Fortem Capital Commodity Absolute Return

Quarterly Commentary – 31st December 2024

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Total Return	2024	Q4
UK 100	9.6%	-0.2%
US 500	24.4%	2.3%
Europe 50	11.0%	-1.8%
Japan 225	20.8%	5.3%
Hong Kong 50	22.6%	-4.9%
US 2000	11.5%	0.3%
Swiss 30	7.5%	-4.7%
Global Equity	18.7%	-0.2%
Global Bond	1.3%	-3.1%
Commodities	5.4%	-0.5%
PGF	**5.3%**	**0.0%**
AGF	**1.2%**	**-0.5%**
DGF	**5.4%**	**0.3%**
USI	**23.2%**	**1.9%**
ARF	**7.1%**	**1.7%**
CARF	**-**	**-1.0%**

2024 saw equity markets post another stellar year of returns led by the US, which posted its second consecutive year of returns greater than 20%. Global bonds in general continued their poor performance as government bond yields remain elevated, but investors found a happy hunting ground in high yield credit where spreads continue to tighten, buoyed by the general optimism over risk assets.

The US economy continued to decouple from the rest of the global economy with the job market remaining buoyant, growth solid and inflation stubborn. The past few years have not been without growth scares with SVB, the tightening of conditions in summer 2023 brought on by US Treasury issuance, and the deterioration in data in summer 2024 all encouraging action from policymakers to loosen conditions significantly each time. These policy reactions had the effect of prolonging economic strength and strong labour conditions.

The latest of those reactions was the start of the cutting cycle following some relatively poor data in July. However, unlike most cutting cycles, conditions, led by increased term premium, have tightened significantly since the first cut in September; the market, in the absence of willingness from policymakers, is taking it upon itself to finally kill off inflation. This can and will only be achieved by a slowing of growth and dampening of demand. There is also, after a Republican clean sweep in November, a new administration which will decide its response to this slowing; they have been openly critical of the previous administration's Treasury issuance policy and have less tools at their disposal to loosen conditions.

The market has not priced this slowdown and is unprepared for this as an outcome.

The Absolute Return Fund returned -1.0% over Q4.

Income

The Fund is fully collateralised by very short-dated, high-grade debt. As such, its liquidity profile extends to the liquidity profile of the Income portfolio. Therefore, when the risks free rate is high so is the base level of return available to the strategy. It allows investors to somewhat 'have their cash cake and eat it' within an alternative allocation.

Beta

The Fund does not allocate to the beta portfolio.

Diversifier

The Fund monetises the premia of commodity carry curve.

Commodity curve strategies are a staple, classic, structural risk premia. Commodities themselves tend to be accessed through futures, most market participants are not taking physical delivery of barrels of oil, tonnes of sugar etc.

The shape of the futures curves tend to be upward sloping, or what is known as in contango. The shape also tends to be concave. This shape is driven by:

- A positive cost of storage
- Producers hedging selling futures further out on the curve

Since the term structure is not straight, there are contracts with more negative roll as they move towards expiry than others, allowing a strategy to be constructed that goes short the front of the curve, where the most negative roll tends to reside, and long further out. Crucially, this leaves the strategy insulated from parallel shifts up and down in the term structure.

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The persistent return is structural, based on the physical make-up of the market and uncorrelated. Incidentally, the premia this Fund earns is that which commodity trackers give away continuously having to roll up the curve to maintain exposure. A good barometer of the premia in action in oil for instance is looking at the long-term return of an 'oil tracker' versus the long -term return of oil spot prices.

As was alluded to last quarter, winter is traditionally when curve strategies are dominated by the risk premium in natural gas, and so it has once more transpired. Winter was entered with exceptionally strong storage reserves of around 4 trillion cubic feet. With that, only an extended period of freezing temperatures that extended to the typically warmer southern states could stop gas from posting its 7th consecutive winter of positive returns. Unfortunately, that is what has unfolded. A series of cold snaps across the US, particularly in the Northeast and down to Texas has caused production 'shut-ins' and spike localised demand versus normal. There is still time this winter for weather to normalise, but even if it doesn't, production levels remain healthy, most of the volatility has centred around the February contract which the strategy is no longer in and with incentives to produce high, storage is likely to recover quickly and natural gas may have a profitable summer when it is usually fairly dull.

Grain markets, particularly corn and soybeans also rallied earlier than usual this year, to the detriment of the strategy. The USDA's unexpected cuts to last year's US yields triggered sharp price increases, especially for current crop contracts. However, sustaining these gains may prove challenging. While US corn production was revised down, record-high estimates for China's corn crop raise questions about their future demand for U.S. exports. There may be some performance to come from the grain complex within the strategy.

Oil prices within energy have also not helped the strategy as a surge in price driven by significant draws in storage at Cushing, which is now at its lowest levels since 2008. The market is finely balance although refinery maintenance in January could ease pressure, while there is also the possibility of increased supply from OPEC, particularly the UAE, which is eager to ramp up production once more.

Outlook

It has been a tough winter for commodity curve thus far as idiosyncratic risks across multiple commodity sectors have aligned simultaneously.

However, if the global economy is destined to slow, commodity prices will struggle to maintain levels as demand falls off while there is another potential catalyst for curve on the horizon. Donald Trump has proven himself previously to be an adept dealmaker, and if he is able to fulfil his promises to end conflicts in both the Middle East and Ukraine, then geopolitical supply side pressures will fade quickly to the benefit of the strategy.

In the meantime, outside of energy most of the term structure is now back in contango, meaning that the roll down premium is back after a number of years in the wilderness.

The past few years have been challenging to the structural premia. However, it is looking likely that 2025 heralds a return to commodity markets in which it can thrive.

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