



Stephan Wrobel

* Founder * Diapason Commodities Management

Wrobel is co-founder of Diapason Commodities Management, a commodity and share-trading operator that creates and distributes products based around commodities. Here he discusses trends in various commodity markets.

What new commodity products are available?

Historically the number of commodity-related products had been very low. In the last three years the number has expanded with new vehicles giving access to the asset class. These are things like listed certificates or structured products sold by banks.

If using the fund route, do you recommend index funds or actively managed funds?

The type of fund selected depends on different needs. In a bull market we've seen indices beat 70-80% of active managers. However, during a correction phase of a bull market, active managers can try to avoid being caught.

What new derivatives products are available?

In the commodity space, the big development has been structured products. There are more exotic products such as hybrids, where you can mix asset classes. Options are available on most indices now. These all allow investors to create a risk/reward profile appropriate to their needs.

This expansion to the product range has been one of the main features during the last 24 months and it's been great news for investors seeking diversification,

portfolio construction and an inflation hedge.

Which commodities would you say are over-priced?

Where is value to be found?

The oil market has been in a consolidation phase since last August, but it doesn't change the bigger picture of a longer-term rise in prices. We'll see triple-digit prices for oil in this decade.

There are opportunities in the agricultural sector, where prices have remained depressed during the last two years, and they offer an interesting value proposition. Agricultural commodities rose in price from 2001 to the end of 2003. But in 2004 and 2005 they had a set back as production levels were so high.

Has rising production dampened prices?

No. There is still growing demand around the world. Stocks of wheat are extremely low – 69 days' worth, that's one of the lowest on record. In China, for example, corn and wheat stocks have fallen since 2000 in a dramatic way, as resources were diverted to developing other industrial sectors. That is a major theme at play.

So it all means that if we have a bad year production-wise, then prices will rapidly accelerate on the upside, as there is simply no buffer in inventory. Water access is another issue. To produce a ton of corn you need a thousand tons of water, so the competition and price of access to water is also rising.

If you own a farm, 30-40% of your costs relate to energy prices. Oil prices have gone up six-fold since 1999, but



agricultural prices haven't moved much, so margins have collapsed and the industry isn't making any money. It's a depressed area, and one way to stay in business is to rely on subsidies. Governments, however, are slowly cutting subsidies around the world, so consequently marginal producers will go out of business and that means we will continue to face a supply constraint.

What impact do you see in agricultural commodity prices given the interest in ethanol and alternative fuels?

If oil remains above \$35-40 a barrel, then agricultural commodities is going to be one of the big themes in the next five to 10 years. Agricultural products such as sugar and corn will be used to produce energy. These deliver a triple whammy: they are cheap to produce, environmentally friendly, and they allow you to rely less on fossil energy, which is often imported.

Do prices in these commodities reflect this?

Sugar has gone from 6 cents to 18 cents. That's still below the 1974 peak of 65 cents.

Brazil is a leader in this field and that's reflected in the strength of the Brazilian real, because the country doesn't have to import so much oil. Three-quarters of the cars sold in Brazil have a flex-engine, which allows them to use a mix of gasoline and ethanol. The same trend is now developing with the corn business in the United States.

Any comments on the move in precious metals prices?

There's a re-monetisation of the gold theme at play. The money supply in paper currencies is growing fast. The start of that move was in August of last year when the market understood that America's spending plans had increased after the hurricanes necessitated the injection of a lot of money into the system. The US also announced that it was not going to publish M3 data, which the market took as a sign that the central bank would keep on increasing the money supply.

What are the implications of the move from backwardation to contango in certain commodities markets?

It means that inventories in

PERSONAL CV

Graduated in economics and finance from the Paris Graduate School of Management, following that with a London Business School programme in macroeconomics.

He has worked at Societe Generale, BNP Paribas, Lehman Brothers and Cargill in a range of trading, research, sales and commodities-oriented roles.

2003 Founded Diapason Commodities Management, along with Jim Rogers and Lionel Motiere, where he now manages commodity investments. The company is based in Lausanne, Switzerland.

some commodities have been replenished to some extent and that has reduced tension for those commodities. Lead and copper are still in backwardation. Crude oil has gone from backwardation to a heady contango situation. The market has become less worried about direct developments, so it is now charging you the cost of carry. When you roll the contract – the roll yield – on crude oil currently, that roll yield is negative. When the markets get intense again, that situation will click into backwardation – a positive roll yield.

What new products are you developing to reflect developments in the commodities markets?

We're launching the first-ever biofuel index with UBS, so investors will be able to capitalize on these growing themes of agricultural commodities.

Any plans to expand operations into Asia?

We've been regularly visiting Asia and are looking carefully at opening an office there. We've been especially focused on Hong Kong, Taipei and Singapore. ■