Why Investors Are Increasingly Turning to Commodity ETFs

How Agricultural Commodity ETFs May Enhance Your Portfolio

Introduction

Experienced investors constantly seek ways to enhance portfolio diversification, manage risk, and capitalize on emerging opportunities. While equities and fixed-income instruments have traditionally formed the foundation of most portfolios, alternative asset classes—such as commodities—are earning greater attention today for their ability to provide an additional layer of resilience, particularly in volatile market environments.

Commodity exchange-traded funds (ETFs)[1] offer an efficient and accessible way to gain exposure to commodities, including energy, metals, and agriculture, without the complexities of direct futures trading. In this category, agricultural commodity ETFs[2] are a compelling investment opportunity driven by rising global demand, variable supply, and inflationary pressures. While commodities are often considered complex and illiquid investments, the ETF structure enables investors to access agricultural markets with a straightforward, liquid, and regulated investment vehicle. This eBook explores agricultural ETFs in greater detail to provide additional insight into this compelling asset class.

[1] Investopedia "Commodity ETF: Meaning, Overview, and Guide"
[2] Investopedia "Agricultural ETFs: What You Need to Know"

Industry Outlook: The Future of Agricultural Commodities

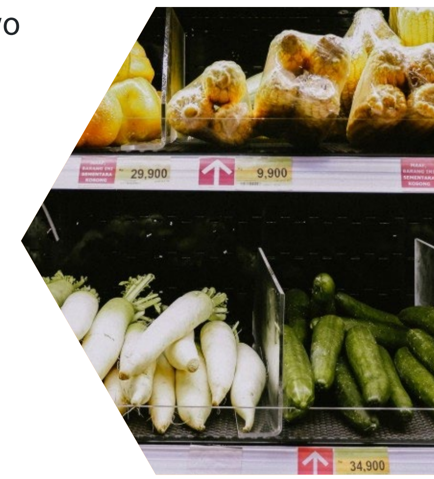
Global Demand for Food Is Rising

The world's population is projected to reach 9.8 billion by 2050[3], underscoring the need for reliable food production and distribution. As economies grow and middle-class populations expand, particularly in emerging markets, food consumption is increasing, especially protein consumption, which drives demand for feed grains like corn and soybeans.

This structural demand growth makes agricultural commodities a cornerstone of the global economy and a vital asset class for investors.

A report from the Food and Agriculture Organization (FAO) highlights that global grain consumption has grown at an average annual rate of 1.3% over the past two decades. Leading commodity analysts say:

> *"Agricultural markets will remain a crucial component of the global economy, with demand outpacing supply in many regions."*



The Role of Inflation in Agricultural Investments

Commodities, particularly agricultural products, have long been recognized as an effective hedge against inflation. Unlike stocks and bonds, whose valuations may be eroded by rising inflation, agricultural commodities may potentially benefit from it. As production costs—including fertilizers, labor, and fuel—have risen, so too have commodity prices. This has much to do with the fact that food is a non-discretionary item, and demand, therefore, is less price sensitive. This can make agricultural commodity ETFs appealing to investors looking to preserve purchasing power and maintain meaningful returns. However, note that there are risks with investing in commodities

Supply Chain Challenges and Climate Risks

Global agricultural supply chains are increasingly affected by climate-related risks and geopolitical instability. Severe weather events like droughts, floods, and hurricanes can disrupt crop yields and create price volatility. Additionally, trade disputes and export bans can influence commodity availability. Understanding these risks is essential for investors who want to incorporate agricultural commodity ETFs into their portfolios.

[3] United Nations, Department of Economic and Social Affairs

Why Agricultural Commodities Matter to Investors

Agricultural commodities are affected by a range of macroeconomic and geopolitical factors, creating both risks and opportunities for investors:

Supply Chain Disruptions & Climate Change: Adverse weather events, geopolitical instability, and logistical bottlenecks can drive price fluctuations, creating short-term trading opportunities.

Government Policies & Trade Agreements: Tariffs, subsidies, and trade pacts can directly influence global agricultural prices.

Inflation Protection: Historically, agricultural commodities have kept pace with or outpaced inflation. Rising production costs often translate into higher commodity prices, providing investors with a natural hedge against inflation.

ETF Investment Options: Understanding Your Choices

Two Main Types of Commodity ETFs

1. **Futures-Based ETFs –** These funds invest in commodity derivatives rather than physical commodities. They provide exposure to price movements without requiring storage or logistics management. Examples include Teucrium's CORN, WEAT, and SOYB ETFs.
2. **Physically Backed ETFs –** These ETFs hold actual commodities, a structure more commonly used for metals like gold. Due to the perishable nature of agricultural commodities, futures-based ETFs are typically the preferred structure.

Different Product Structures

Investors have several ETF structures to choose from:

Single Commodity ETFs – These ETFs provide targeted exposure to a specific agricultural commodity (e.g., CORN for corn, WEAT for wheat).

Diversified Commodity ETFs – These funds provide broader exposure to multiple agricultural commodities, such as TAGS, which holds a mix of corn, wheat, soybeans, and sugar.

Actively vs. Passively Managed Funds – Some ETFs track an index, while others involve active management to optimize returns.

What About Contango and Backwardation?

Futures-based commodity ETFs can be affected by market conditions known as contango and backwardation:

Contango

Contango occurs when futures contract prices increase along the maturity curve (a chart showing current prices for contracts with different expiration dates). In a contango environment, each successive contract is more expensive than the one before it. For futures-based ETFs, this means selling expiring contracts at lower prices and buying new ones at higher prices. This "sell low, buy high" rollover leads to a **negative roll yield,** reducing returns over time—even if the spot price of the commodity remains unchanged. Contango is common in commodities with storage costs, like oil, and is a key factor in futures-based ETF performance.

Backwardation

The opposite occurs in a Backwardated market. Rolling from a higher-priced near-term contract to a cheaper, longer-term contract generates a positive roll yield. If oil's spot is $70 and the next month's contract is $68, the ETF picks up $2 per contract on the roll. Positive roll yields can help boost returns beyond futures price gains.

Mitigating the Negative Impacts

ETFs aren't helpless against these forces. Some get creative to dodge contango's bite or capitalize on backwardation:

Optimized Roll Strategies:

ETFs using optimized roll strategies don't just roll into the next month. They pick contracts further out on the curve (e.g., 3–12 months) where contango might be flatter, reducing roll costs. The catch? It can disconnect returns from spot price moves.

Multi-Contract Exposure:

Funds like the Teucrium Wheat ETF (WEAT) spread holdings across multiple maturities. This dilutes contango's drag by averaging roll yields.

Dynamic Rolling:

Some ETFs use algorithms to shift maturities based on the curve's shape. If contango steepens, they might delay rolls or pick less punitive contracts. It's not foolproof—costs and complexity rise.

Regulatory Considerations for Agricultural Commodity ETFs

Investing in commodity ETFs requires an understanding of regulatory frameworks, including:

Commodities Futures Trading Commission (CFTC) Oversight: The CFTC regulates futures trading and ensures compliance with commodity market regulations.

Tax Implications: Different tax treatments apply depending on the ETF structure, affecting capital gains reporting and tax efficiency.

Market Volatility Controls: Regulatory safeguards such as position limits and circuit breakers help prevent excessive volatility in commodity trading.

Historical Performance of Agricultural Commodity ETFs

Commodity ETFs have historically shown periods of strong performance, particularly during inflationary environments. For instance, during the inflationary pressures of 2021-2022, several agricultural commodity ETFs significantly outperformed many traditional asset classes.[4]

Understanding historical trends can provide investors with insights into potential future performance. However, it's important to remember that past performance does not guarantee future results.

[4] Investopedia "Agricultural ETFs: What You Need to Know"

Investment Suitability: Who Benefits from Agricultural Commodity ETFs?

The Active Trader

Short-term price fluctuations based on weather forecasts, crop reports, and geopolitical events create opportunities for traders.

Liquidity and accessibility allow traders to gain exposure to commodities without directly engaging in futures contracts.

The Registered Investment Advisor & Long-Term Investor

Diversification Benefits – Agricultural commodities often exhibit a low correlation with equities and bonds, making them a valuable addition to consider for risk mitigation. Of course, diversification does not guarantee a profit or protect against loss in a declining market.

Portfolio Enhancement – These assets may serve as a hedge against macroeconomic risks, such as inflation and supply chain disruptions.

Simplified Market Exposure – Investors can gain exposure to commodity markets with ETFs without dealing with futures contracts or margin requirements.

Understanding Tax Considerations for Commodity ETF Investors

Taxes can significantly impact after-tax investment returns, so it is important that investors consult with an investment professional before selecting a particular investment.

Commodity ETFs generally fall under two different tax structures:

Tax Treatment	Section 1256 ETFs	1099 ETFs (No K-1)
Tax Reporting	K-1 Form	Standard 1099
Tax Rate	60/40 capital gains treatment (60% long-term, 40% short-term)	Ordinary capital gains rates

How to Get Started with Agricultural Commodity ETFs

Key Takeaways[5]

- Agricultural commodity ETFs are often sought after to help mitigate inflation, for potential diversification benefits (i.e., returns not correlated to traditional asset classes), and access to essential global markets.
- Understanding ETF structures, regulatory considerations, and tax implications is crucial for making informed investment decisions.
- Active and passive strategies offer different benefits, and investors should align their choices with their investment goals.

By integrating agricultural commodity ETFs into an investment portfolio, you can access a critical global asset class that historically provides non-correlated returns, and inflation hedging.

Schedule a call with us here to learn more about our Teucrium agricultural commodity ETF solutions.

[5] Investopedia "Top Agricultural Commodity ETFs"

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Disclosures

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Futures Risks: Commodities and futures generally are volatile and are not suitable for all investors.

Futures investing is highly speculative and involves a high degree of risk. An investor may lose all or substantially all of an investment. Investing in commodity interests subject each Fund to the risks of its related industry. These risks could result in large fluctuations in the price of a particular Fund's respective shares. Funds that focus on a single sector generally experience greater volatility. Futures may be affected by **Backwardation:** a market condition in which a futures price is lower in the distant delivery months than in the near delivery months. As a result, the fund may benefit because it would be selling more expensive contracts and buying less expensive ones on an ongoing basis; and **Contango:** A condition in which distant delivery prices for futures exceeds spot prices, often due to costs of storing and insuring the underlying commodity. Opposite of backwardation. As a result, the Fund's total return may be lower than might otherwise be the case because it would be selling less expensive contracts and buying more expensive ones.

Actively managed funds do not seek to replicate the performance of a specified index, may have higher portfolio turnover, and may charge higher fees than index funds due to increased trading and research expenses.

Active portfolio management, including market timing, can subject longer term investors to potentially higher fees and can have a negative effect on the long-term performance due to the transaction costs of the short-term trading. In addition, there may be potential tax consequences from these strategies. Active portfolio management and market timing may be unsuitable for some investors depending on their specific investment objectives and financial position. Active portfolio management does not guarantee a profit or protect against a loss in a declining market.

Exchange-traded funds (ETFs) trade like stocks, are subject to investment risk, fluctuate in market value and may trade at prices above or below the ETF's net asset value (NAV), and are not individually redeemable directly with the ETF. Brokerage commissions and ETF expenses will reduce returns. ETFs are subject to specific risks, depending on the nature of the underlying strategy of the Fund, which should be considered carefully when making investment decisions. **For a complete description of a Fund's principal investment risks, please read the prospectus before investing.**

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