Crystal balls, capsize bulkers, and iron ore- more Alice in Wonderland

Contributed by

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It's a busy season with client meetings, full of eager investors all wondering which direction the shipping markets are heading. I finally found a good prop, in a dusty junk shop- a crystal ball looking thing (maybe from a Christmas tree?) that I painted little cracks on. So when the question comes up, I can pull the little ornament out of my backpack and say, "My crystal ball broke a few years ago." But fortunately, we do have useful indicators to point to; my role, many times, is to point investors toward some of these indicators. Though I've been busy with tankers, one of the clients wanted some insights into the drybulk side of things- my old stomping grounds.

At this point in time, almost all of the "spot" drybulk markets are in a weakened condition, however forward indicators- what owners and charterers are doing in the marketplace, present a brighter picture, albeit not a great picture- at least for now. Much of what happens, or not, in drybulk, is really about China, and, more specifically, happens in the iron ore business.

I'm not an extreme China-watcher, but lately, the news from the iron market has not been good. Of the 1.2 billion tons that comprise deepsea trades, about 800 million tons, or around 2/3, go to China. The ore price has nearly hit a two year low, breaking to the downside below the all-important $100/tonne- down from approximately $140/tonne at the turn of the year. Yet Chinese mills continue to make steel, and more importantly, the big miners are in an expansion phase.

The forward pricing curve for freight swaps (also known as Forward Freight Agreements, or FFA's) is throwing off positive vibes. The trade to watch is the time charter composite- an averaging of daily hires on four routes with worldwide coverage, which gives a useful approximation of what a Capesize vessel is worth in spot trades. Last week, the spot quote, from the Baltic Exchange in London, was $11,205/day. For comparison, the settle price assessed by the Baltic on swaps reflecting Q3 2014 was just shy of $22,000/day- a level where every owner will make money. For Q4, typically an active time for moves of iron ore from Brazil and Australia in China, the assessment (based on bids and asked in trading) is just under $29,000/day- nice cash flow for owners. For 2015, not as actively traded, the quarterly assessments were around $25,100/ day and $28,900/day.

The forward physical market (period time charters) exudes caution in terms of activity (but optimism for expectations); there have not been more than a handful of Capesize vessel leases reported with durations of more than a year. Going back to late April, Cargill- one of the most active drybulk traders, took the "C. Summit", an aging Capesize bulker (therefore, worthy of a discount compared to more modern tonnage) for $19,000 / day, on a one year period deal. Presently, this vessel is in the coal trades. Swiss Marine, a ship operator (steered by ex Cargill folks) did a five year deal on the 2011 built "Trinity Star", at $25,250/day. Savvy operators are placing a bet (that's all it is, unless they backstop it with cargoes they've taken in) that vessel hires will be above the charter in level over the period- extending out to 2019. And finally, I found a transaction booked by K-Line, a big Japanese owner, taking the 2005 built and Greek registered "Aquabella" for 5 to 8 months, with a rate tied to the aforementioned time charter composite (currently at $11,205), but giving the owner a minimum of $15,000/day. Just guessing here, but K-Line likely took the vessel in against commitments it has to deliver cargoes- with freight rates maybe tied to the same numeraire. Possibly, it's an instant arbitrage profit on freight. My buddies at K-Line's local outpost are not big fans of freight swaps, so, I reiterate- it's only an educated guess.

So, why this dichotomy between a deteriorating ore market, and healthy expectations for vessels largely dependent on ore? One school of thought is that lower ore prices- partly attributable to dramatic increases in output from the big miners, will force Chinese mines to shut down. Perversely, this would lead to increased importing of ore into China. One widely blasted forecast, from Goldman Sachs, suggests that ore prices be $80/ton in 2015. It would seem that ship operators like Cargill and its spawn are not the only gamblers here- the mining companies (behaving much like the huge containership operators- who we'll save for another column) are in a race to Armageddon- towards lowest cost at all cost. In the Alice in Wonderland world of bulk shipping- this race might actually generate a healthy flow of cargoes. If the world moves more into recovery mode- well….even better. Then I can put that silly crystal ball away and find some other jokes to tell at meetings!

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