Flash Boys: are markets rigged?

Although the title might thoughts towards an 80’s TV-show, Michael Lewis’ new book, Flash Boys, is in fact a very worrying account of how the US stock market might be rigged by high frequency traders. In light of this release, the New York Times has published the fascinating story of Royal Bank of Canada trader Brat Katsuyama, who was among the first to realize what high frequency trading did to the market and went on to establish the first “fair-access platform”, the IEX (click here). Could the same be happening in commodity markets? Some say yes (click here), but the story will certainly gain more attention now that the Federal Bureau of Investigation (FBI) has launched a probe into high frequency trading (click here).

Economic historians usually label the western economic miracle leading up to the industrial revolution as the “Great Divergence”. However, we could easily apply the same terminology to the recent developments in commodity markets. Agricultural commodities for once have largely been on the rise. Including commodities such as butter, coffee, orange and pork belly, the Financial Times has estimated that full breakfast on average may have increased by around 24 percent over the first three months of 2014 (click here). While current regional concerns such as the drought in Brazil may take some of the blame, farmers around the world are also jittering on the prospect of another “El Ninõ” and the destructive weather patterns that tend to follow (click here).

The other leg of this “Great Divergence” is industrial commodities, where copper in particular saw a large price decreases over the last month. The trigger for this volatility was sluggish economic data out of China and the fact that the country had its first corporate bond default. The latter was of particular concern since as much as 95 percent of warehouses bonded copper may serve as collateral for loans and other financing arrangements (click here).

Some speculate that the recent events might signal the end of “Dr. Copper” as bellwether for the economy, as the metal’s price likely says more on the current state of China, where about 40 percent of global copper production is consumed, rather than the global economy (click here). Currently China is planning to cut its subsidies (click here) and steel mills may be particularly hard hit. A recent survey by Macquarie Commodities Research among steel mills found that “*for the first time in the history of the steel survey not one smaller mill reported that they are making money*”. Click here to read the recap of the survey by the Financial Times.

The controversies relating to the warehousing issues at the London Metal Exchange (LME) continue to make headlines. Rusal, the World’s largest aluminium producer, had filed a lawsuit against the LME’s new warehousing rules that would oblige warehouses with queues longer than 50 days to unload more metal than they bring in. To the frustration of aluminium purchasers, the ruling went against the LME when the court deemed the exhange’s consultation procedure to be “unfair and unlawful” (click here). Oleg Deripaska, chief executive of Rusal, is therefore probably the only Russian oligarch with a smile on his lips these days – even though his company recently had to take a net loss of USD 3.2 billion for the financial year 2013 (click here)

However, at least on one point there seems to be some convergence between agricultural and industrial commodities. Participants in the oil and cotton markets increasingly agree that the major contracts and price benchmarks are in need of a reform. Slowing output from the North Sea is increasingly calling for a reform of the Brent benchmark to potentially include grades from West Africa, Kazakhstan and even Russia and the United States (click here). The cotton market, on the other hand, is already one step ahead as “World Cotton” futures are set to list on the Intercontinental Exchange during the second half of 2014 (click here). Be sure to stay up-to-date on the Kairos portal for the latest developments in the world of commoditites.

Link 1: <http://www.nytimes.com/2014/04/06/magazine/flash-boys-michael-lewis.html?smid=fb-share&_r=0>

Link 2: <http://www.zerohedge.com/news/hft-has-disconnected-commodities-fundamentals>

Link 3: <http://www.cnbc.com/id/101488947>

Link 4: <http://www.ft.com/intl/cms/s/0/2ac2dbe6-adae-11e3-9ddc-00144feab7de.html?ftcamp=crm/email/2014318/nbe/CommodsDaily/product&siteedition=intl>

Link 5: <http://www.ft.com/intl/cms/s/0/77275cf0-a8f9-11e3-9b71-00144feab7de.html?ftcamp=crm/email/2014312/nbe/>

Link 6: <http://www.globaltimes.cn/NEWS/tabid/99/ID/848052/Copper-prices-slump-amid-rising-fears.aspx>

Link 7: <http://www.economist.com/news/finance-and-economics/21599814-finance-not-economics-may-explain-coppers-recent-plunge-broken-contacts>

Link 8: <http://www.businessweek.com/news/2014-02-27/china-s-subsidies-end-prompts-forecasts-for-slower-growth>

Link 9: <http://blogs.ft.com/beyond-brics/2014/03/25/default-risks-surge-at-china-steel-mills-survey/>

Link 10: <http://www.bloomberg.com/news/2014-03-27/lme-warehouse-delays-get-extended-as-judge-bars-fix-plan.html>

Link 11: <http://www.bloomberg.com/news/2014-03-28/rusal-posts-3-2-billion-net-loss-in-2013-on-prices-writedowns.html>

Link 12: <http://www.ft.com/intl/cms/s/0/50d240ae-a955-11e3-9b71-00144feab7de.html?ftcamp=crm/email/2014312/&siteedition=intl>

Link 13: <http://www.ft.com/intl/cms/s/0/77da6d4a-abba-11e3-aad9-00144feab7de.html?ftcamp=crm/email/2014317/>