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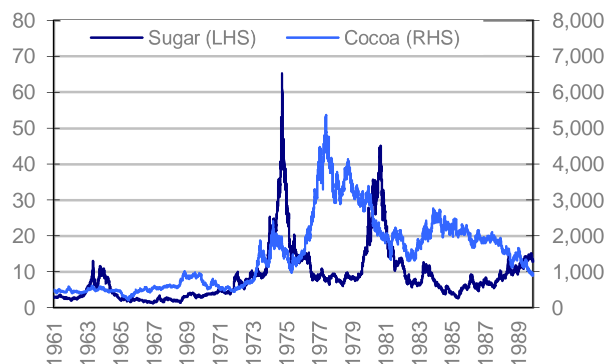
COMMODITY PRICE VOLATILITY – DEJA VU – JULY 2012

"Events will take their course, it is no good being angry at them."
Euripides, Bellerophon, 430BC

In recent years, there has been much cavilling and mud-slinging about commodity price volatility. In an unstable world, it is convenient for governments to have a bogey-man and it is easy to add commodity speculators to the bag of pariahs that already includes banks and other financial institutions. Hyperbole such as ***"Speculation in basic foodstuffs is a scandal when there are a billion people starving in the world"*** (Michael Barnier, EU Commissioner) has lent support to a variety of tub-thumping agencies, such as the World Development Movement. In pride of place on their website, they note ***"…[commodity markets] over the last 10 years have changed almost beyond recognition. Deregulation has enabled speculators to dominate, causing drastic spikes and crashes in prices."***

Really? Any cursory glance at commodity prices over time would prove that high volatility is not a recent phenomenon. In the 1970s, the cocoa and sugar markets were tremendously volatile;



In very short periods of time, these markets increased more than six-fold before subsequently surrendering all their gains. In sugars case, it then quadrupled before collapsing again. In a similar four year period (1973-1977), cotton futures more than tripled, then halved, then doubled and then halved. And everyone knows about the oil price shock of the late 1970s – oil prices almost trebled in 1979 from an opening of \$15/bbl to \$40/bbl. This in turn was a key factor in the gold price also spiking 400% from \$200/toz to \$800/toz. And it wasn't just the 1970s. In the 1990s, the corn price doubled and then halved.

But the biggest mover of that decade was coffee – see above.

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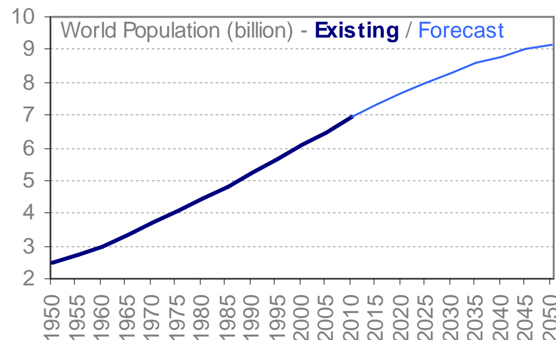
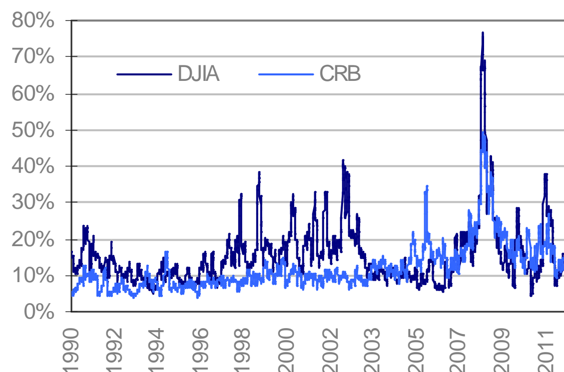
The reality is that commodity prices have always been relatively volatile and that they have NOT "changed almost beyond recognition". Why is this? Quite simply the supply of commodities is relatively inelastic and always vulnerable to event risk. Geopolitical risk can significantly impact metals and energy, while food crops are obviously vulnerable to extreme weather events. If one major growing area loses a harvest, prices will rise! Especially when demand continues to grow. While economic difficulties may weigh on industrial demand, the world stills requires food (even in recession) and as the population continues to soar, there is always a background upside bias to food prices;



The worlds population has almost doubled since the commodity price turbulence of the 1970s (3.69bln to 7.02bln = +90%) and it continues to grow by approximately 10%pa.

SUMMARY

Commodity prices can be volatile – but it has always been this way! Indeed the same price volatility was why early farmers established futures trading and developed hedging strategies. The world has grown, and technology has opened markets up to a much wider audience but commodity markets remain driven by supply and demand factors – ultimately it is these that drive price direction, not "evil" speculators. And in any case, commodities are generally no more volatile than equities. The chart below compares historic volatility of the Dow Jones Industrial Average (containing 30 stocks) with the Reuters Commodity Research Bureau index (containing 19 commodity markets). Perhaps surprisingly commodity volatility (CRB) averages 12% over the period vs. 16% for equities.



Understanding commodity price volatility is key to a successful investment in commodity markets. At Jaguar, we have a small team of commodity experts, with the portfolio managers each having at least 25 years experience commodity trading. **Managing commodity investments is not just what we do – it is ALL we do…**