Lloyds Chambers 1 Portsoken Street
London E1 8HZ
Tel: 020 7702 0888 Fax: 020 7702 9452
www.hermes.co.uk

PRESS RELEASE

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Hermes analysis shows outlook for commodities at 10-year high

Hermes Fund Managers' commodities analysis of the futures markets shows the outlook for commodities is the best it has been in 10 years.

The analysis shows that a broad 'backwardation' of around **1.7%**[1] – whereby current spot prices are higher than those indicated in futures contracts – exists across the broad commodity spectrum. 2013 was the first year a passive commodity investor received a positive roll return since 2003. This was due to a number of commodity forward curves being in strong backwardation all year, notably Brent and soybeans. Commodities in sustained backwardation indicate physical scarcity. In the past, backwardation and a positive roll yield has been a strong sign for positive commodity returns.

Jason Lejonvarn, Strategist, Hermes Commodities, commented: "Sustained backwardation is unusual and a key signal for commodity investors. It indicates not only a positive roll return but an enhanced commodity risk premium overall."

There are three sources of returns from investing in commodity futures, including roll yield, the rise in the spot price of commodities over time and the 'risk-free cash' return, which is priced into contracts to compensate investors for providing liquidity in the market. The roll yield, which comes when commodity investments are 'rolled over' from one period to the next, is the least significant historically, having returned -0.71% per annum between 1970 and 2013[2]. However, the current backwardation being seen offers much higher returns: roll yields in commodities in 2013 delivered a passive return of 1.5% while the current backwardation in Brent oil implies a return of 5% from the roll yield alone over the next year and a record backwardation in soybeans currently offers an annualised return of 20%[3].

By buying a futures contract, investors can also benefit from a rise in the spot price because backwardation indicates that a futures contract will trade at a higher price as it approaches expiry.

Jason Lejonvarn continued: "The existing backwardation can be attributed to current spot prices being driven higher by surprisingly strong demand and shortages developing. Some of it is related to supply disruptions but it is largely a reflection of the economic cycle. Global growth has bottomed out and we are returning to trend growth, which is raising demand across the board.

"Commodities tend to do well in the late expansionary cycle, starting from the transition point from early to late expansion. Given where we are now, we believe it is logical that commodities will be the next asset class to outperform."

Hermes is one of the largest managers of commodities in pension assets and offers two strategies that invest in commodities, including the Hermes Enhanced Beta strategy and the Hermes Commodities Absolute Return Strategy.

[1]Source: Bloomberg and Hermes based on S&P GSCI Commodity Index
[2]Source: Bloomberg and Hermes based on S&P GSCI Commodity Index
[3]Source: Hermes Q2 2014 Commodities Outlook

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For further information, please contact:

Hermes Fund Managers

Jeannie Dumas	Melanie Shelley	Katie Sunderland
+44 (0)20 7680 2152	+44 (0) 20 7680 2110	+44 (0)20 7680 2315
j.dumas@hermes.co.uk	m.shelley@hermes.co.uk	k.sunderland@hermes.co.uk

Notes to Editors:

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*Please note the total AuM figure includes £3.4bn of assets managed or under an advisory agreement by Hermes GPE LLP (“HGPE”), a joint venture between Hermes Fund Managers (“HFM”) and GPE Partner Limited. HGPE is an independent entity and not part of the Hermes group. £0.4bn of total group AuM figure represents HFM mandates under advice. Source: Hermes as at 31 December 2013.