# Primary Concerns

4th April 2018

contact[at]phenixcam.ch

## Material Witness - *insights from the Manager*

**Coming up Trump's**

*- The White House adds to solid returns from the model portfolio*

*Thierry Ralet, CEO & Founder*

## Mark to Market - *observations from the front line*

**The Old World Order**

*- why we do not see the new oil contract as earth-shattering*

*Sean Corrigan, Chief Investment Strategist*

## Material Witness - *insights from the Manager*

**Coming Up Trump's**

The paper portfolio we are running at present on a month-to-month basis, solely for illustrative purposes, showed a positive return of +4.0% in March, mainly due to large gains in the energy complex, in the agriculture contracts, but also on livestock.

With respect to that latter, we should emphasize that our models were both short of Lean Hogs but the corresponding long in Live Cattle in the BCOM model was enough to give rise to a notable difference in alpha between the two indices. We should also note that such structural anomalies are the principal reason why we choose to split our positions between the two main benchmarks.

We maintain our short positions in grains, something which finally paid off as fears of Chinese import restrictions as a retaliation for the imposition of tariffs on steel and aluminium dampened enthusiasm. We must now keep a wary eye on how the market continues to react to lower than expected acreage estimates from the USDA

As for energy, though somewhat mitigated by offset by our short positions in RBOB, Gasoil & Natgas, the rebound of WTI and Brent after February's lacklustre performance was largely thanks to President Trump's inclusion of a number of noted 'hawks' on his policy team. By raising fears that the Administration now intends to renege on the terms of the settlement with Iran negotiated by his predecessor—and thus jeopardise that nation's growing contribution to global oil supply— this sparked a rally which was doubly beneficial in being led by the front-end where, in an already backwardated market, the weight of our positioning lay.

We are usually at pains here to point out that the model's returns do not reflect the full benefit of our unique methodology because they do not incorporate the effects of the intra-month rebalancings we will regularly be carrying out. In this instance, however, this would have had relatively little impact, with only an adjustment to the long position in Zinc offering much chance for improvement—and that only to a minor degree.

Beyond that, the only action we could have taken would have been to reduce the overall exposure and to take some profits towards the end of the month, though the increment involved would barely have amounted to 10bps.

As we move into April, we maintain the long exposure to energy but—given that the signals dictating this stance are a little more mixed than they were last month—the long positions in WTI, Brent & Gasoil are combined with shorts on the rest of the complex. We also have more opportunities (both long & short) in industrial metals as the market is becoming less unidirectional in its behaviour. We also continue to hold shorts among the grains, but not the softs.

**Thierry Ralet**

**CEO & Founder**

th.ralet[at]phenixcam.ch

+41.79.471.63.02

## The Old World Order

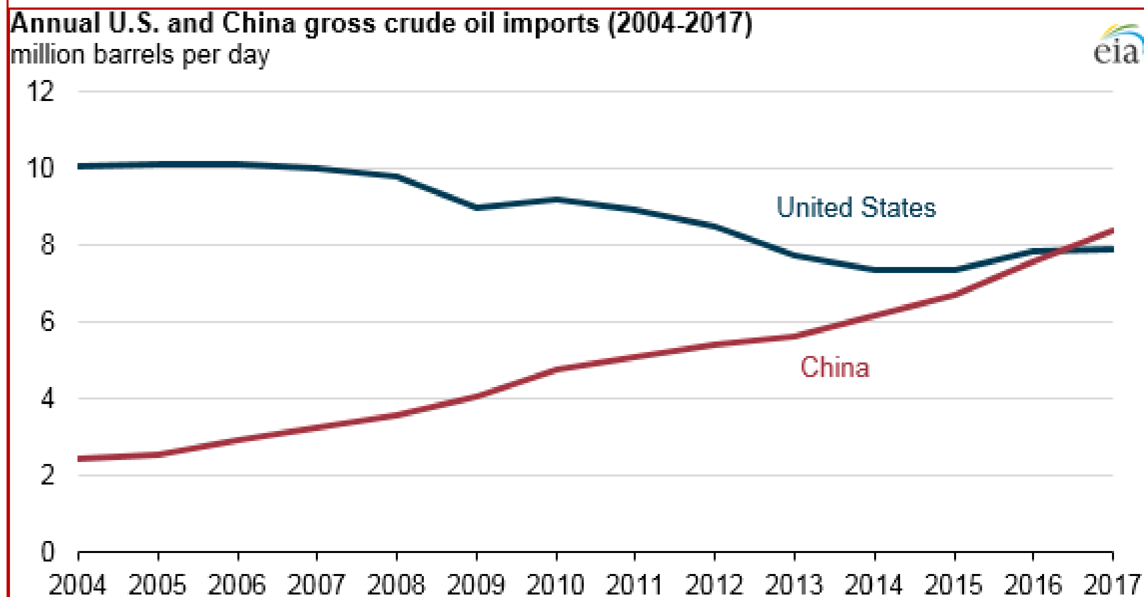
There has recently been a great deal of press coverage of the launch of the crude oil futures in Shanghai – much of it needlessly breathless, not to say hysterical, in nature.

By supposedly providing a framework within which the likes of Saudis can be invited (some reports have used the term, 'compelled') to conduct their future business with China in yuan, not dollars, the new contract has been invested with all manner of quasi-magical powers, from better enabling 'price discovery' in China (being the world's biggest net consumer of others' oil obviously does not afford it an influence of any other kind, it appears), to enhancing the renminbi's convertibility. This last, we are solemnly assured, will spearhead the abandonment of the US currency as the global unit of account and transactional medium of choice and, hence, will usher in both the dissolution of America's hegemony abroad and undermine the debt-laden edifice which engirdles its economy at home.

Since recent experience inclines us to the view that much of the scepticism already being expressed about such a prospect will not prove to be entirely misplaced, it is to those doubters' principal antagonists—the believers in the revolutionary character of current events—to whom we will here turn our attention.

The first point to emphasise is that, whether or not the contract settles in renminbi or riyals, swiss francs or cigarettes, Thai baht or baseball cards, it is but a matter of milliseconds – and usually of only a few pips in transaction costs – to parlay the proceeds into any other currency of one's preference in the forex market.

**Now it is true that the value of a money is principally set by its utility in conducting exchanges of all kinds; that this is a major factor in determining people's willingness to hold it both for transactional and precautionary purposes; and that this is the attribute which is decisive in setting that money's purchasing power. Thus, any diminution in the scope of voluntarily-held real balances of a money should cause it to suffer some degree of depreciation: a loss of value which, if it becomes sufficiently noteworthy, can itself be the trigger for a further reduction in those balances and hence lead to successive rounds of depreciation.**




Thus, in theory, if China starts to buy its oil in its home currency, rather than in USD, this could somewhat diminish the latter's appeal, especially in the rather unlikely limiting case whereby the seller of that oil choses to hoard his yuan, Nibelung-like, in sterile inactivity.

If, instead, the Saudis—who, after all, have been unusually cash-strapped of late—spend them on Chinese goods and assets, the reciprocal cancellation of part of the trade removes most of any first-order effects in that regard. Moreover, in a world where such primitive bilateralism is not the norm, the Saudis are just as likely to try to pay for the wares of some third party, using those same yuan. If this latter protagonist does not share his customers' new-found penchant for Beijing's issue, he may be the one to swap his revenues immediately for funds denominated in the trusty old greenback. Again, the immediate impact is much attenuated as he does.

While waiting to see how it actually does turn out, there are several ways we may attain a sense of scale of what this might involve.

Firstly, if we examine Mainland China's two-way goods trade with Saudi, we see that, in 2017, the GACC reported exports of some $18.2 billion and imports of $31.8 billion (of which an estimated $25.5 billion took the form of oil products). At once, we can see that this not only represented a tiny fraction of the $17 *trillion* global trade total for that year but that it left a net settlement figure of a mere $13.5 billion—effectively a rounding error in all that immense traffic.

Secondly, if we approach it from the angle of oil shipments, the IEA estimates that China will require around 9 million barrels a day in excess of its domestic supply capabilities in 2018, while the Saudis have recently pledged to keep exports at around the 7 mbpd mark for this coming year. Thus, even if the latter shipped *all* its oil to China (rather than between a sixth and a seventh of it, as at present) and *if* it priced all those barrels in yuan, at ~$60 a pop, this would amount to a bill of no more than $420 million a day.

Conversely, if China succeeded in persuading *all* of its suppliers to take yuan in return for its net uptake, this would amount to some $540 million a day (perhaps we should ironically record it as CNY3.4 billion, given what is being projected). This may sound substantial, but when we realise that global foreign exchange turnover exceeds $5 trillion a day, we are talking about 1 whole basis point of difference.

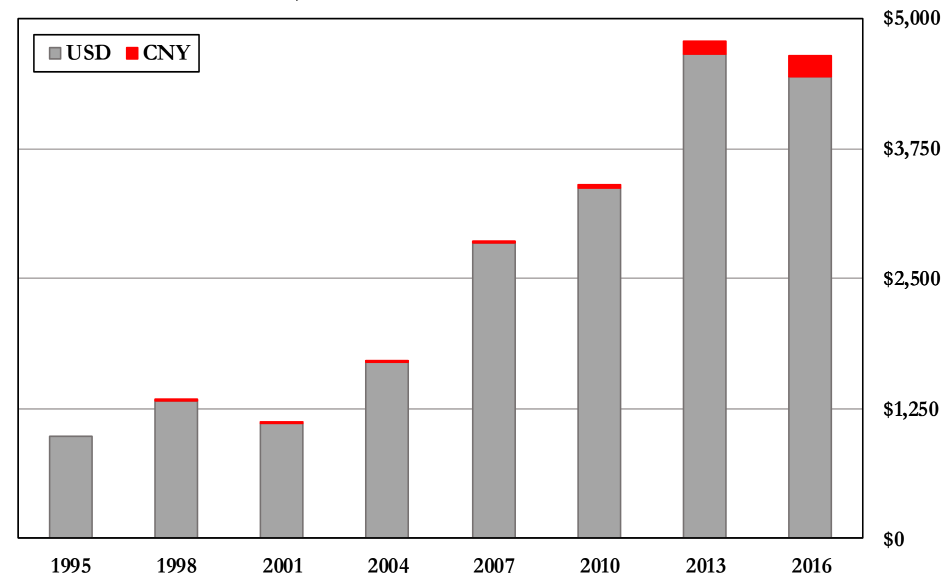
Similarly, if we limit ourselves to a consideration of the $2 trillion in spot and outright forward transactions which take place in pairs involving the dollar (circa 85% of all such activity undertaken, the BIS tells us), we still do not reach 3 basis points a day in loss of business. Even in terms of the minimally significant $100 billion or so of CNY trades that take place on the same count (95% of them against the USD), that still represents no more than one half of one percent of routine turnover.

Finally, let us consider the exchanges themselves. Between them, WTI and Brent trade over 2 million contracts a day (equivalent to around 3 weeks of global consumption) and have open interest of 5.4 million contracts (almost 8 weeks' worth). It is admittedly very early days yet, but Shanghai received (well orchestrated?) rave reviews for managing an average of just over fifty thousand over its first three weeks of operation and so far has built open interest of around 15,000 contracts (predominantly on the front month), for a gain of 1,000 a day which puts us on track to match the NYMEX – oh - by around Christmas 2025.

**Every journey of a thousand miles begins with a single step, as they say, but the overthrow of the present world order nevertheless still seems a long way off, indeed.**

**Sean Corrigan**

**Chief Investment Strategist**



## Disclaimer

**The following statements are intended to inform investors of the uncertainties and risks associated with investments and transactions in transferable securities and other financial instruments. Investors should remember that the price of Shares and any income from them may fall as well as rise and that Shareholders may not get back the full amount invested. Past performance is not necessarily a guide to future performance and Shares should be regarded as a medium to long-term investment. Where the currency of the relevant Fund varies from the investor's home currency, or where the currency of the relevant Fund varies from the currencies of the markets in which the Fund invests, there is the prospect of additional loss (or the prospect of additional gain) to the investor greater than the usual risks of investment.**

- This Fund achieves its market exposure through the use of commodity-linked financial derivative instruments.
- Commodity prices and therefore the value of commodity-linked financial derivative instruments can be more volatile than investments in traditional securities.
- At times the Fund may be concentrated in one or more individual commodities which may further increase volatility.
- Although the majority of the Fund's assets will be invested in cash, cash equivalents and short-dated instruments, investors should be aware that the Fund may not benefit from the returns arising from those investments and that those investments will serve primarily as collateral for financial derivative instruments (principally swaps).
- Investors may see the value of their investment fall as well as rise on a daily basis, and they may get back less than they originally invested.
- Investors should be aware that, in response to certain market circumstances, for temporary defensive purposes the Fund may have very limited, if any, exposure to commodity-linked financial derivative instruments.
- The Fund is denominated in USD but may have exposure to non-USD currencies.
- The Fund will be managed with reference to the volatility of its benchmark but not with respect to the benchmark's constituents.
- The Fund uses financial derivative instruments to achieve its investment objective.
- The Fund's investment approach is speculative and entails risks. There can be no assurance that the investment objective of the Fund will be realized.
- Commodities investing may be subject to a higher degree of market risk because of concentration in a specific industry, sector or geographical sector.