

RESOURCEFUL INVESTING

Infrastructure for the energy supply will draw investment of \$20 trillion by 2030—and then there's metals and water

Growing demand for natural resources, such as energy, metals and even water—combined with supply challenges—is driving long-term, natural resources inflation. Fortunately, there are a number of ways for advisors to adjust clients' asset allocations to capitalize on these opportunities.

There is a cyclical element to the current natural resources inflation, which has been exacerbated by recent harsh weather. But the long term view is compelling. Consider the following:

Global development. Improved living standards and increased global development are driving tremendous demand for natural resources. Many developing countries are at a stage where resource demand as a percentage of gross domestic product is much greater than that in developed economies. Up to 70% of energy-demand growth is projected to originate in emerging countries.

Inadequate infrastructure. Infrastructure scarcity is characterized by inadequate oil refining capacity and insufficient facilities for the mining and processing of industrial metals. The International Energy Agency projects that global investment in energy supply infrastructure alone will reach more than \$20 trillion by 2030. Oil field service companies, industrial metal suppliers and firms with specialized construction and project management expertise will be some of the primary beneficiaries.

You can gain exposure to these opportunities with equities, currency diversification and commodities. The proliferation of exchange-traded funds makes it easier than ever to gain exposure to emerging-market and global infrastructure growth. ETFs can target regions or industries that may benefit.

Investing in natural resources may provide the additional benefit of diversification against a weaker dollar. Higher-yielding commodity currencies, such as the Canadian and Australian dollars, may continue to strengthen against the U.S. dollar due to upward resource-price pressure.

Commodity index funds have three sources of potential return: change in current physical market (spot) price; the return earned on the collateral assets a fund holds against futures contracts; and the return earned as contracts are "rolled" forward with the passage of time.

Changes in spot prices are easily accessible and understood. Most individual investors focus on this aspect of commodity investing and base their decisions on whether fundamental support exists for price increases.

But the potential return on a fund's collateral assets can be a significant source of actively managed value-add. Funds may invest these assets in a variety of liquid instruments, ranging from T-bills and Treasury Inflation-Protected Securities to asset-backed securities. Equally important, the roll return may be positive or negative, independent of spot-price returns. This is possible due to the mechanics of the futures markets, where forward prices may be lower or higher than near-term prices, and the passage of time may work for or against a fund.

Finally, funds will differ as to which commodity index they choose to mimic, with one consequence being varying allocations to energy versus other commodities contained within a given index. With a broad range of vehicles available, you should be able to gain exposure to long-term, natural resources inflation in a manner consistent with your clients' comfort levels. ■



** Investing in natural resources may provide the extra benefit of diversification away from a weaker dollar.*

** You should be able to gain exposure to this sector in a way that's consistent with your client's comfort level.*

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