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COM ETF: 2nd Quarter Commodity Recap 2023

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The 2nd quarter proved to be a challenging one for the notable broad commodity indices as they were down anywhere from -2% to -5% for the quarter and roughly -10% for the year.

With that in mind, it comes as no surprise that the majority of the individual commodities that make up the *Auspice Broad Commodity Index (ABCERI) weakened during the quarter.

In spite of this, the Direxion Auspice Broad Commodity Strategy ETF (COM) outperformed most of its peers on a relative basis. The COM ETF is still one of the few broad commodity strategies that showed a positive return YTD despite correcting -2.3% for the quarter. This tactical approach, by only holding the commodity markets that are showing upside momentum along with earning a return on Cash has helped smooth out the ride relative to other broad commodity benchmarks.

The broad commodity benchmarks have retracted over the last 12 months, a typical correction historically, given the strong two- year commodity rally from the April 2020 Covid lows.

While energy and metal markets have been under pressure, the broader basket of agricultural markets have pushed to higher levels.

Food prices, as represented by the *UN Food and Agriculture World Price Index, have actually diverged versus agricultural commodities recently and softened. This is a first and unique divergence since 2020, and we think food prices will potentially follow agricultural commodities and revert upwards, leading to increased inflationary pressures.

The risk-on sentiment continued in the second quarter as the U.S. equity markets once again produced outside gains. The *VIX supported this narrative as it touched a new 52- week low during the course of the quarter.

However, most of the commodity markets did not participate for the ride higher. Unlike their U.S. counterparts, the Chinese equity markets had a rough performing quarter, as their economy continues to be sluggish and demand is stalling. We will see if China can come out of its current malaise and avoid the potential for a global slowdown.

Despite this, India has become a major factor. With its population now surpassing China and the fastest growing middle class in the world (expected to be the largest by 2027), commodity consumption there is accelerating. India's emerging middle class will likely drive demand for the copper, iron ore, zinc, aluminum, and energy resources needed to supply the construction of modern infrastructure and cities, and power homes and industry. The government of India is set to spend nearly 20% of its fiscal year 2023 budget on capital investments, (source: Bloomberg as of 1/22/23) the most in at least a decade. From energies to metals to soft commodities, India is poised to consume a growing rate of an undersupplied commodity sector.

This could be a catalyst for the overall commodity rally to resume. In addition, the current geopolitical landscape between the U.S. and China, along with knock-on effects of the Russia-Ukraine conflict can potentially lead to supply constraints reemerging.

Many assumed as we entered the second quarter, that the Fed would be shifting from a more hawkish to dovish mindset, but that hasn't materialized. Although the Fed slowed down their rate hike cycle and even paused hikes at their meeting in June, the Fed seems to be continuing their tightening cycle, as Fed fund futures is now pricing in a rate hike at their next meeting along with no anticipated rate cuts for the balance of 2023. Inflation continues to remain persistent, and despite it easing a bit, still has a long way to go to reach its stated 2% target. If inflation continues to remain elevated in combination with higher rates, this could lead to a stagflation environment, which could propel commodity prices higher.

It was a difficult quarter overall for the Energy sector, with the exception of Gasoline. Although OPEC+ remains steadfast in its commitment to production cuts, it has not been enough to curtail the further drop in Crude Oil prices. The ongoing global demand slowdown in conjunction with a continued glut of Oil supplied to India and China by Russia have been the major deterrents keeping a lid on prices. However, the ongoing geopolitical implications of the Russia/Ukraine conflict combined with the recent added wildcard of potential civil unrest within Russia should help keep a higher floor with prices. In regards to Gasoline, it was up slightly for the quarter as you have the potential for a seasonality trade with the anticipation of travel being robust this summer. The COM ETF continues to have no exposure within the Energy complex based on current price tr ends.

Overall, the Grains and Softs had a mixed quarter as Sugar and Soybeans provided some gains. As our partners at Auspice have previously noted, there seems to be a disconnect between the actual agricultural commodity markets and underlying food prices. They expect food prices and broad inflation metrics to resume upwards soon. (source: Auspice as of 5/3/23)

The continued geopolitical fallout with Russia and Ukraine bears watching as the Grains could be the sector most directly impacted. Russia and Ukraine are commonly referred to as the "breadbasket" of Europe and the ongoing conflict is adversely effecting Ukraine's farmland and infrastructure, which could lead to some production issues with the Grains , but most notably Wheat. In addition, if Russia does not continue to uphold the Black Sea grain initiative this could curtail exports and lead to supply constraints.

The other major factor when it comes to Grains is weather and the impact it can have on crop yields.

In the case of Corn, the dry weather conditions in the U.S. earlier in the quarter set the stage for a potentially difficult crop. The price of Corn initially spiked as a result. However as we entered June, there were improving weather conditions and actual planting numbers came in higher than expected resulting in a steep sell off in Corn during the mid to latter part of the month. During the course of the month, COM entered a long position in Corn, but exited the position shortly thereafter as price trends quickly deteriorated. In regards to Soybeans, the acreage numbers sharply dropped relative to expectations and soybeans finished higher for the quarter.

The Sugar market continued to be a key performance driver for the strategy in the second quarter although it gave back some of the sizable gains as the quarter closed. The strategies ability to generate performance attribution from any of the 12 commodities differentiates it from most peers that tend to have fixed weightings in their commodity allocations. Sugar has been a beneficiary of increased demand that has coincided with an El Nino weather pattern in Asia and Africa (drier conditions) and South America (heavy rains) that can cause crop damage globally.

The Metals complex was a laggard in the second quarter as both the Precious (Gold & Silver) and Industrial Metal (Copper) resulted in losses. Copper's price weakness in the first two months of the second quarter, resulted in the strategy going to Cash with the position. Copper dropped below a key level of support at $4 during the quarter and has not regained it since. The concern of a global slowdown supported by uninspiring economic data from China sent the Industrial Metal lower.

The Precious Metals saw some weakness as the quarter unfolded as the Fed remains hawkish, supporting the narrative of Bonds as the preferred flight to safety. The U.S. Dollar slightly rising as well did not help the Precious Metals cause.

As we move into the month of July, as of 7/15/2023, COM is currently Long 4 out of the 12 positions (Gold, Silver, Sugar and Soybeans). Although it has been a choppy environment for many commodities this year, we still believe that there will be continued opportunity in select commodities, as evident thus far this year. Inflation appears to be a global issue that is here to stay. The agricultural inflation (Agflation) could be the catalyst for commodities in the years to come.

In 2023, COM has shown the ability to get defensive by going to Cash, as the majority of individual commodities are showing a downward price trend. At present, with U.S. interest rates on the rise, the strategy is receiving a return on Cash, while the strategy waits to employ further positions.

The rules based tactical nature of the COM ETF, has shown its ability to distinguish itself from most of its peers on both a risk and return basis. Although we never want to focus on the short term, COM has further reinforced thus far in 2023 why it stands out amongst the crowd.

*Definitions:

https://www.direxion.com/definitions-index-descriptions

*The Auspice Broad Commodity Index (ABCERI) aims to capture upward trends in the commodity markets while minimizing risk during downtrends. (source: auspicecapital.com)

*The FAO Food Price Index (FFPI) is a food price index by the Food and Agriculture Organization (FAO) of the United Nations. The FAO Food Price Index (FFPI) is a measure of the monthly change in international prices of a basket of food commodities. The FFPI is considered an indicator of future inflation and cost trends in the food industry.

*The CBOE Volatility Index (VIX) is a measure of expected price fluctuations in the S&P 500 Index options over the next 30 days. Sometimes referred to as the "fear index," VIX is a reflection of investor uncertainty and expected future price fluctuations across the broader financial market.

*Stagflation is a period of stagnant economic growth accompanied by persistently high inflation and a sharp rise in unemployment

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