The Post-2008 Commodities Trade: 
Market Liquidity & the Three “C’s”

June 2014

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Biggest Change In Financial Energy Since 2008?

*Price discovery* in commodity derivatives markets has increased significantly since 2008. True *liquidity*, if anything, has deteriorated.

Definitions in this context:

**Price discovery**: Rapid, transparent, and non-preferential access to price information

**Liquidity**: The ability (and willingness) of market participants to execute volume and manage risk at price, from both a market and credit perspective.
Framing the Discussion

The 3 eras of commodity derivatives trading

- Pre-2003
- 2003-2008
- Post-2008

Classifying commodity market participants

- Buyers vs. sellers
- Providers of liquidity vs. users of liquidity

Focus on post-2008: The three “C’s”

- Credit (Capital Costs)
- Correlation
- Centralized Clearing
# The Post-2008 Commodities Trade

## How Participation Changed In 2003-08

<table>
<thead>
<tr>
<th>Category</th>
<th>Buyer / Seller</th>
<th>Liquidity User / Provider / Both?</th>
<th>Change Circa 2003-08?</th>
<th>Change Post-Crisis?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Energy Producers</td>
<td>Seller</td>
<td>User</td>
<td>Decline in systematic hedging as prices increased</td>
<td>Huge growth; credit, backwardation are challenges</td>
</tr>
<tr>
<td>Energy Consumers</td>
<td>Buyer</td>
<td>User</td>
<td>More systematic hedging as prices increased</td>
<td>Should be tempted by backwardation...</td>
</tr>
<tr>
<td>Financial Institutions</td>
<td>Both</td>
<td>Provider</td>
<td>Number of banks and VaR in commodities increased</td>
<td>Significantly reduced VaR as a sector, many exits</td>
</tr>
<tr>
<td>Trading Houses / Merchants</td>
<td>Both</td>
<td>Provider</td>
<td>Diminished post-Enron</td>
<td>Back in force! Filling vacuum left by banks</td>
</tr>
<tr>
<td>CTAs / Algorithmics</td>
<td>Both</td>
<td>Neither?</td>
<td>Early growth...</td>
<td>Significant growth thanks to clearing</td>
</tr>
<tr>
<td>Macro Hedge Funds</td>
<td>Both</td>
<td>Both</td>
<td>Increased allocations to career commodity experts</td>
<td>Reduced allocations; less risk in deferred tenors</td>
</tr>
<tr>
<td>Institutional Investors</td>
<td>Buyer</td>
<td>User</td>
<td>New kid on the block!</td>
<td>Back to vanilla beta; net outflows in 2014</td>
</tr>
</tbody>
</table>
Here’s What Happened in 2003-08...
Another View of Spreads & Flat Price Diverging

As a Time Series...

- Mo. 1 Brent (left)  --  Mo. 1 - Mo. 6 Spread (right)

... But diverge dramatically starting ~2003

Spreads and flat price move together historically...

As a Scatterplot...

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Fast Forward to Post-2008...

As a Time Series...

Chaos...

... Order!

Mo. 1 Brent
Mo. 1 - Mo. 6 Brent

As a Scatterplot...

R² = 0.5439

1990-2003
2003-2008
2009-Present

R² = 0.1227

R² = 0.8447
Long-dated WTI Spreads Outpace Flat Price
What’s Changed Post-2008? The Three “C’s”

Credit ( / Capital Costs)

Correlation

Centralized Clearing
The Post-2008 Commodities Trade

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