WealthCE

Commodity Basics

Commodities are the hard assets that are mined, drilled, drained, picked, plucked, or cut down. They're the base raw materials that create all of the goods used in construction, fashion, automotive, digital, and other product categories. They all have several unique properties in common. All commodities can be stored, for at least a small period of time. All commodities can be traded; though transporting them varies in difficulty. Lastly, all commodities are interchangeable, but substituting them may result in slight quality differences. These differences may be reduced or enhanced by refinement and other developments.

There are 3 major categories of commodities, and commodity futures bear these classifications. Agricultural products covered by futures include cocoa, coffee, concentrated juices, corn, livestock varieties, soy, sugar, and wheat. Energy futures commonly traded include coal, crude oil, electricity, ethanol, natural gas, nuclear, solar, wind. Metal futures include aluminum, copper, gold, nickel, palladium, platinum, silver, steel, and zinc.

Why should you trade commodities, and by extension commodity futures? They diversify your assets and your risk exposure. Commodities values rise in times of inflation: increased amount of money chases the same amount of raw materials, resulting in higher nominal prices for commodities. They rise with inflation. Equities are adversely affected by inflationary values. Share values are derived from company cash flow projections, which decrease when they have to pay more money for the same amount of raw materials. Commodities reduce exposure to inflationary risk; equities increase exposure to inflationary risk. The same applies to bonds, commodities, and inflation. Inflation reduces the impact of nominal returns, essentially canceling out bond returns when inflationary rates are higher than the stated bond yields. Investing partially in commodities helps protect you against some risks, but will open you to others.