



## Customer Advisory: Learn About Risks Before Investing in Commodity ETPs or Funds

Recent market volatility due to the COVID-19 (coronavirus) pandemic has prompted many investors to purchase shares of trading vehicles that use futures contracts or other commodity interests, either in hopes of profiting from a recovery in particular commodity prices or as a means of diversifying their portfolios. These trading vehicles may be organized as exchange-traded products (ETPs) or mutual funds, but that does not necessarily mean they will behave like traditional exchange-traded funds (ETFs) or mutual funds that invest in stocks, bonds or other asset classes. For example, these vehicles might not provide investors opportunities to “buy the dip” or profit from long-term price gains in the underlying commodity.

### Fundamentally Different Than Securities

Commodity ETPs and mutual funds invest in futures, options, swaps, or foreign exchange and often are commodity pools, whose operators are regulated by the CFTC. Commodity futures markets present different risks than securities markets. For example, when individual investors or mutual funds buy shares in a company, they own a portion of that company. Those shares are assets, and can be owned indefinitely.

Commodity pools (including commodity-based ETPs), on the other hand, purchase time-limited contracts that convey the right to buy or sell an asset—called the “underlying asset”—at some point in the future. The contracts do not convey ownership in the asset itself. The value of the shares in the commodity pool may not track the value of the underlying asset over time.

This difference is because unlike with stocks, a futures contract cannot be held indefinitely in hopes that a fallen price will recover. Futures contracts expire, and contract holders must either deliver or take delivery of the underlying asset, or close out their contracts by taking an offsetting position before the delivery date. For example, to offset 10 long contracts to buy June liquid natural gas, you would need to short 10 contracts to sell June liquid natural gas.

### Know the Risks

For energy commodities and associated futures contracts, risks are often related to supply and storage availability. For agricultural commodities and associated futures contracts, such as corn, soybeans, or wheat, the risks are often weather related. Meanwhile, metals such as gold, copper, and palladium and their futures contracts are affected generally by industrial and macroeconomic factors. Whether the pool you plan to invest in focuses on a single commodity or a broad mix of commodities, you should research the risks associated with the commodities

### What to Ask When Considering a Commodity ETP

Assess carefully any representations that, by trading commodity interests, a pool should outperform stock and bond funds during recessions or in other financial downturns. A pool’s actual performance may indicate otherwise. As you review the prospectus or disclosure document for a commodity ETP fund consider:

- What financial instruments will the commodity pool be allowed to trade? How do those instruments behave when markets go up or down?
- What could happen to those financial instruments in extreme market conditions?
- What changes to the announced trading strategy is the commodity pool operator (CPO) permitted to make, and under what circumstances? Can changes be made without notifying participants?



and the industries that utilize them. You should know what conditions could influence their prices and actively monitor those conditions while you participate in the fund.

In addition, there is a risk that the pool's holdings or strategies could shift to compensate for changes in market conditions. The pool's disclosure documents will describe its objectives, trading strategies, principal risks, and flexibility to make changes. Read these disclosures thoroughly and watch for updates, notices, or supplements on the fund's website.

Commodity pool disclosure documents also must include information about the following:

- **Management and Firm Principals.** The names of the pool operator, pool managers, and commodity trading advisors, as well as ownership information and registration status.
- **Fees and expenses.** Management fees, advisory fees, brokerage fees and commissions, and interest paid.
- **Break-even analysis.** A table showing the amount the pool must earn after one year (in dollars and percentage terms) to recover the amount of your initial investment plus fees and expenses.
- **Performance.** The pool has to accurately report its past performance.
- **Redemption information.** How to redeem shares in the pool, including any restrictions that may exist.

## The Impact of Rolls on Annual Returns

Finally, rising commodity prices may actually create a drag on commodity pool annual returns. The only way for a pool to maintain an ongoing position in a particular commodity futures contract would be to conduct a “roll”—closing out the expiring contract (also called the “near” or “front-month” contract) and entering another contract with a later delivery date (called “out-month” contracts). If the prices for out-month contracts are increasing, then the pool may lose money each time front-month contracts are rolled. Small increases in price, month over month, could be a sizable drag on annual returns when added to applicable trading and management fees. By contrast, when out-month contract prices decrease, it could have the opposite effect and result in a “roll yield.”

For more information about commodity pools or commodity futures markets, visit [cftc.gov/LearnAndProtect](https://cftc.gov/LearnAndProtect).