Analysis.Commodities

MARKET SHOCKS 2015

How tumbling prices caught investors cold

Money pulled from products weighted towards oil and metals as collapse takes its toll –

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When Glencore chief executive Ivan Glasenberg spoke to analysts and investors in August after the publication of annual results, he made a surprising admission.

The man regarded by many as the savviest trader of his generation conceded that he could not read the Chinese economy and had been "surprised" by the downturn in commodity prices.

Glencore's pugnacious boss was not alone in misreading the market. Many analysts, investors and executives have been wrongfooted by this year's across-the-board collapse.

The decline in oil that set in last year has gone further than many expected with Brent plumbing its lowest price in 11 years just before Christmas.

That slide hurt commodities as investors have withdrawn money from investment products that were heavily weighted towards oil but also contained exposure to metals and grains.

Not surprisingly, broad-based indices such as the Bloomberg Commodity index of 22 raw materials have fallen to their lowest levels since the financial crisis. In addition, surprises such as China's devaluation of its currency in August have undermined investors' sense of confidence in the world's largest commodity consumer.

"The sector as a whole, and all of us, spent a great portion of the year chasing our tails," Kieron Hodgson, analyst at Panmure Gordon & Co, says.

In metals, the slump in nickel, has surprised almost everyone. It has fallen more than 40 per cent, outstripping even oil. Zinc, which was widely expected to rise in price this year because of the flagged closure of two large zinc mines in Australia and Ireland, has fallen 28 per cent.

In January Goldman Sachs expected zinc prices to rise 16 per cent over the next 12 months — to $2,500 a tonne — and nickel 22 per cent. Instead, zinc is now trading at $1,503 a tonne on the London Metal Exchange.

The surprise has also been evident in the response of the world's largest mining companies, which waited months before announcing plans to cut their debt and capital spending and lay off thousands of employees.

Glencore has accelerated its debt reduction plan while Anglo-American plans to sell or shut 60 per cent of its mines but only after the two companies became the worst performers on the FTSE 100 this year. Glencore has lost 71 per cent and Anglo-American 75 per cent in 2015, burdened by heavy debt loads.

Arguably the biggest factor weighing on metals prices has been a slowdown in China. Investors were given a warning in January when a group of Chinese hedge funds were alleged to have been behind an attempt to push the copper price lower when most London-based traders were sleeping.

The so-called “bear raid” came as many China-based traders believed demand forecasts were too optimistic, with western analysts slow to price in a shift in China’s economy towards more consumer-led consumption after years of infrastructure-led growth. By the following month copper had fallen 10 per cent.

Oil’s drop has also been a shock for investors in natural resources. At the start of 2015 most analysts expected international benchmark Brent to recover to about $70 a barrel by the end of the year, after dropping 50 per cent in the last six months of 2014. Instead, after a bounce to $67 in May, the price has since almost halved from that level.

The oil industry has embraced a mantra of “lower for longer” prices with $280bn of future investment cut in the face of Opec’s unwillingness to rein in production and the surprising resilience of output outside the cartel.

“We believe the Chinese economic slowdown is an important inflection point for commodity markets,” says Jeremy Weir, chief executive of commodity trader Trafigura.

“Combined with uncertain prospects for global GDP growth in 2016, it means that markets, whether for oil or for metals and minerals, will be characterised by surplus supplies and relatively depressed prices for some time to come — in some markets, for another several years.”