# Top commodity managers tip refiners and oil products for Q4

Tue, Oct 9 2012

* Energy and grains boost fund performance in Q3
* Tight oil product inventories to support prices in Q4
* Scepticism about Chinese spending sets in

By Claire Milhench

LONDON, Oct 9 (Reuters) - Leading commodity fund managers are focusing on refined oil product futures and U.S. refining stocks in the fourth quarter as U.S. gasoline and European gasoil supplies tighten, and U.S. refiners benefit from strong margins.

Managers at Quantex and Threadneedle who outperformed their peers in the third quarter are targeting the energy segment in their commodity funds, believing the sector still has legs.

Seasonal refinery maintenance and unexpected outages due to fires and explosions are keeping refined products supplies tight in both the United States and Europe, whilst operating refiners are enjoying high margins.

Peter Frech, who manages the top performing Quantex Commodity Fund, has been building a position in U.S. refining stocks, believing they are undervalued.

"I am focused on plants in the U.S. heartlands, which can buy cheap WTI crude and export refined products to Europe and Latin America," said Frech. "Their profit margins are very high at the moment but people distrust them - they think it is just a cyclical move."

But Frech believes it could be a structural shift because of the U.S. oil shale boom: "We could have a regional over-supply of U.S. crude for several years," he said.

He added that because the market doesn't expect refining strength to be sustained, stocks such as Hollyfrontier, Valero and Marathon Petroleum are mispriced.

The Quantex fund, which invests in both commodity futures and natural resources equities, topped a Lipper performance league table of 130 actively managed commodity funds in the third quarter, up 22.21 percent.

The average actively managed commodity fund in the Lipper Global Commodity sector was up 8.48 percent after a strong quarter in which managers were able to take advantage of rallies in agriculture, energy and precious metals.

Threadneedle's Nicolas Robin, co-manager of two commodities funds in the top 20, said the biggest driver for his outperformance was an overweight in oil products, an underweight in natural gas and a position in the Brent/U.S. crude spread.

"We prefer Brent to WTI and we continue to see that trading at a large premium. We also still like oil products," he said.

"We are seeing a very strong heating oil market and that has performed very nicely. Any cold snap will have a very positive reading for heating oil and Brent."

The Threadneedle Enhanced Commodities Fund and the Columbia Commodity Strategy Fund, which is sub-advised by Threadneedle, generated double-digit returns over the quarter, benefiting from 7 percent overweight positions in U.S. gasoline and European gasoil.

Robin said the U.S. East Coast market was "super tight" with oil products inventories coming off pretty hard over the summer.

He highlighted production issues in the Americas with an explosion at Venezuela's Amuay refinery in August and flooding caused by Hurricane Isaac, which temporarily closed some Louisiana refineries. "The U.S. gasoline season has supposedly ended but we are seeing counter-seasonal strength," he said.

CHINA BUBBLE

Both Robin and Frech are more sceptical about the base metals market, citing weakness in China, although Threadneedle has benefited from an off-benchmark position in lead, which was up over 22 percent in Q3 according to S&P GSCI.

Robin attributed its strong performance to tightness in the scrap metal market and restocking ahead of winter car battery demand. He is sticking with lead in Q4 but steering clear of zinc, copper and aluminium, expecting a deterioration in China.

Frech has been running with a near-zero exposure to industrial metals in futures and equities and remains bearish about China's economic prospects. "They have a gigantic credit bubble that is about to pop," he said.

"Fixed investment as a percentage of GDP is at an absolute high - they are over-investing in infrastructure that has no economic value, financed with cheap bank credit. Base metals stocks are priced on another round of stimulus but they will crash if that is not sustained."

He believes that gold and silver miners, where he has a strong overweight, still have some catching up to do, however. Key holdings include Pan American Silver, Iamgold , Silver Wheaton and African Barrick.

"There is a still a disparity between the stocks and the futures - people love to hate this sector. The analysts are very bearish, which is a good sign as far as I'm concerned," he said.

The mining investments helped the fund outperform in the third quarter, as did an overweight to agriculture futures.

Frech also attributed some of his outperformance to the hybrid fund's flexibility: "We are not a benchmark-hugging fund. We can make active bets if we have strong convictions, which is why we had 40 percent in precious metals last quarter and zero in base metals."

He is moderately bullish for the fourth quarter and believes it is starting to matter more how managers are positioned after two quarters when sentiment has tended to drive commodity markets, rather than fundamentals.

"With QE3 behind us the risk on/risk off mechanism is slowly going away, which is better for a stock-picker," he said.

The worst-placed funds in the Lipper Global Commodity sector were predominantly market neutral funds, which adopt long/short strategies that attempt to smooth returns by minimising directional exposure. Such funds tend to underperform during strong market rallies.