Basics of Commodity Trading

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Background: Commodities

- The focus of the past decades: energy raw materials. The trading of other commodities was initially scarcely seen by investors. Metal deposits were plentiful, agricultural raw materials abounded: the supply of industry and consumers was regarded as secure.
- Supply and demand on the global raw materials markets are now increasingly becoming the focus of public attention.
- Portfolio managers and private investors show increasing interest in investing in commodities. Capital invested, for example in commodity indices, has been rising steadily for years.
- Strong demand from countries such as India and China, as well as Tiger states and emerging markets, geopolitical risks, but also regional environmental factors can lead to significant price increases on commodity markets.

Commodities as a Asset Class

- The international commodity markets differ fundamentally from the stock markets in some respects.

Commodities (Agrar)	Shares
Renewable resource available in unlimited quantities	Limited Quantity
Purchase for Processing	Purchase for Investment
Maturities (Temin Contracts)	No Expiry Dates

Commodity Classes

- It is well known what coffee and sugar, unleaded petrol or natural gas are used for. The futures exchanges and trading volumes are less well known.
- Against this backdrop, the following section provides a brief introduction to commodities traded in large volumes on the international commodity markets.
- In principle the asset class of the commodities is divided into three categories:
- 1) The so-called' hard commodities', which include industrial metals in particular, but also precious metals as a subcategory.
- 2) In addition, there are the' soft commodities', which include all tradable agricultural commodities.
- 3) And last but not least, the' energy sector', which includes fossil fuels concerned.

Commodities

Energies

- Crude Oil
- Light Crude Oil
- Fuel Oil
- Gas Oil
- Unleaded Petrol
- Natural Gas
- Carbon Emissions

Metals

- Gold
- Silver
- Platinum
- Palladium
- Copper
- Aluminium
- Lead
- Nickel
- Tin
- Zinc

Agrarian

- Cocoa, Coffee
- Sugar, Orange Juice
- Corn, Oats, Wheat
- Sojabohnen, Reis
- Soybeans, Rice
- Cotton, Wood
- Pork Bellies
- Cattle
- Live Cattle
- Lean Pigs

History of Commodity Markets

- The origins of the modern commodity markets are to be found in the USA, where during the 19th century trades in agricultural commodities such as wheat, maize, cattle and pigs was standardized in contract form.

- Today's commodity trades are therefore based on the fact that in former times farmers wanted to sell their crops/goods in advance on time.

- In this way, suppliers were able to hedge themselves against price fluctuations and had direct access to the capital resulting from the sales price: The seller gained planning security.

- The same applied to the buyer or customer, who also received planning certainty with regards to the purchase price and the delivery of the goods: in other words, he gained independence from possible supply bottlenecks in the future.

Commodity Trading

- As this trading is computerized and largely standardized today, the commodity trading takes place at futures markets. Producers and entrepreneurs who want to exchange goods for money directly become active on the physical spot or cash market.
- As futures trading meant lower risks for all market participants and thus greater planning certainty, it represents the status quo in commodities trading today.
- For investors, the commodity futures markets are of particular interest because they allow only speculation on price movements without being interested in the physical supply and storage of the respective commodity. (exception: precious metals)
- Thus, if investors want to invest in commodities for the purpose of investing money and value, they acquire the corresponding futures contract instead of the commodity in question.

Futures Trading

- The seller of a commodity futures (standardised contract) undertakes to deliver a commodity in a certain quantity and quality, at a certain place and at a certain point in time in the future (therefore future).
- The buyer undertakes to pay the agreed purchase price (namely the future price) at this point in time.
- As already mentioned, futures markets also differ with regard to the holding period of equity markets:
- For example, there are different maturities and expiration dates for commodity future contracts.
- Energy futures such as crude oil or natural gas, for example, have monthly expiration dates. Meanwhile, cotton can only be traded with maturities in March, May, July and December.
- The holding period for shares, on the other hand, depends on the individual decision of the investor. CFDs on the futures in question offer the same in commodity trading.

- Investors investing in commodity futures for the purpose of capital investment do not want to be involved in the physical delivery of commodities. However, as each futures contract has a clearly defined maturity with a fixed maturity date, the investor has to liquidate his position before this date is reached.

- If the investor wishes to continue investing in the corresponding commodity, the proceeds from the sale must be reinvested in a longer-term futures position. Jumping from one future to another is called "rolling".

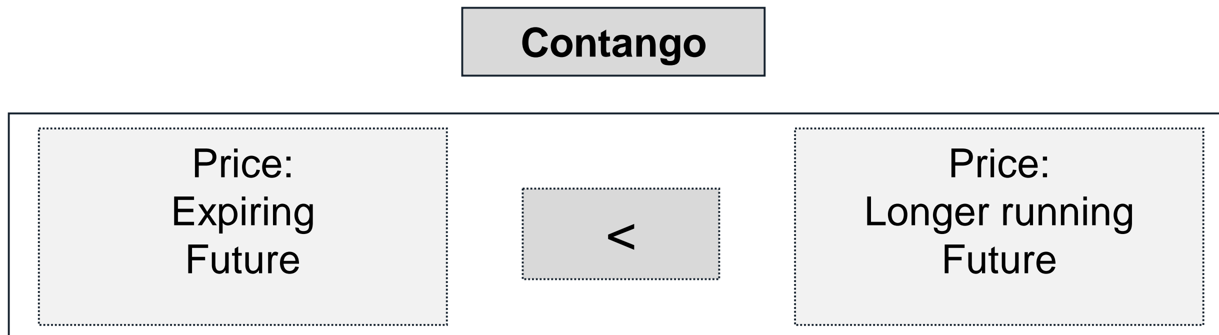
- Since each commodity future has its own price, depending on its maturity, the next future to roll into will be quoted at a different price level. The proceeds from the old future can therefore be lower or greater than the amount required to purchase the new future.

- There are therefore two different price constellations for rolling from an expiring future into a longer-term contract, called "contango" (= premium) and "backwardation" (= discount).

Contango

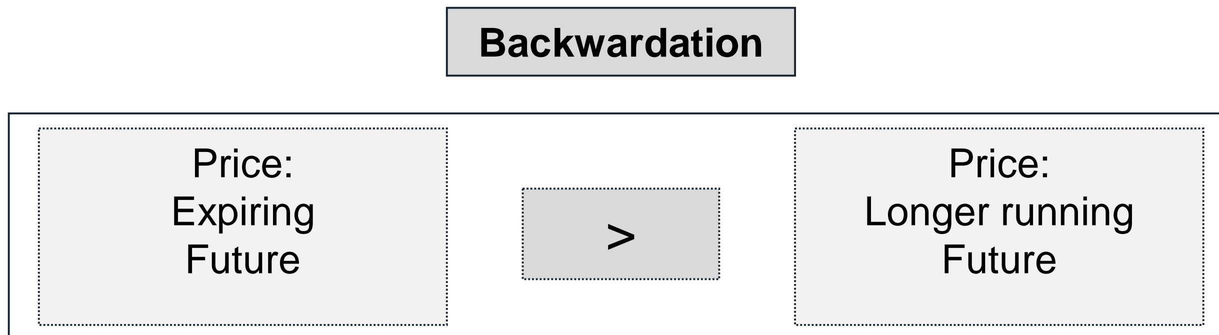
- For most commodity contracts,' Contango' is usually present. This means that the longer-term future is priced higher compared to the shorter-term future.

- This is due to the fact that goods which have a later delivery date, i. e. which have to be stored longer (= higher storage costs), are traded with a corresponding surcharge.



Backwardation

- If the price for the longer-term futures contract is lower compared to the price for the shorter-term futures contract, this is referred to as' backwardation’.
- This reflects market expectations that the commodity will depreciate in value until maturity of the longer term futures.

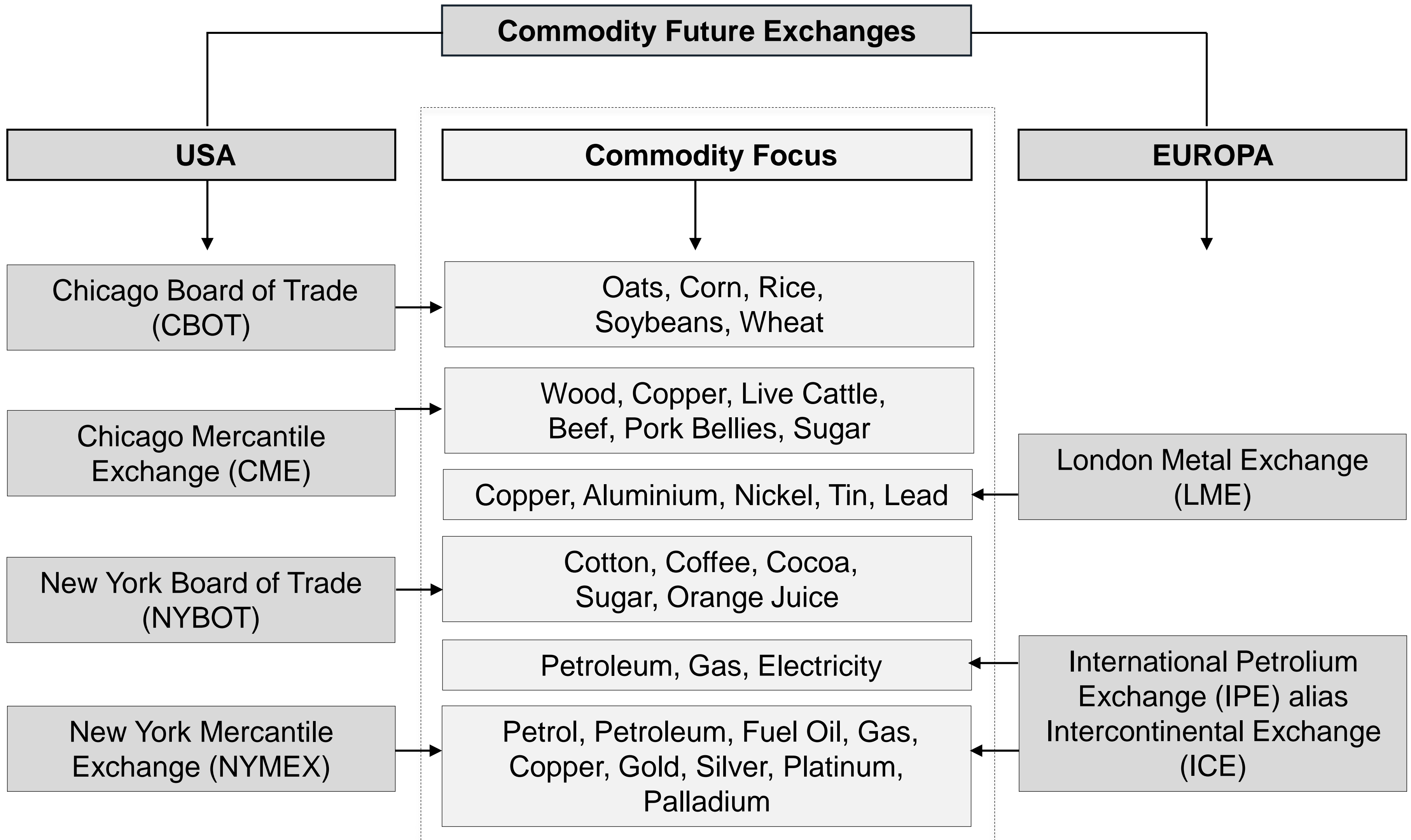


- The roll-related appreciation or loss in value has no direct impact on the investment amount, since the investor initially converts from one maturity to another without affecting the value of the investment.
- The position refers to fewer units of the underlying commodity, but it is worth more per unit.
- Unlike stock index futures (always contango), most commodities are listed temporarily in contango and temporarily in backwardation.

Commodity Futures Exchanges

- To date, Chicago (CBOT & CME) is the market leader in futures trading in agricultural and livestock commodities. In the meantime, however, the markets for agricultural commodities have at least become relatively less important - and sometimes ethically justified.
- The largest trading volumes in terms of value are nowadays handled with energy sources. Crude oil is still the top priority.
- The most relevant commodity futures run on Light Sweet Crude Oil. The US grade' WTI' is traded on the New York NYMEX and the European counterpart' Brent' is traded on the London ICE.
- Traditional industrial metals are traded primarily on the London Metal Exchange, while precious metals are traded primarily on the NYMAX in New York.

Bernstein Bank



Commodity Trading via Bernstein Bank

- Trading of both standard contracts and partial and mini contracts possible
- No transaction costs (no commission)
- Only financing costs and the relevant spread are estimated.
- Settlement and pricing of CFD positions based on exchange-traded futures contracts
- Automatic rolling of commodity positions

Case Study – Spot Deal Gold

- Gold can be traded easily and conveniently at the Bernstein Bank. All transactions are commission-free. We also note very narrow spreads.

- Opening of the position: You assume that the gold price will fall. Our price is 1,257.70/1,258.00 US dollars per troy ounce and you decide to sell one contract at a price of 1,257.70 (1 standard contract equals 100 troy ounces of gold).

- As collateral, a margin of 2.5 percent = USD 3,144.25 must be deposited for each contract. To limit risk, you have placed a stop-loss order of USD 15 above the opening price.

- The risk of loss is: 1 contract x $100 per point x 15.0 points = $1,500.00

- Closure of the position: a few days later, the gold price actually fell and we are trading at 1,223.20/1,223.50 US dollars. They decide to realize the gain and close the position at 1223.50 US dollars per troy ounce.

- The trading profit of the short trade is now calculated as follows:

	Entry	1.257,70
-	Exit	1223,20
=	**Difference**	**34,5**

- The profit made is: 1 contract x $100 per point x 34,5 points = $3.450, -
- The interest rate adjustments must also be taken into account when calculating the total profit. Since you have entered a short position, your account will be credited with interest. The interest accruing on your trading position is calculated daily by calculating the relevant interest charge or credit on the daily closing price.

Would you like to learn more about CFD trading and Bernstein Bank?

- Take a look at our education portal: you will find valuable information about CFD trading, our trading platform, the financial markets and stock exchange trading in words and pictures. We regularly offer interactive live webinars on a wide range of trading topics.
- Be up to date with our research portal: we offer daily market updates, technical analyses, podcasts and the business calendar with all upcoming market movers.
- Open a demo trading account online today: free of charge and without obligation. You are already a step ahead? Open a live account in just a few steps: Free of charge and without obligation directly via our website.
- Do you have any questions? Please get in contact with us at any time via phone or email. Our service team will answer your questions and assist. The contact details can be found on our website.

Thank you for your Interest

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