Commodity trading

Commodity trading value drivers 2019

The big question remains "What will drive 2019 commodity trading performance?". 2018 has been a somewhat disappointing trading year in terms of price development. However, oil price volatility picked up creating more trading opportunity. Some of the volatility is induced by supply-demand fundamentals. More uncertainty around the political and institutional set up will add uncertainty and will add to volatility.

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Introduction

As we start into 2019, the hope is that the upcoming year will offer more trading opportunity than in the previous year. 2018 has been disappointing in terms of overall price development but did offer more trading opportunity by the end of the year. Can this positive sentiment be taken into 2019 and will it prevail throughout the year? What are the key value drivers to watch as the year matures?

Starting point

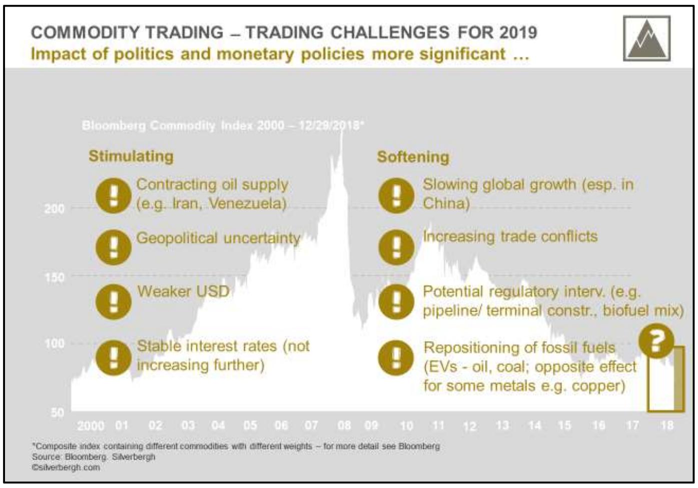
Looking back, some of the value drivers with a negative impact on trading activity and opoortunity we pointed out already in 2017 prevailed into the 2018 trading season incl. e.g. low volatility, narrow correlations, limited liquidity at the long tail. Overall after a good start in the beginning of the year, commodity prices contracted over the 2018 trading period. By the end of the year, volatility picked up attracting more capital. As such, some market participants contempleted to ramp up their trading activity. So, what can we expect from the 2019 trading season?

Trends to watch

In line with our overall value driver perception, we expect that political risks will play a more important role than in the past. Discontinuities in the political arena become more frequent and will leave their mark on trading markets. Will this be negative per se for trading activity? No, on the one hand, economic supply-demand fundamentals might be affected. On the other hand, this will also be a driver for volatility which creates trading opportunity. If this is captured and if market participants 'play their hand successfully', it will offer the opportunity to capitalize the existing trading activity and hence renew the 'license to trade'. This is a challenge several commodity trading market participants intend to resolve in 2019.

Independent of supply-demand fundamentals in different asset classes, overarching patterns are important to understand as they may leave their mark on a single market. As several markets are globally traded and USD denominated, the role of the US and the state of the demand side are of utmost importance.

- **Stimulating impact:** From a global supply perspective, oil production increases. However contracting oil supply from individual suppliers e.g. Venezuela and Iran will contribute to higher prices. Additionally, the agreement of the OPEX+ countries to maintain the recently agreed quotas will add to price discipline. Spill over price effects into other commodity markets (e.g. softs and metals) might appear. Spiced with some geopolitical uncertainty e.g. LATAM, US-Russia-China and potentially new conflicts in Eastern Europe will add to price volatility.



A weaker USD might also support stronger commodity prices. What would one have to believe in order to see this materializing? The US FED would need to keep interest rates at low levels (in order not to kill economic growth and put burden on the unemployment rate). Additionally, the US trade deficit would need to remain high without the possibility of a fast trade agreement e.g. with China (reducing the trade surplus).

This stimulus can still take effect even though economic perspectives in China today are softer than expected last year. The Chinese economy slows down and order book effects in Chinas machinery industry can already be perceived.

- **Softening impact:** Trading market conditions however might remain challenging if global growth slows further. This might be the case if e.g. China has to further correct growth numbers downwards during 2019. Brexit negotiations might stall adding more uncertainty to the transition process with the result of slower international trade and consumption. Unresolved trade conflicts or additional trade hurdles (tariff & non-tariff) would support this outcome.

On individual commodities like gas, oil, coal or palm oil regulatory interventions, revised political objectives or amended technical specifications might put pressure on current price levels. Additionally, supply-demand balances of fossil fuels in the energy supply portfolio e.g. fuels, coal will be impacted as sales of electric vehicles (EVs) increase. Premium automotive manufactures will launch several models in 2019/20 and will start volume production. Also, the build out of renewables will continue in line with public policy objectives internationally. On the contrary as there is a potential softening impact of this development on fossil fuels, this would substantiate a continued stimulus for some metals e.g. copper.

Summary

What do we conclude? Challenges and opportunities are distributed slightly differently compared to the previous year. We perceive a riskier and more volatile politically induced economic macro environment. However, there are strong signs for somewhat attractive trading market conditions and prices in 2019. Some instability might create additional trading opportunity rather than destroy a positive market sentiment.

Outlook

For some market participants, 2019 will be an important year as they have to proof that they can create value and can attract capital for trading purposes.

Either trading performance will increase, or decisions will need to be taken to re-allocate economic capital and review the trading footprint. As a result, some trading activities might be closed, sold or partnerships might be considered. These decisions will also be driven by the evolution of cost-income ratios (CIR), margins (which are tight today), a decreasing capital base and challenging conditions to re-finance respectively capitalize.
