The RICI® Enhanced^{SM} indexes – attracting increasing interest from institutional investors

The Royal Bank of Scotland discusses the development of a series of indexes called the RICI® Enhanced^{SM} Series. These indexes aim to avoid the negative roll yield in benchmark commodity indexes with lower volatility and optimised performance

> The Royal Bank of Scotland (RBS), with subsidiary ABN Amro, developed a series of intelligent rules-based commodity indexes in conjunction with well-known commodity commentator Jim Rogers in October 2007, that have seen widespread acceptance from investors. Unlike traditional commodity indexes, which use a passive roll-mechanism approach, the RICI® Enhanced^{SM} series of indexes offer innovative strategies that provide optimised returns using different commodity futures curves and underlying fundamentals.

The RICI® Enhanced^{SM} series has a tailored roll schedule for each component, a diverse range of 36 components and aims to deliver stable commodity exposure with optimised returns with low volatility. Each of the RICI® Enhanced^{SM} series of indexes can be customised by investors to create their desired exposure. Institutional investors in Europe and Asia have purchased the RICI® Enhanced^{SM} series of indexes for their discretionary portfolios or for the alternative portion of their portfolios, with the aim of outperforming traditional commodity indexes over the long term. RBS can deliver the RICI® Enhanced^{SM} series of indexes in various payouts and wrappers and an Undertakings for Collective Investment in Transferable Securities III-compliant fund has recently been launched based on the flagship index, the RICI® Enhanced^{SM} Global Index.

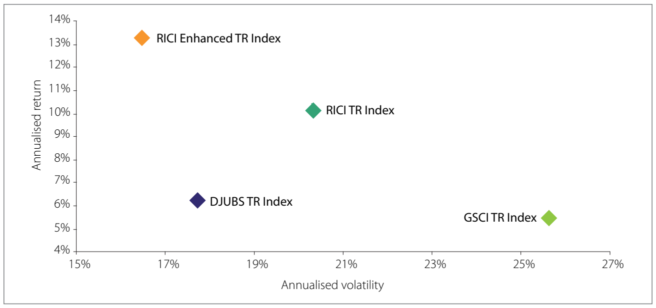
The RICI® Enhanced^{SM} Global Index takes a 'bottom up' approach, where each individual commodity has a tailor-made roll mechanism, where liquidity, seasonality/cyclicality and term structure are taken into consideration, with the aim of delivering an improved risk-adjusted return for each commodity. Passive commodity indexes invest in front-month contracts and roll them shortly before expiration, this can result in a negative roll return when the relevant segment of the futures curve is in contango (usually experienced more at the front end of the curve). The RICI® Enhanced^{SM} Index attempts to remedy the negative roll return by investing in various futures maturities, where the roll return is less negative or more positive. For example, summer and winter are considered for energy contracts, avoiding the need to pay for their liquidity premium. This is done by investing in monthly contracts where players with inherent price risk (for example, the producers) are ready to sell the forwards at a discount in order to close out their price risk.

With 36 listed commodities at present, the RICI® Enhanced^{SM} Global Index remains the most broadly diversified commodity index in existence. The weighting of the agricultural sector has been increased compared with many traditional commodity indexes at the expense of the energy sector.

The RICI® Enhanced^{SM} Global Index is the flagship index of the RICI® Enhanced^{SM} series and major sub-indexes include energy, agriculture and metals. More granular indexes include crude oil, distillate products and natural gas, livestock, grains and oilseeds, fibres, soft commodities, industrial metals and precious metals, while there are 36 individual indexes for each component.

The RICI® Enhanced^{SM} series of indexes aims to deliver higher returns than front-month-futures rolling indexes when curves are in contango, or deliver almost similar returns when markets are in backwardation, making them attractive to institutional investors with their intelligent use of commodity fundamentals that has provided outperformance against traditional commodity indexes over the long term, coupled with lower volatility.

Annualised historical risk – returns



Note: Past performance does not guarantee and is no indication of future performance.
Data Source: Bloomberg, August 2004 to August 2009

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