

How real assets can add uncorrelated returns

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A portfolio holding dozens of companies across a wide range of sectors can appear well diversified. Yet, an external shock can expose shared vulnerabilities, sending many of those holdings lower in unison. That's one reason why resources and commodities have become appealing for many advisors seeking sources of uncorrelated returns for their clients.

These investments offer exposure to assets whose prices can move independently of equity valuations and volatility in credit markets. That's the starting point for Petar Pejovic, senior portfolio manager with Pejovic Bighill Private Wealth at Wellington-Altus Private Wealth Inc. in Winnipeg. He says when equity markets tumble, diversification across companies may provide less protection than clients expect.

His approach is to hold physical commodities over shares in the companies that produce them. Gold is one example. Specifically, Mr. Pejovic holds bullion partly as protection against monetary debasement, seeking to preserve purchasing power over the longer term. He expects the U.S. dollar to decline and sees a risk that other currencies will also lose value.

Mr. Pejovic cautions Canadians already invested in domestic equities that adding mining stocks could increase an existing concentration in resources. For anyone with broad exposure to the S&P/TSX Composite Index, materials and energy companies already account for roughly 30 per cent of the index.

"You should be careful about supplementing additional weightings in commodities-driven equities," he says. "Avoid doubling up."

He also warns against drawing lasting conclusions from short periods when gold and equities moved in tandem, as they have recently. Gold has outperformed equity markets

on a risk-adjusted basis over a period beginning before the 2008 global financial crisis. That suggests even a small allocation could have improved outcomes compared with an equity benchmark such as the S&P 500.

Copper and uranium draw interest

Resources and commodities include sectors ranging from energy to precious metals and minerals, to timber and agriculture. As the global population grows and industrialization continues, demand for these assets will only increase, making them potentially lucrative investment opportunities.

For Mr. Pejovic, copper and uranium are also attracting his interest. Copper offers exposure to investment in transmission infrastructure, while uranium provides a connection to nuclear power demand.

Global copper demand is projected to rise from 28 million metric tonnes in 2025 to 42 million by 2040, according to S&P Global, supporting the long-term demand case.

Yet, Mr. Pejovic adds that copper can share economic drivers with technology holdings. Materials used in data centres may benefit from the same spending that supports AI companies, creating some shared risks.

Overall, Mr. Pejovic prefers to allocate approximately 20 per cent to physical real assets, funding that equally from equities and fixed income. That results in a mix of about 50 per cent stocks, 30 per cent bonds and 20 per cent real assets.

Choosing the right vehicle

Shares in a resources company can be attractive, offering accessible, liquid exposure, but returns reflect business decisions as well as commodity prices. A producer that has hedged future sales may benefit less from rising commodity prices, while receiving some protection when those prices decline.

Advisors should look closely at the underlying investment and the quality of the company's assets and its history, says Robert Rothenberg, senior wealth advisor and senior portfolio manager with Rothenberg Wealth Management at Harbourfront Wealth Management Inc. in Montreal.

"Management track record is huge," he says.

A diversified exchange-traded fund, mutual fund or offering-memorandum (OM) vehicle might spread exposure across producers and resource sub-asset classes. Advisors still need to examine its holdings and costs.

Physical commodity vehicles serve a different purpose, removing the producer's operating decisions from the investment. Their structure still deserves scrutiny, as physically backed holdings and derivatives-based funds can behave differently.

"You're trying to build out a portfolio that smooths out the ride," Mr. Rothenberg says.

New OM-based products have entered the Canadian market in recent years, offering access to private resource investments. These vehicles can introduce different sources of return, yet also new risks.

Know redemption provisions

Advisors and investors should understand redemption provisions before committing capital, Mr. Rothenberg says, including the circumstances in which withdrawals may be restricted. They should also examine how investments are valued and how fees affect the amount of capital put to work.

Infrequent valuations can make reported performance appear smoother without showing that the investment carries the same economic risk. For advisors, access to capital must also fit the client's retirement spending needs and estate obligations.

"How does your estate settle this when there's an outstanding private investment, for example, that you can't get out of?" Mr. Rothenberg asks.

For Mr. Pejovic, who favours liquid real asset holdings, the aim is to broaden sources of return through a vehicle that provides the intended exposure on terms the client can accommodate. The objective should be clear: Is the investment intended to provide uncorrelated returns, downside protection or both?

Advisors and investors alike need a clear reason for holding the investment. "It comes down to why do you own that gold or base metals exposure?" Mr. Pejovic says.

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