex Total Return (DJUBINTR), the index is a commodity group subindex of the Bloomberg CITR. The index is composed of longer-dated futures contract s on aluminum, copper, nickel and zinc. It reflects the return on fully collateralized futures positions and is quoted in USD.

London Metal Exchange Warehouse Stocks – A report from the London Metal Exchange (LME) that details the breakdown of stocks by warehouse company per location and deliveries in and out for the stated month. The report also contains the waiting time for queued metal as on the last business day of the stated month. The LME is a commodities exchange in London, England, that deals in metal futures. Contracts on the exchange include aluminum, copper and zinc. Trading on the LME can be done in three main ways: through open outcry, a telephone system between member companies or the LME Select, an electronic trading platform. The LME is a non-ferrous exchange, which means that iron and steel are not traded on the exchange.

Shaghai Stock Exhange Composite Index - A market composite made up of all the A-shares and B-shares that trade on the Shanghai Stock Exchange. The index is calculated by using a base period of 100; the first day of reporting was July 15, 1991.

SummerHaven Dynamic Commodity Index - is an index designed to reflect the performance of a portfolio of 14 commodity futures. The index is reconstructed each month from 27 possible futures contracts. The 14 selected contracts are equally weighted and represent six sectors: Energy (WTI crude oil, Brent crude oil, natural gas, heating oil, gasoil, RBOB gasoline), Precious Metals (gold, silver, platinum), Industrial Metals (aluminum, copper, lead, nickel, tin, zinc), Grains (corn, soybeans, soybean meal, soybean oil, wheat), Livestock (live cattle, feeder cattle, lean hogs) and Softs (coffee, cocoa, cotton and sugar).

One cannot invest directly in an index.

Diversification does not eliminate the risk of experiencing investment loss.

Commodity Fund Disclosures:
Download a copy of a Fund's Prospectus by clicking one of the following: USCI, USAG, USO, USL, USOU, DNO, USOD, BNO, UNG, UNL, UGA, UHN, or CPER. Please read the Fund's Prospectus carefully before investing.

USCI, USAG, USO, USL, USOU, DNO, USOD, BNO, UNG, UNL, UGA, UHN, and CPER are commodity pools regulated by the Commodity Futures Trading Commission. These Funds are not mutual funds or any other type of Investment Company within the meaning of the Investment Company Act of 1940, as amended, and are not subject to regulation thereunder.

Past performance does not guarantee future results.

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Leveraged and inverse exchange-traded products pursue daily leveraged investment objectives which means they are riskier than alternatives which do not use leverage. They seek daily goals and should not be expected to track the underlying benchmark over periods longer than one day. Due to the compounding of daily returns, returns over periods other than one day will likely differ in amount and possibly direction from the target return for the same period. They are not suitable for all investors and should be utilized only by investors who understand leverage risk and who actively manage their investments. For more on correlation, leverage and other risk factors, please read the prospectus.
USOU and USOD are new and have a limited operating history.

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