

iShares Market Perspectives

The Commodity Conundrum: Can Commodities Stay Strong Without Inflation?

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Executive Summary

The past decade has witnessed a broad and sustained rally in most commodity markets. Even more recently, the rally has held up surprisingly well despite a decelerating economy and little evidence of inflation in developed countries. This state of affairs has left many investors questioning whether commodities are in a bubble, making many reluctant to commit new money to the asset class.

While many cyclically oriented commodities have been under pressure, and are likely to remain that way given further weakening of the global economy, we continue to believe that investors should consider maintaining a strategic weight to commodities as an asset class.

Although individual commodity prices can be extremely volatile, over the past 25 years the volatility of a broad commodity index has been in line with that of developed market equities. Furthermore, across a long-term horizon commodities are diversifying and have historically helped improve the risk/return characteristics of a portfolio. Finally, while the lack of a dividend or income stream makes commodities difficult to value, we find little evidence to support the notion that the entire commodity complex has entered into a bubble.

That said, the future trajectory for commodity returns will largely be determined by the macro environment. Over the long term, commodities, and gold in particular, have historically benefited from inflation and a weak dollar. In addition, the returns of more cyclical commodities like industrial metals are influenced by economic growth.

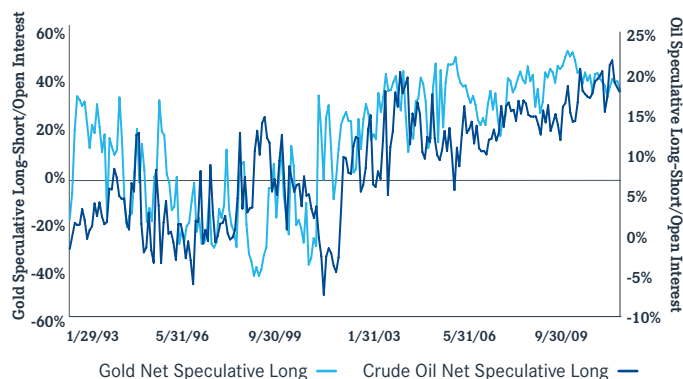
However, arguably the greatest determinant of commodity performance is likely to be the level of real interest rates. Historically, commodity prices have benefited the most not from inflation, but from low or negative real rates, which lower the opportunity cost of holding an asset that produces no income. Perversely, as long-term interest rates fall, even in the face of stabilizing inflation, this is arguably supportive for commodities. To the extent long-term rates remain low or negative – even in the context of a slow growth economy – this may be the most important consideration for the asset class in general, and for gold in particular.

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CHART 1

Net Speculative Commodity Interest 1993 to Present



Source: Bloomberg, as of 6/30/11. Net Speculative Commodity Interest indicates the degree to which investors are allocating to the asset class.

“The next shock? The price of oil has fallen by half in the past two years, to just over \$10 a barrel. It may fall further.”

The Economist, March 4 1999

Out of Favor to Flavor of the Decade

The Economist was not the only famed institution to get its commodity call wrong. About two years after *The Economist* famously suggested that crude oil was going to \$5/barrel, the Swiss National Bank was in the process of dramatically reducing its gold stocks, mostly replacing them with paper currencies. Between May 2000 and September 2001, the Swiss National Bank sold 320 tons, averaging 20 tons a month. At the time, gold prices averaged about \$270/ounce; so much for the market timing skills of central banks.

In fairness to both *The Economist* and the Swiss National Bank, by the late 1990s many had long since abandoned commodities as an asset class. The notion of holding physical assets as a strategic part of a portfolio would have been considered eccentric, if not irresponsible, even a decade ago. Of course, as was the case with equities in the early 1980s, that was the opportune moment to buy. Since the lows in 1998, a broad commodity benchmark – the CRB Index – is up approximately 150%. For many of the better known commodities, the gains have been much more spectacular. Over the same time period, gold is up approximately 500%, copper has gained around 550%, and crude oil has advanced by 800%.

Today, both institutional and retail investors have been increasingly allocating to this asset class. This newfound fascination with physical assets is even more interesting when you consider that commodities are typically viewed as an inflation hedge, and the last decade has been characterized by the lowest inflation rates since the early 1960s.

In evaluating whether investors should continue allocating to the asset class, we focus on three aspects of commodity investing. First, we look at the risk characteristics, i.e. how risky and diversifying are commodities? Second, we attempt to answer the question, are commodities in a bubble? Finally, we examine the macroeconomic

conditions that have historically impacted commodity prices. As we’ll highlight in the final section, contrary to popular wisdom, inflation is not the single most important variable.

Broad Commodity Risk: About the Same as Stocks

Before addressing the fundamental arguments for and against commodities, it is useful to start by going back to first principles and revisiting the arguments for including commodities in a long-term strategic asset allocation.

To start, it will be helpful to quickly review the data sets used in this paper. The data was primarily taken from spot indexes or other proxies for physical commodity prices, such as US producer price indexes. As such, we are not addressing implementation issues such as roll returns and the implications of implementing through futures contracts. Second, the analysis comparing commodity performance to macro factors is based on annual returns.

Many investors view commodities as inherently risky, even when compared to other volatile assets like stocks. While this is certainly true for a specific commodity, to a large extent this is an unfair comparison. For an investor allocating to a broad commodity index – the equivalent of a broad equity index like the MSCI All Country World Index (ACWI) – commodities have been slightly less volatile than stocks over the past 25 years. Since 1985, the standard deviation of monthly returns for the Journal of Commerce (JOC) Index has been around 3.5%, less than that of global equities.

It is true that individual commodities have had substantially higher volatilities. Over this same period, the volatilities for silver and crude oil have been roughly twice that of stocks. However, we would again assert that it is misleading to focus on a single commodity, just as it would be misleading to characterize equity market volatility by looking solely at the mining industry.

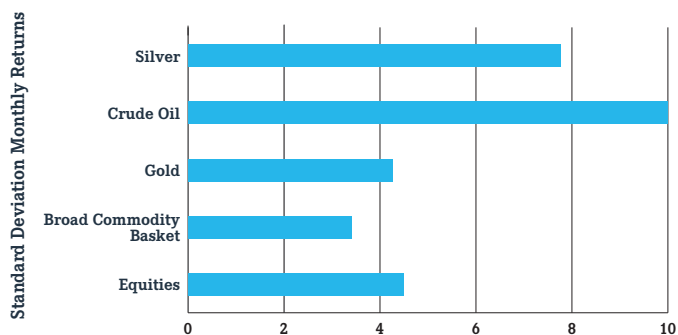
The second question we wanted to address is, which commodities are the most diversifying? While our basic approach is to allocate to a broad commodity index, for investors willing to take a more granular approach are there individual commodities with a particularly negative historical correlation with equities? From the perspective of a basket of US stocks, gold and energy have historically had the highest negative correlation with US equities.

This should not be that surprising. In the case of gold, the metal has historically done best under either unexpected inflation or periods of extreme turbulence and risk aversion, both conditions under which equities could be expected to underperform. In the case of energy, rising crude prices have both contributed to rising inflation as well as acted as a drag on growth. In addition, in at least three instances – the early 1970s, 1990, and 2008 – rising energy prices immediately preceded, and arguably contributed to, the onslaught of a recession and bear market.

The diversifying benefits of commodities in general and gold in particular are also apparent from a basic portfolio construction exercise. A mean-variance optimization – basically a portfolio construction methodology designed to maximize allocation to different

CHART 2

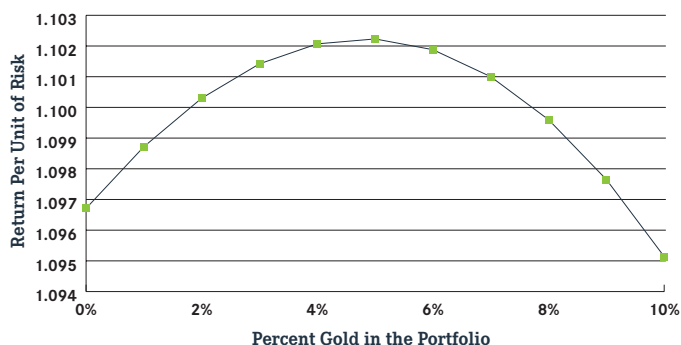
Commodity Volatility vs. Equities 1985 to Present



Source: Bloomberg, as of 6/30/11. Commodities are represented by the JOC Commodity Index, equities by the MSCI ACWI Index. **Past performance does not guarantee future results.**

CHART 3

Portfolio Frontier - Including Gold



Source: Bloomberg, as of 7/31/2011. The chart shows the return per unit of risk associated with increasing the share of gold in a strategic allocation. The starting strategic allocation is a 50/50 mix of equities and fixed income. For example, a value of 10% in the x-axis is associated with an allocation that has 45% equities, 45% fixed income and 10% gold. **Index returns are for illustrative purposes only. Index performance returns do not reflect any fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index. Past performance does not guarantee future results.**

assets in order to produce the highest return per unit of risk – produces a higher ratio of return-to-risk ratio through the inclusion of a modest commodity portion.

Take for example a stocks/bonds portfolio comprised of a 50% allocation to the MSCI World Developed Market Index and 50% to the Barclays Capital U.S. Aggregate Bond Index. As shown in Chart 3, the return per unit of risk is enhanced through the allocation of a small, around 3%, allocation to commodities.

Historically, performance has also improved through a small allocation to gold. As the accompanying chart illustrates, an allocation of up to 4%-5% to gold may help increase return for a given level of risk.

Even for those investors with no strong conviction or belief in the

sustainability of the commodity rally, holding a small portion of a portfolio in commodities has historically improved the efficiency, i.e. return per unit of risk, of a traditional stock/bond portfolio.

Are Commodities in a Bubble?

For many – even those who accept the long-term strategic value of the asset class – this appears to be an inopportune time to buy commodities. With commodities up dramatically over the past decade, asset allocators are reasonably concerned that they have missed the rally and are reluctant to buy at these prices.

Assessing whether commodities are expensive is a much more abstract task than it is for stocks, bonds, or real estate. Unlike traditional asset classes, commodities offer no yield, so assessing fair value is a bit of a meaningless exercise. In effect, commodities are worth whatever someone is willing to pay for them at a given point in time. Trying to assess fair value is an even more esoteric exercise when it comes to gold. Unlike other commodities, which at least have a practical use, gold can be thought of as a proxy currency, making it less susceptible to fair value analysis.

With that in mind, one exercise that may prove useful is to adopt a monetarist bent and compare the change in the price of a commodity with the change in the supply of money. While many cyclical commodities can be impacted by changing demand functions in the near term, over a long-term period the change in the price of a commodity should bear some relationship to the change in the amount of money in circulation. At least historically this has been the case. For most commodities, the long-term change in price divided by the long-term change in the money supply has been relatively stable over time. In those periods when the commodity looked particularly cheap or expensive relative to changes in the money supply, the commodity typically reverted to the mean.

As an example, the attached chart tracks the change of the price of the Journal of Commerce (JOC) Index versus the change in US M2¹, the most popular measure of money supply. The base year is 1985. As can be seen, over the past 25 years, this broad measure of commodity prices has actually trailed the growth in the supply of money. While commodity prices have rebounded strongly since 2003, and again since the market lows in 2009, these gains merely corrected the long-term decline that started in the late 1980s and continued through the 2001-2002 recession.

What about gold? In the case of gold, we have data going back to the inception of the money supply figures in 1959. On this measure, gold does indeed look somewhat expensive, with prices around 35% higher than would be implied simply by the growth in M2. While this is more expensive than any other period since the late 1980s, it is worth highlighting that relative to the supply of money current valuations look modest when compared to the spike in gold in the late 1970s and early 1980s.

¹ In addition to physical currency, in the United States M2 includes current accounts, most savings accounts, retail money market accounts and money market mutual funds, and small certificates of deposits.

CHART 4

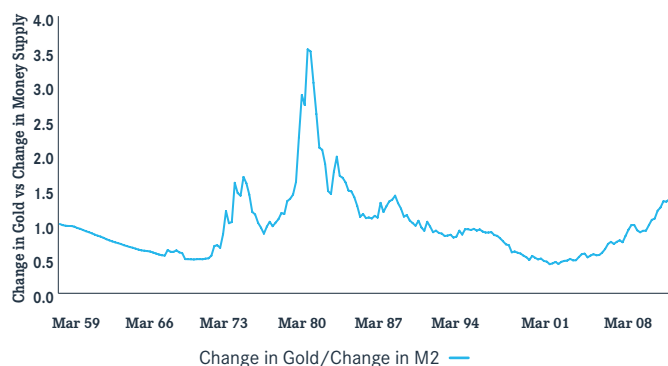
**Journal of Commerce Index Price vs. M2 Change
1985 to Present**



Source: Bloomberg, as of 6/30/2011.

CHART 5

**Gold Prices vs. M2 Change
1959 to Present**



Source: Bloomberg, as of 6/30/2011. Based on gold spot per troy ounce.

Based on this metric, one would conclude that gold appears somewhat overvalued, although it would seem to be an exaggeration to suggest gold was in a bubble. Upon further analysis, even this modest premium can be explained given the macro, and specifically fiscal environment. In the past, the ratio of the change in the price of gold to the change in the money supply has been driven by a number of factors. The most intuitive one is inflation and inflation expectations. As gold is viewed as an inflation hedge, investors generally pay a higher premium for gold when inflation expectations are higher. While inflation expectations spiked briefly in the spring, they have since receded. This makes it difficult to argue that gold's premium is being driven by imminent inflation fears. Instead, the rally in gold can be partly explained by longer-term inflation fears being driven by deficit spending.

Historically, gold has traded at a premium relative to the change in the money supply when federal spending is rising rapidly. The logic being higher spending has historically led to higher deficits. When deficits are high investors rationally worry about the end game, i.e. will the government ultimately deal with large deficits by attempting to monetize the debt thereby creating a surge in the money supply? Today, this appears to be a growing concern among investors. Over the past decade, the relationship between federal spending and gold

prices relative to M2 has strengthened. As the US fiscal situation remains precarious, this may support gold prices, even in the absence of any near-term signs of inflationary pressures.

When to Own Commodities

In order to quantify the impact of the macro environment on commodity returns, we compared annual returns for several different commodities against three separate macro-economic dimensions: inflation, economic growth, and real interest rates. We compared these scenarios to five classes of commodities: gold, silver, energy, metals, and food. In order to obtain the longest possible time series, we used producer prices as a proxy for energy, metals, and food so as to be able to take the analysis back to 1970.

Most investors view commodities as an effective inflation hedge. Historically, commodities have outperformed other asset classes during inflationary periods, but what is the actual link between inflation and different commodities?

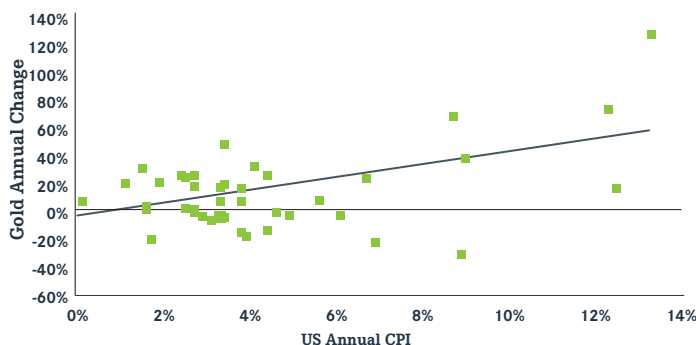
Not surprisingly, in the past the link has been strongest for gold. Unlike other commodities, gold has no useful purpose other than as a store of value. Because gold is not influenced by cyclical considerations, i.e., economic activity, its value has tended to track inflation and inflation expectations. Since 1970, roughly 25% of the variation in gold prices can be explained by changes in the US Consumer Price Index (CPI). Roughly speaking, for every 1% increase in the CPI, gold prices have risen by around 5%.

While gold prices have historically risen with inflation, the actual relationship has been a bit more complicated. In the past, small changes in inflation have not been particularly relevant for gold. In other words, when the CPI has risen from 2% to 3% this has not resulted in a corresponding increase in gold. Instead, gold prices have responded the most when the CPI is already elevated – 5% or higher. Under these circumstances, the relationship between gold and inflation has been much stronger. If you take these non-linear effects into account, inflation actually explains roughly 40% of the variation in the price of gold since 1970.

Another way to think about inflation and gold is that gold generally does best when the dollar's value is eroding. Part of this relationship is mechanical. As gold is valued in dollars, a declining dollar by definition

CHART 6

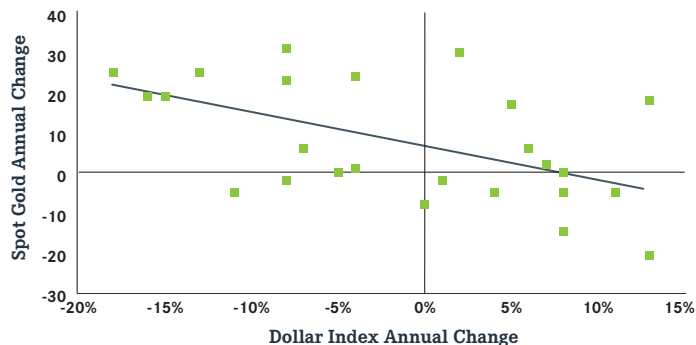
**Gold vs. Inflation
1970 to 2010**



Source: Bloomberg, as of 6/30/2011. Based on gold spot per troy ounce.

CHART 7

Gold vs. Dollar 1985 to 2010



Source: Bloomberg, as of 6/30/2011. Based on gold spot per troy ounce.

will lead to higher gold prices. However, the relationship between gold and the dollar also reflects a second dynamic. In those periods when investors are uncomfortable with any fiat currency, including the dollar, gold is the natural beneficiary – and increasingly these days the Swiss franc.

Historically, there has been a similar relationship between inflation and silver. In the past, silver prices have also risen the fastest when inflation is higher, although the relationship has been less pronounced than between inflation and gold. In the case of silver, between 1970 and 2010 inflation explained roughly 14% of the variation in price. Why is the relationship stronger for gold than for silver when both are deemed precious metals? One hypothesis is that silver, unlike gold, has industrial uses. Roughly 50% of silver demand is driven by industry, and as a result, inflation is less central in silver trading than it is for gold. What is interesting is that similar to gold, silver's relationship with inflation is non-linear in that inflation matters the most when it is already elevated.

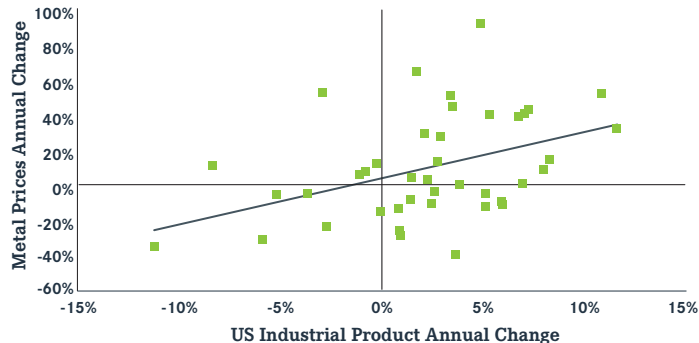
In contrast, energy-related commodities have displayed a different relationship with inflation. Similar to silver and gold, energy prices generally rise with inflation (although in this instance the causal relationship is not clear, as rising energy prices by definition cause inflation). But what differentiates energy prices from precious metals is that higher inflation is actually associated with slower growth in energy prices. In other words, modestly rising inflation tends to be accompanied by rising energy prices, but energy prices do not continue to rise in a linear fashion with inflation. Instead, as inflation continues to rise, energy prices tend to flatten, a response to monetary tightening. As inflation rises, the Fed reacts by tightening monetary conditions, which in turn induces a slowdown in the economy, which ultimately results in reduced demand for oil.

For other commodities, the relationship between inflation and price changes has been far weaker, and for the most part statistically insignificant. The bottom line: for investors thinking of commodities as an inflation hedge, historically gold and silver have been the most effective in this role.

However, while food and industrial metal prices have not had a significant relationship with inflation, they have tended to move with economic activity. This is particularly true for industrial metals like zinc

CHART 8

Metal Prices vs. Economic Growth 1970 to 2010



Source: Bloomberg, as of 6/30/2011. Metal prices are represented by the US Producer Price Index of iron and steel.

or aluminum. Since 1970, industrial metals have had the strongest relationship with economic growth – measured in this instance by changes in US industrial production – with food prices a close second.

Interestingly, energy has not had a particularly strong relationship with US growth, although it has had a weak relationship with global growth. The significance of global growth over US growth arguably reflects the global nature of the crude market, as well as the fact that over the past decade marginal demand is increasingly coming from emerging markets, not the United States. In addition, there are also some quirks in the data series which may be distorting the relationship between energy prices and economic growth; the most notable of which was 2009, when oil rose by 77% despite negative growth. Excluding that data point, between 1985 and 2008, economic growth explained roughly 10% of the variation in energy prices. In contrast, both gold and silver have demonstrated little or no long-term relationship with economic growth.

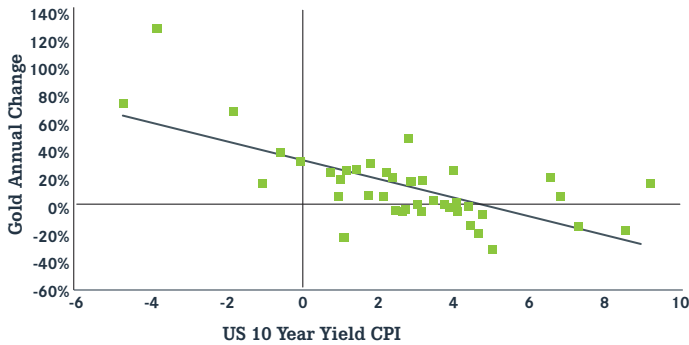
Historically, what has most impacted commodity prices is not inflation or growth but real interest rates, or the difference between the yield on the 10-year US Treasury and the annual change in the US CPI. As mentioned previously, commodities differ from traditional asset classes in that they provide no income. In an environment in which real- or inflation-adjusted yields are high, investors tend to pay a heavy price to own commodities. In addition, when real yields are high, the storage costs for holding commodities are usually much higher. As a result, all commodities have historically had a strong, inverse relationship with real yields. Commodities are typically strongest when real yields are low or negative, as they are today.

The relationship between real rates and changes in commodity prices is particularly strong for gold. Again, we would attribute this to gold's unique role as primarily an investment and store of value. During periods when real yields are high, the opportunity cost for holding gold rather than an income-producing asset is significant. In periods like today, when both nominal and real rates are low, there is little opportunity cost to holding gold.

The relationship between real rates and gold actually dwarfs other factors. Over the past 40 years, real rates account for roughly 45% of the annual variation in gold prices. And unlike many factors that have historically driven commodity prices – such as inflation – this

CHART 9

**Gold vs. US Real 10 Year Rates
1970 to 2010**



Source: Bloomberg, as of 6/30/2011 Based on gold spot per troy ounce.

relationship has strengthened in recent years. Over the past 20 years, the level of real rates has explained nearly 60% of the annual change in gold prices.

While gold clearly evidences the strongest relationship between real rates and price changes, the same dynamic is evident in all the commodity classes. With the exception of the relationship between growth and industrial metals, real interest rates have historically been the most important determinant of price changes for each class of commodities.

Slow Growth, No Inflation, but Steady Commodities?

The meek shall inherit the earth, but not its mineral rights.
J. Paul Getty

Investing in commodities presents a number of paradoxes, all of which make allocation to the space more difficult than for other asset classes. On the one hand, most physical commodities are necessities, ensuring constant demand – something which cannot be said in the case of financial assets. On the other hand, commodities are distinct in that they produce no cash flow – unlike other physical assets like real estate – and are therefore difficult to value. Finally, the broad asset class masks considerable differences in the characteristics and

fundamentals of different commodities. For example, while both gold and copper are metals, they react very differently to changes in the economic landscape.

What can be said is the following. Commodity volatility, at least at the asset class level, has historically been similar to equities. Commodities have the added benefit of generally behaving very differently under rising inflation than paper assets. As a result, they tend to be diversifying over long time horizons. This is particularly true of gold, which has the added benefit of being seen as a potential “safe haven” asset, and as such tends to hold its value during periods of crisis.

That said, commodities, like most assets, do best under certain conditions, although those conditions are not as heterogeneous as many investors assume. While inflation normally benefits most commodities, its impact is not as strong as generally assumed, at least not outside of the precious metals. Inflation, and an accompanying drop in the dollar, has historically been most beneficial for gold. For food and industrial metals, growth matters more.

Finally, and arguably most importantly, investors should give serious consideration to the rate environment. Across all the commodity classes, the level of real interest rates has been an important determinant of commodity returns.

This relationship between real rates and commodity performance also helps explain the following conundrum: why have commodities held up in an environment in which inflation has generally been so low? What has distinguished the last decade is an environment in which monetary policy has been exceptionally loose by historical standards and nominal rates have been unusually close to, or in many cases below, the rate of inflation. In such an environment, the opportunity costs as well as the storage costs for holding commodities are low. These conditions also give rise to anxiety over future inflation, a concern reinforced by uncertainty as to the ultimate end game of the US fiscal situation. Ironically, if the Fed keeps the short end of the curve anchored at zero due to fears over anemic growth and low inflation, this will perpetuate the low real-rate environment and may give an unintended boost to commodity prices.

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Investing involves risk, including possible loss of principal.

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Investments in shares of the Commodities Trust are speculative and involve a high degree of risk. You could lose all or a substantial portion of your investment in the shares of the Trust. Before making an investment decision, you should carefully consider the risk factors and other information included in the prospectus. The value of the shares of the Commodities Trust, which seeks to track the S&P GSCI® Total Return Index (“Index”), depends on the value of CERFs held by the Investing Pool, which are futures contracts on the S&P GSCI® Excess Return Index (“S&P GSCI-ER”), and will fluctuate based on the prices of commodity futures contracts reflected in the S&P GSCI-ER. Commodities markets have historically been extremely volatile. Shares may outperform or underperform the Index.

The price you receive upon the sale of your shares may be less than their NAV. The NAV will fluctuate with changes in the market value of the Investing Pool's assets, and market supply and demand.

Shares of the Commodities Trust may not provide the anticipated benefits of diversification from other asset classes. The lack of an active trading market for the shares may result in losses on your investment at the time of disposition of your shares.

The Commodities Trust issues shares representing fractional undivided beneficial interests in its net assets. Please note that, since the shares of the Commodities Trust are expected to reflect the price of commodities, as described more fully in the prospectus, held by the Commodities Trust, the market price of the shares will be as unpredictable as the price of those commodities have historically been.

The price received upon the sale of shares of the Commodities Trust, which trade at market price, may be more or less than the value of the commodities represented by them. If an investor sells the shares at a time when no active market for them exists, such lack of an active market will most likely adversely affect the price received for the shares. **For a more complete discussion of risk factors relative to the Commodities Trust, carefully read the prospectus.**

Following an investment in the Commodities Trust, several factors may have the effect of causing a decline in the prices of the commodities and a corresponding decline in the price of the shares. Among them: (i) a change in economic conditions, such as a recession, can adversely affect the price of the commodities. These commodities are used in a wide range of industrial applications, and an economic downturn could have a negative impact on its demand and, consequently, its price and the price of the Trust; (ii) a significant change in the attitude of speculators and investors towards the commodities. Should the speculative community take a negative view towards the commodities, a decline in world commodities prices could occur, negatively impacting the price of the Trust; (iii) a significant increase in the commodity price hedging activity by commodities producers.

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Because shares of the Gold Trust are created to reflect the price of the gold held by the Trust, the market price of the shares will be as unpredictable as the price of gold has historically been. Additionally, shares of the Gold Trust are bought and sold at market price (not NAV).

Shares of the Gold Trust are created to reflect, at any given time, the market price of gold owned by the trust at that time less the trust's expenses and liabilities. The price received upon the sale of the shares, which trade at market price, may be more or less than the value of the gold represented by them. If an investor sells the shares at a time when no active market for them exists, such lack of an active market will most likely adversely affect the price received for the shares. **For a more complete discussion of the risk factors relative to the Gold Trust, carefully read the prospectus.**

Following an investment in shares of the Gold Trust, several factors may have the effect of causing a decline in the prices of gold and a corresponding decline in the price of the shares. Among them: (i) Large sales by the official sector. A significant portion of the aggregate world gold holdings is owned by governments, central banks and related institutions. If one or more of these institutions decides to sell in amounts large enough to cause a decline in world gold prices, the price of the shares will be adversely affected. (ii) A significant increase in gold hedging activity by gold producers. Should there be an increase in the level of hedge activity of gold producing companies, it could cause a decline in world gold prices, adversely affecting the price of the shares. (iii) A significant change in the attitude of speculators and investors towards gold. Should the speculative community take a negative view towards gold, it could cause a decline in world gold prices, negatively impacting the price of the shares.

The amount of gold represented by shares of the Gold Trust will decrease over the life of the trust due to sales necessary to pay the sponsor's fee and trust expenses. Without increase in the price of gold sufficient to compensate for that decrease, the price of the shares will also decline, and investors will lose money on their investment. The Gold Trust will have limited duration. The liquidation of the trust may occur at a time when the disposition of the trust's gold will result in losses to investors.

Although market makers will generally take advantage of differences between the NAV and the trading price of Gold Trust shares through arbitrage opportunities, there is no guarantee that they will do so. There is no guarantee an active trading market will develop for the shares, which may result in losses on your investment at the time of disposition of your shares. The value of the shares of the Gold Trust will be adversely affected if gold owned by the trust is lost or damaged in circumstances in which the trust is not in a position to recover the corresponding loss. The Gold Trust is a passive investment vehicle. This means that the value of your shares may be adversely affected by trust losses that, if the trust had been actively managed, might have been possible to avoid.

Important Information Regarding an Investment in the iShares Silver Trust ("Silver Trust")

Shares of the Silver Trust are created to reflect, at any given time, the market price of silver owned by the trust at that time less the trust's expenses and liabilities. The price received upon the sale of shares of the Silver Trust, which trade at market price, may be more or less than the value of the silver represented by them. If an investor sells the shares at a time when no active market for them exists, such lack of an active market will most likely adversely affect the price received for the shares. **For a more complete discussion of risk factors relative to the Silver Trust, carefully read the prospectus.**

Following an investment in the Silver Trust, several factors may have the effect of causing a decline in the prices of silver and a corresponding decline in the price of the shares. Among them: (i) A change in economic conditions, such as a recession, can adversely affect the price of silver. Silver is used in a wide range of industrial applications, and an economic downturn could have a negative impact on its demand and, consequently, its price and the price of the shares. (ii) A significant change in the attitude of speculators and investors towards silver. Should the speculative community take a negative view towards silver, a decline in world silver prices could occur, negatively impacting the price of the shares. (iii) A significant increase in silver price hedging activity by silver producers. Traditionally, silver producers have not hedged to the same extent as other producers of precious metals (gold, for example) do. Should there be an increase in the level of hedge activity of silver producing companies, it could cause a decline in world silver prices, adversely affecting the price of the shares.

The amount of silver represented by shares of the Silver Trust will decrease over the life of the trust due to sales necessary to pay the sponsor's fee and trust expenses. Without increases in the price of silver sufficient to compensate for that decrease, the price of the shares will also decline, and investors will lose money on their investment. The Silver Trust will have limited duration. The liquidation of the trust may occur at a time when the disposition of the trust's silver will result in losses to investors.

Although market makers will generally take advantage of differences between the NAV and the trading price of Silver Trust shares through arbitrage opportunities, there is no guarantee that they will do so. There is no guarantee an active trading market will develop for the shares, which may result in losses on your investment at the time of disposition of your shares. The value of the shares of the Silver Trust will be adversely affected if silver owned by the trust is lost or damaged in circumstances in which the Silver Trust is not in a position to recover the corresponding loss. The Silver Trust is a passive investment vehicle. This means that the value of your shares may be adversely affected by trust losses that, if the trust had been actively managed, might have been possible to avoid.

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