BEACON POINTE ADVISORS

BEACON POINTE RESEARCH WHITE PAPER

COMMODITIES- IS IT THE RIGHT TIME?

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CONFIDENTIAL – PROPRIETARY

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Introduction

In November 2006, Beacon Pointe published a white paper on commodities and advised our clients to stay on the sidelines until more clarity was obtained regarding the global demand for commodities. It was believed that a slowdown in the US economy, due to declining real estate and a slowdown in consumer spending, was a possibility.

Further, it was deemed that because of the historical coupling of the GDP growth in the rest of the world with that of the US economy, if the US GDP rate of growth declined, this could possibly result in a slowdown in global demand for commodities.

In the paper, we had cautioned that negative sentiment was likely to prevail in the short-term as investors became wary of the possible repercussions of a possible slowdown in US economic growth.

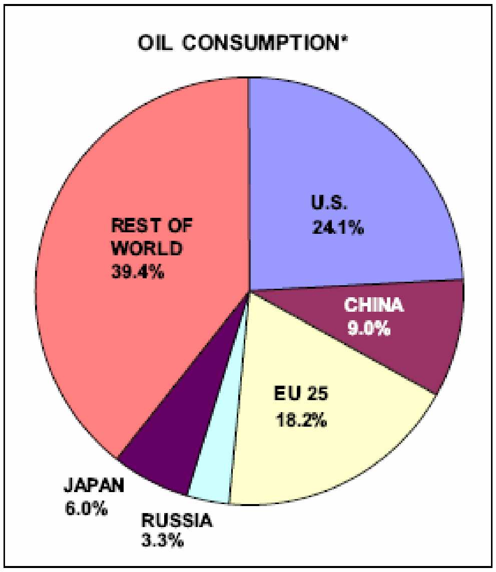
Our Perspective – Bull Case

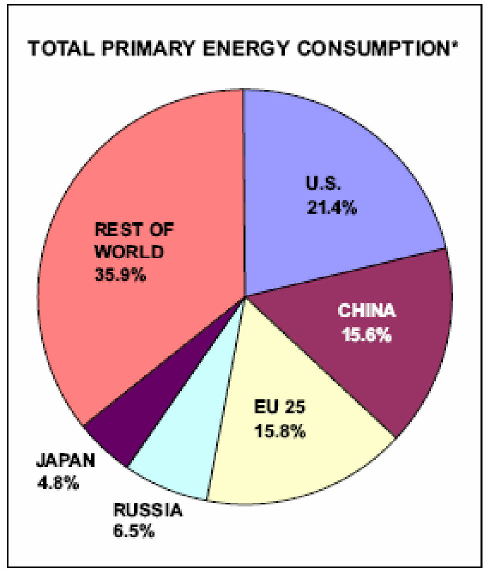
There appears to be little doubt that economic growth in the US might likely decline going forward - stemming primarily from the slowdown in real estate and possible crimping of consumer spending. However, it appears that the rest of the world may continue to grow, thus decoupling a long correlation with US GDP growth.

Many of the emerging markets, including China and India, are simultaneously embarking on economic growth rarely seen before. China and India are expected to grow in excess of 8% annually over the next few years.

For the first time ever, oil consumption of countries in the developing world has risen to that of the developed world.

The global consumption of oil and all primary energy is shown below:





Source: BP Statistical Review of World Energy, June 2007

We believe that the growth in many of the countries in the developing world will continue for several more years as many of these are infrastructural plays, which are backed by their respective governments, are not dependent on the state of the financial markets.

The rising middle class in the emerging markets is likely to fuel demand for commodities that go in finished products such as apparel, autos, airplanes, processed food, and many other consumer oriented products. In addition, global development of financial systems including increasing acceptance of investments in the financial markets is likely to fuel consumption through growing prosperity.

We believe that the growing demand for commodities will likely result in sustained high prices until the next global recession. We further believe that higher prices are necessary to entice companies that sell commodities into further exploration and production activities.

Therefore, Beacon Pointe believes that the demand for commodities is most likely to continue for at least another 3- 5 years, and as such, it is appropriate to include commodities in an asset allocation framework.

The previous paper illustrated the other major factors for including commodities in an asset allocation:

- Low correlation with stocks and bonds – this is important because in an inflationary environment, stocks and bonds are more closely correlated than we have witnessed in the past 20 or so years of disinflationary environment.

- Possible inflationary hedge.
- Strong equity-like returns.

Commodities – The Bear Case

The bears in the market place are not enthusiastic about the prospects for commodities as they say the possibility of global slowdown is likely due to a slowdown in the US. Recent developments and data points refute this stance as the rest of the world continues to grow due to domestic consumption.

However, Beacon Pointe does acknowledge that global growth may possibly slow to some extent as US consumption is approximately 20% of global consumption.

A case in point is the recent update from International Energy Association (www.iea.org) that called for global demand growth to rise from the initial estimated 1.6% year over year to approximately 2%, despite the knowledge that there could be a possible slowdown in the US.

Bears also point to the fact that many of the futures are in contango[1] and thus it is difficult to earn returns, as investors historically made money on the positive roll yield from the backwardated futures in commodities.

Studies have shown, however, that the existence of contango in the future curve is not necessarily indicative of future returns declining. Supply demand imbalance is the key to returns in the commodities world.

Commodities - Conclusions

- Despite the possible slowdown in the US, Beacon Pointe believes it makes prudent sense to include commodities in an asset allocation framework as we anticipate the growth of the rest of the world to decouple from its historical correlation with US economy.
- Beacon Pointe believes that commodities play an important role in a portfolio primarily due to their negative or minimal correlation to domestic and international stocks & bonds. In addition, high, equity like returns of commodity indexes result in a portfolio with higher returns at lower risk levels.
- The best way to gain exposure to commodities is to use strategies based on the commodity indices. Beacon Pointe is of the opinion that the Dow-Jones Commodity Index is an appropriate index to replicate, as it is more diversified than the Goldman Sachs Commodity Index and has sector weights limited to 33% as a risk management tool.

[1] For more on contango and backwardation, please see paper published November, 2006, "Commodities – Is it The Right Time?"

Commodities - Conclusions

- Beacon Pointe believes including commodities in a portfolio enhances returns while lowering risk, thus resulting in higher Sharpe ratios. As such, we recommend making a strategic allocation to commodities.

- Please contact your Beacon Pointe consultant should you have any questions (866-272-1272.