

Lucerne University of
Applied Sciences and Arts

**HOCHSCHULE
LUZERN**

Wirtschaft

Understanding Commodities

**Nicolas Bürkler, Dr. Martin Spillmann,
Prof. Dr. Roger Rissi, Peter Sigg, Dr. Daniel Schmitt,
Paul Vernon, Camillo Zbinden**

Schriften aus dem Institut für Finanzdienstleistungen Zug IFZ
Band 28
Verlag IFZ – Hochschule Luzern

Understanding Commodities

By

Nicolas Bürkler
Dr. Martin Spillmann
Prof. Dr. Roger Rissi
Peter Sigg
Dr. Daniel Schmitt
Paul Vernon
Camillo Zbinden

Verlag IFZ – Hochschule Luzern

Published by Verlag IFZ – Hochschule Luzern.
Made in Switzerland.

Copyright © 2015 by IFZ

ISBN: 978-3-906488-53-0

IFZ Schriftenreihe: Band 28

Institut für Finanzdienstleistungen Zug
www.hslu.ch/ifz
ifz@hslu.ch

Printed by Druckerei Odermatt AG, Dorfplatz 2, 6383 Dallenwil NW

Dedication

To all those who have spent their evenings burning the midnight oil to complete a project that will not only be a fresh insight into the field of commodities but has also been great reason for so many of us to come together and share knowledge.

We are very grateful to the head of the Institute for Financial Services Zug for all the support and faith they showed in this project as well as undertaking the financial aspects involved with producing this book. And to all those who's words and idea's not only contributed to this book but in fact built it chapter by chapter, we would like to offer a word of gratitude and thanks.

A great many thanks to all the men and women from CAS Commodity Professional as well as the professionals from Lugano Commodity Trading Association (LCTA) and Zug Commodity Association (ZCA) who have taken the time to put forth interesting insights and discussions which have greatly helped in the creation of this book.

Lastly we would like to thank all who have contributed big or small to seeing this book completed, it has been a long but fruitful journey. Thank you

Preface

The aim of this book is to give an introduction and understanding of commodities. The six chapters approach students and people intrigued by commodity markets. But it shall also provide an interesting lecture to the advanced practitioners in the fields of the commodity industry.

Market places, its players, business conditions and challenges are changing rapidly. Therefore, the full value chain is seen as subject matter for financial risks. In addition, financialization of society and commodity markets is described in detail. Investing into commodities, compliance, and controversies among speculation are all subjects in further chapters.

This publication has emanated from a collaboration of experts who have compiled and realized a new instruction course called CAS Commodity Professional. It is offered by the Lucerne University of Applied Sciences and Arts and takes place in Zug and Lugano, and is supported by the commodity industry associations ZCA and LCTA in Zug and in Lugano respectively.

List of contributing authors:

Chapter I by Martin Spillmann

Chapter II by Martin Spillmann & Nicolas Bürkler

Chapter III by Nicolas Bürkler & Daniel Schmitt

Chapter IV by Roger Rissi & Peter Sigg

Chapter V by Camillo Zbinden & Paul Vernon

Chapter VI by Nicolas Bürkler & Peter Sigg

This book would not have been realized without the motivated effort of a team. Special thanks go to Nicolas Bürkler for the editorial work, to Christoph Küng for administrative support, and – finally – to Christoph Lengwiler and Linard Nadig from the Institute for Financial Services Zug (IFZ) for publishing. The authors wish you pleasure reading it.

Table of Contents

Dedication	5
Preface	7
Table of Contents	9
List of Figures and Tables	13
I. Introduction to Commodities	15
1 Terms and Concepts	15
1.1 What are Commodities?	15
1.2 2000s Commodities Boom	16
1.3 Time is Money	18
2 The Players	20
2.1 Leading Commodity Firms	20
2.2 Leading Trading Places	26
2.3 Trading Firms and Trading Places in Context	29
3 Global Trends and Changing Market Parameters	30
3.1 Socio-Demographic and Political Megatrends	30
3.2 Changing Business Conditions	33
3.3 How Commodity Firms Respond	35
4 Stakeholders and Society Demands	39
4.1 Commodity Trading in the Public Eye	39
4.2 Who are the Main Stakeholders?	43
4.3 Current Main Initiatives	45
II. Managing the Value Chain	51
1 Introduction	51
2 Partners along the Commodity Value Chain	52
2.1 The Commodity Value Chain	52
2.2 Partners in the Commodity Value Chain	53
2.3 Frictions and the Question of Systemic Relevance	57
3 Implication for Risk Management concerning the Value Chain	59

III. Financialization & Theoretical Background	63
1 Terms and Background Information	63
1.1 Introducing the most importance Terms and Definition	63
1.2 Why is the subject “Financialization” important?	64
2 Future and Spot Market at Glance	67
2.1 Models of Expected Returns	67
2.2 Theoretical Markets	69
2.3 Relationships in Practice	71
3 Historical Price Dynamics and Volatility Patterns	73
3.1 Different Price Dynamics	73
3.2 Volatility Patterns	76
3.3 Influential Factors of Price Dynamics	79
4 Financialization of Commodity Markets and Society	81
4.1 Differences: financialized vs non-financialized Commodities	83
4.2 Costs of Price Instabilities	87
4.3 Concentration, Market Power and Access Restriction	88
IV. Commodity Investments	91
1 Introduction	91
1.1 Financialization: Why physical Commodity Traders should care	92
1.2 What’s so special about Commodities?	94
2 Categorizations of Commodity Markets	94
2.1 Rationale for an Inclusion of Commodities in an Portfolio	97
2.2 Ways to participate in Commodity Markets	101
3 Practice of Commodity Investing	107
3.3 Price driving Factors	107
3.4 Strategic and Tactical Asset Allocation	108
4 Trading Strategies	115
4.5 Directional Trades:	116
4.6 Curve Positioning	116
4.7 Spread Trades	116
4.8 Commodity Options	116

V. Compliance in Commodity Trading	119
1 Introduction	119
2 Key Compliance Topics	120
2.1 Corporate Governance and the Internal Compliance Program	120
2.2 Sanctions and Embargoes	124
2.3 Anti-Money Laundering and Terrorist Financing	130
2.4 Corruption	136
2.5 Country Risk Assessment	137
2.6 Environmental and Ethical Issues	138
2.7 The Relationship with and the Roles of Banks	139
2.8 Regulatory Environment and New and Pending Regulations	142
3 Summary and Conclusions	144
VI. Political Discussion and Controversy among Speculation and Financialization	147
1 Introduction	147
2 Controversy in Agricultural Investment	148
2.1 Diagnosis of Causality	149
2.2 Detailed Analysis of the Controversy	151
2.3 Summarizing Agricultural Investments	157
3 Concluding Financialization	157
3.1 Influences of Commodity Prices in Developing Countries	157
3.2 Broader View than just Speculation	158
3.3 Suggestions for lower Commodity Price Volatility	160
Bibliography	163