Author:

Ryan O. Issakainen, CFA
Senior Vice President
Exchange Traded Fund Strategist
First Trust Advisors L.P.

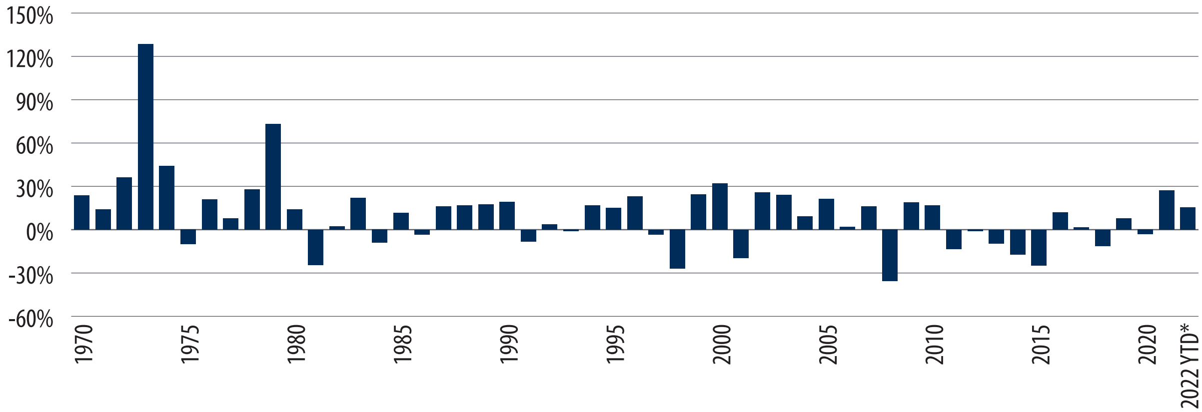
Co-author:

Andrew Hull
Vice President
Exchange Traded Fund Strategist
First Trust Advisors L.P.

Is it Too Late to Allocate to Commodities ETFs?

Commodity prices have been in rally mode since March of 2020. The Bloomberg Commodity Index rose by 27.1% in 2021, the strongest calendar year increase in over 20 years, and the second strongest year since the 1970s (see chart below). So far in 2022, the index is up another 15.5% (as of 2/28). However, recent gains follow a decade of dismal performance. Prior to 2021, 7 of the 10 calendar years through 2020 delivered negative returns. In our view, there are good reasons to believe that commodity prices may continue to trend higher in the months and years ahead. In the near-term, we expect inflationary pressures fueled by loose monetary policy and the recent unprecedented expansion of the money supply in the U.S. to provide a strong tailwind for commodity prices, especially if demand for goods and services rebounds with the lifting of Covid pandemic restrictions. Geopolitical tensions and the conflict between Russia and Ukraine may also play a role in raising commodity prices. Longer-term, a transition to renewable energy and electric vehicles, along with necessary investments in related infrastructure, may fuel a substantial increase in demand for certain raw materials. We believe broad commodities ETFs, such as the First Trust Global Tactical Commodity Strategy Fund (FTGC), may help investors benefit from these trends.

Bloomberg Commodity Index Annual Total Returns



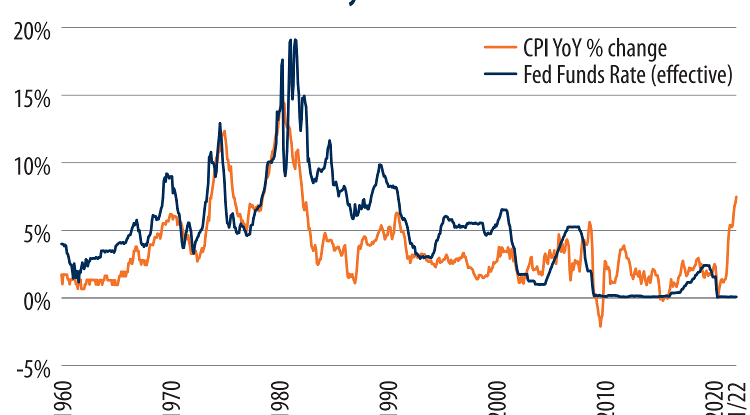
Source: Bloomberg. *2022 YTD as of 2/28/2022. **Past performance is not a guarantee of future results.** For illustrative purposes only and not indicative of any actual investment. Indexes do not charge management fees or brokerage expenses, and no such fees or expenses were deducted from the performance shown. Indexes are unmanaged and an investor cannot invest directly in an index.

Taming Inflation Takes Time

Idiosyncratic factors always play a role in determining commodity prices, and many of these can help explain why certain commodities rallied in 2021. For example, corn prices climbed because of drought conditions in parts of the U.S., natural gas prices were impacted by increased demand for electricity generation due to low wind power output, and grains rose on stockpiling in China. On the other hand, commodity price increases were quite broad based in 2021. Of the 23 commodities included in the Bloomberg Commodity Index, 19 gained more than 15%[1]. Since commodities are often critical inputs for finished goods, rising commodity prices often contribute to higher prices and inflationary pressures. According to the Federal Reserve Bank of St. Louis, the long-term correlation between price changes in the Bloomberg Commodity Index and PCEPI inflation is 0.79[2].

Unsurprisingly, as commodity prices increased over the past year, so too has inflation. Over the past 12 months, the consumer price index (CPI) increased by 7.5% and the producer price index (PPI) jumped 12.2%[3]. For reference, the last time the CPI was as high as it is today (February 1982), the fed funds rate stood at 14.8%. While the Federal Reserve has grown more hawkish in 2022, indicating plans to accelerate the pace of tightening monetary policy, history shows that it often takes time for tightening cycles to slow down inflation.

Fed Policy and Inflation



Source: Bloomberg. As of 1/31/2022. There is no assurance past trends will continue.

[1] Source: Bloomberg.
[2] Data based on 12-month percent changes from January 1995- December 2019. PCEPI is the Personal Consumption Expenditures Price Index.
[3] Source: Bloomberg as of 1/31/22.

Strong Demand and Tepid Supply Growth

The easing of Covid-related restrictions around the world is another factor that may impact commodity prices, as demand for various commodities grows. Increased demand doesn't always translate to higher prices, especially if supply grows at roughly the same rate. However, given the unpredictable nature of the pandemic so far, commodity producers may be cautious to increase supply for fear of additional shutdowns. For example, even as WTI crude oil prices surged to $88.15/barrel on 1/31/22, there were still 43% fewer active U.S. oil rigs (495) compared to 1/31/19 (862), when WTI Crude oil was $53.79/barrel[4]. The Organization of the Petroleum Exporting Countries (OPEC+) has also announced only moderate production increases in response to rising oil prices. Industrial metals and iron ore miners have also been cautious with capital expenditures, often preferring to return capital to shareholders instead of expanding production.

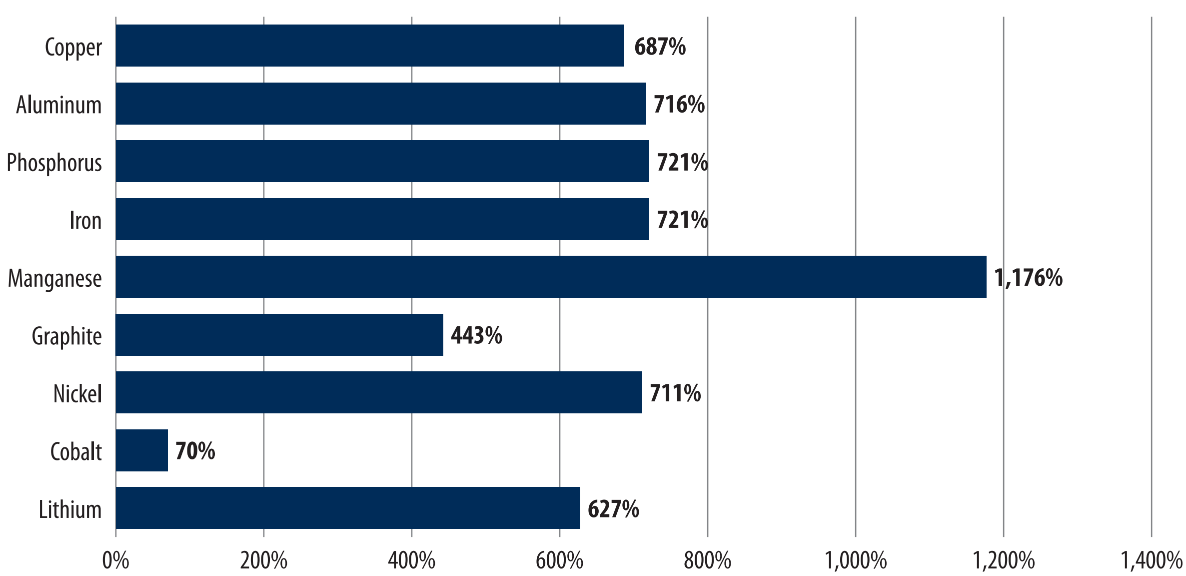
Beyond the pandemic, another reason that supply increases may lag is that producers have had less incentive to develop commodity resources and infrastructure over the past decade due to low or falling commodity prices. Along those same lines, energy producers have had an additional disincentive for developing long-term projects due to regulatory uncertainty and a growing bias towards renewable energy production. Who wants to invest in a 20-30 year project, only to be hit with new regulations 5-10 years later that eat up cash flows over the next 10-20 years?

Despite rising prices, we expect demand for commodities to remain strong as economic activity picks up. The new orders component of the ISM manufacturing survey has reported growth for 20 straight months[4], and economists estimate U.S. real gross domestic product (GDP) growth to be 3.3% in 2022[5], above the 10-year average of 2.1%[6]. We anticipate record corporate profits and U.S. household net worth should also boost demand for finished goods that depend on raw commodities.

Renewable Energy Transition

Longer-term, we believe increases in renewable energy generation and electric vehicle production, along with the necessary development of related infrastructure, could significantly increase demand for various commodities. For example, a single three-megawatt wind turbine requires 4.7 tons of copper, 3 tons of aluminum, 2 tons of rare earth elements, and 335 tons of steel[7]. While electric vehicles (excluding hybrids) don't utilize fossil fuels, batteries require significant quantities of metals. The typical electric vehicle battery requires approximately 18 pounds of lithium, 77 pounds of nickel, 44 pounds of manganese, and 31 pounds of cobalt[8]. Solar panels also require large amounts of copper, silicon, silver, and zinc. Time will tell how well producers are able to keep up with surging demand for these commodities, and at some level price increases usually reduce demand. However, we believe the impact of certain subsidies and regulations related to renewable energy and electric vehicles may raise the price levels at which demand destruction might normally occur.

Estimated Growth in Metal Demand from Batteries (2020-2030)



Source: BloombergNEF. There can be no assurance past trends will continue or projections will be realized.

[4] Source: Bloomberg.

[5] Source: Wall Street Journal, *Omicron, Inflation Drive Down U.S. Growth Outlook*, 1/16/22.

[6] Source: Federal Reserve Economic Data as of 12/31/21.

[7] Source: National Wind Watch, *Metals and minerals in wind turbines*, 8/30/13.

[8] Source: IMF, *Metals Demand From Energy Transition May Top Current Global Supply*, 12/8/21.

Commodity Futures Exposure with FTGC

The First Trust Global Tactical Commodity Strategy Fund (FTGC) is an actively-managed ETF that provides exposure to a diversified portfolio of exchange-listed commodity futures contracts. Unlike index-based broad commodity strategies, which determine portfolio allocations based on levels of production and/or liquidity for certain commodities, FTGC's allocations seek to maintain a robust level of diversification targeting a narrower range of volatility. From FTGC's launch in October 2013 through January 2022, the fund has achieved a standard deviation of 13.1%, compared to 13.8% for the Bloomberg Commodity Index and 23.2% for the S&P GSCI®. Another potential benefit of the actively-managed strategy employed by FTGC is its flexibility to select futures contracts along the futures curve, seeking to maximize total returns.

As investment professionals evaluate portfolio allocations, we believe commodities merit a closer look. Despite the recent rally, we see several factors that may support further increases in the months and years ahead, including inflation and the lag in implementing monetary policy, supply and demand dynamics, and the long-term transition to new forms of energy. Significant geopolitical risks and sanctions against Russia could further constrain the supply of some commodities and boost prices. After a lost decade, we believe investors may benefit from increased exposure to commodities in the years ahead.

Performance Summary (%) as of 12/31/21	1 Year	3 Year	5 Year	Since Fund Inception
FTGC Performance*				
Net Asset Value (NAV)	28.09	11.56	4.44	-2.02
Market Price	27.84	11.57	4.44	-2.00
Index Performance**				
S&P 500 Index	28.71	26.07	18.47	15.20
Bloomberg Commodity Index	27.11	9.86	3.66	-2.38
S&P GSCI®	40.35	7.99	2.80	-6.60

Performance data quoted represents past performance. Past performance is not a guarantee of future results and current performance may be higher or lower than performance quoted. Investment returns and principal value will fluctuate and shares when sold or redeemed, may be worth more or less than their original cost. You can obtain performance information which is current through the most recent month-end by visiting www.ftportfolios.com.

Inception Date: 10/22/2013. Expense Ratio: 0.95%.

*__NAV__ returns are based on the fund's net asset value which represents the fund's net assets (assets less liabilities) divided by the fund's outstanding shares. **Market Price** returns are determined by using the midpoint of the national best bid offer price ("NBBO") as of the time that the fund's NAV is calculated. Returns are average annualized total returns.

**__The Bloomberg Commodity Index__ is the fund's benchmark. Indexes do not charge management fees or brokerage expenses, and no such fees or expenses were deducted from the performance shown. Indexes are unmanaged and an investor cannot invest directly in an index.

You should consider a fund's investment objectives, risks, and charges and expenses carefully before investing. Contact First Trust Portfolios L.P. at 1-800-621-1675 or visit www.ftportfolios.com to obtain a prospectus or summary prospectus which contains this and other information about a fund. The prospectus or summary prospectus should be read carefully before investing.

Risk Considerations

Investors buying or selling fund shares on the secondary market may incur customary brokerage commissions. Market prices may differ to some degree from the net asset value of the shares. Investors who sell fund shares may receive less than the share's net asset value. Shares may be sold throughout the day on the exchange through any brokerage account. However, unlike mutual funds, shares may only be redeemed directly from a fund by authorized participants in very large creation/redemption units. If a fund's authorized participants are unable to proceed with creation/redemption orders and no other authorized participant is able to step forward to create or redeem, fund shares may trade at a discount to a fund's net asset value and possibly face delisting.

A fund's shares will change in value, and you could lose money by investing in a fund. There can be no assurance that a fund's investment objective will be achieved. The outbreak of the respiratory disease designated as COVID-19 in December 2019 has caused significant volatility and declines in global financial markets, which have caused losses for investors. While the development of vaccines has slowed the spread of the virus and allowed for the resumption of "reasonably" normal business activity in the United States, many countries continue to impose lockdown measures in an attempt to slow the spread. Additionally, there is no guarantee that vaccines will be effective against emerging variants of the disease.

In managing a fund's investment portfolio, the portfolio managers will apply investment techniques and risk analyses that may not have the desired result.

A fund that effects all or a portion of its creations and redemptions for cash rather than in-kind may be less tax-efficient.

Commodity prices can have significant volatility, and exposure to commodities can cause the value of a fund's shares to decline or fluctuate in a rapid and unpredictable manner.

The failure or bankruptcy of a fund's and the subsidiary's clearing broker could result in substantial loss of fund assets.

To avoid exceeding position limits set by the Commodity Futures Trading Commission, a fund may have to liquidate commodity contract positions at disadvantageous times or prices which may result in substantial loss of fund assets.

Investments linked to the prices of commodities may be considered speculative and subject a fund to greater volatility than investments in traditional securities. A liquid secondary market may not exist for certain commodity-linked derivatives which may make it difficult for a fund to sell them at a desirable price.

A fund may be subject to the risk that a counterparty will not fulfill its obligations which may result in significant financial loss to a fund.

As the use of Internet technology has become more prevalent in the course of business, funds have become more susceptible to potential operational risks through breaches in cyber security.

Certain securities are subject to call, credit, inflation, income, interest rate, extension and prepayment risks. These risks could result in a decline in a security's value and/or income, increased volatility as interest rates rise or fall and have an adverse impact on a fund's performance.

The use of derivatives, including futures contracts, can lead to losses because of adverse movements in the price or value of the underlying asset, index or rate, which may be magnified by certain features of the derivatives.

Trading on foreign commodity markets is not regulated by any U.S. government agency and may involve risks not applicable to U.S. exchanges.

The frequent trading of commodity futures contracts may increase the amount of commissions or mark-ups that a fund pays when it buys and sells contracts which may detract from a fund's performance.

A commodity price may change substantially between periods of trading due to adverse news announcements.

A fund may be a constituent of one or more indices or models which could greatly affect a fund's trading activity, size and volatility.

Leverage may result in losses that exceed the amount originally invested and may accelerate the rates of losses.

Certain fund investments may be subject to restrictions on resale, trade over-the-counter or in limited volume, or lack an active trading market. Illiquid securities may trade at a discount and may be subject to wide fluctuations in market value.

A fund and a fund's advisor may seek to reduce various operational risks through controls and procedures, but it is not possible to completely protect against such risks.

Short selling creates special risks which could result in increased gains or losses and volatility of returns. Because losses on short sales arise from increases in the value of the security sold short, such losses are theoretically unlimited.

A fund with significant exposure to a single asset class, country, region, industry, or sector may be more affected by an adverse economic or political development than a broadly diversified fund.

A fund does not invest directly in commodities. Rather, it invests in a wholly-owned subsidiary, which will have the same investment objective as a fund, but unlike a fund, it may invest without limitation in commodities. The subsidiary is not registered under the 1940 Act and is not subject to all the investor protections of the 1940 Act. Thus, a fund, as an investor in the subsidiary, will not have all the protections offered to investors in registered investment companies.

If, in any year, a fund which intends to qualify as a Registered Investment Company (RIC) under the applicable tax laws fails to do so, it would be taxed as an ordinary corporation.

Trading on the exchange may be halted due to market conditions or other reasons. There can be no assurance that the requirements to maintain the listing of a fund on the exchange will continue to be met or be unchanged.

Securities issued or guaranteed by federal agencies and U.S. government sponsored instrumentalities may or may not be backed by the full faith and credit of the U.S. government.

Portfolio holdings that are valued using techniques other than market quotations may be subject to greater fluctuation in their valuations from one day to the next than if market quotations were used.

A fund may invest in securities that exhibit more volatility than the market as a whole.

"Whipsaw" markets in which significant price movements develop but then repeatedly reverse, may cause substantial losses to a fund.

The information presented is not intended to constitute an investment recommendation for, or advice to, any specific person. By providing this information, First Trust is not undertaking to give advice in any fiduciary capacity within the meaning of ERISA, the Internal Revenue Code or any other regulatory framework. Financial professionals are responsible for evaluating investment risks independently and for exercising independent judgment in determining whether investments are appropriate for their clients.

First Trust Advisors L.P. (FTA) is the adviser to the fund. FTA is an affiliate of First Trust Portfolios L.P., the fund's distributor.

First Trust Advisors L.P. is registered as a commodity pool operator and commodity trading advisor and is also a member of the National Futures Association.

Definitions

Standard Deviation is a measure of price variability (risk). **Correlation** is a measure of the similarity of performance. The **Bloomberg Commodity Index** is made up of exchange-traded futures on physical commodities and represents 20 commodities, which are weighted to account for economic significance and market liquidity. The **S&P GSCI®** is recognized as a leading measure of general price movements and inflation in the world economy and is designed to be investable by including the most liquid commodity futures, and provides diversification with low correlations to other asset classes. The **S&P 500 Index** is an unmanaged index of 500 stocks used to measure large-cap U.S. stock market performance.