ABSTRACT

Commodity investments have become one of the most popular assets since 2000s because they are believed to offer diversification benefits to the traditional portfolios. This study expands the boundary of researches in commodity investment to the area of Expected Utility Theory. It aims to examine the attractiveness and benefits of commodities when portfolios are estimated based on expected utility maximization.

The optimal portfolios that include and do not include commodity were estimated using full scale optimization as an alternative to mean-variance approximation for investors with different preferences toward risk. Resulting portfolios were evaluated to see how an addition of commodities can improve portfolio performance. The paper includes an analysis of optimization premium investors would require to compensate them for not investing in commodities.

The findings indicate that futures contract on gold, physical gold investment and futures contract on light sweet crude oil are very attractive as alternative investments. These three types of commodity instruments represent largest proportion of the optimal portfolios. An addition of commodities to the traditional portfolio raises investors' welfare in term of expected utility. During inflationary period, commodity investments represent larger proportion of the optimal portfolio. The sub-sample analysis shows that, gold investment is a desirable asset to hedge against inflation. They represent large proportion of the optimal portfolio and significantly raise investors' expected utility. Investors who hold portfolio of traditional assets require certain amount of optimization premium in compensation to equate their welfare to the amount achieved by investors whose portfolios include commodities.