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IN THE NEWS

End of the commodities super-cycle

Contributed by

Barry Parker

Barry Parker is a financial writer and analyst. His articles appear in a number of prominent maritime periodicals including Lloyds List, Fairplay, Seatrade, and Maritime Executive and Capital Link Shipping.

The past few weeks present a startling example of why forecasting commodity prices is a tricky business…and putting such prognostications in writing is downright perilous. As the ink was just drying on my recent suggestions that floating storage would bolster the tanker markets for awhile, as I channeled various tanker and energy analysts, the oil markets undertook a big upward correction. Yes, I had hedged myself by reminding readers that the front end (spot and nearby) portion of the forward curve in oil is likely to be far more volatile than it was in 2009 (the last storage-induced tanker boom). But, bottom line, the economics briefly evaporated for contango trades loosely described as "buy now /sell forward, and hold on a tanker in between".

Two weeks ago- the spread between March 2015 and Jan 2016 WTI futures was a comfortable $10/barrel- over 10 months Late last week, after a big rally in the front months, this spread was closer to $8.00/barrel- which works back to around $0.80/barrel/month- slightly below the lower limit for a viable storage deal. Maybe for this reason, hires on the big tankers eased last week, according to broker market reports. Owners with spot vessels are hoping their ships reach load areas in time for the next spike.

Commodity analysts- looking at the underlying WTI and Brent contracts, have suggested that last week's price action might have merely a "dead cat bounce" which brought about "short covering", as oil finds its way to the correct price. The nearby positions need to move lower (more than those a year or so out on the curve) in order to fuel renewed excitement in the tanker markets- and, not so indirectly, in the shares. One indicator that the taps might not be turned off at oil wells around the U.S. (which, unlike other oil producers, has not vowed to pump, baby, pump, but just might anyway) was seen in a late January announcement by Kinder Morgan. KMI said that it would be acquiring a Bakken producer, Hiland Partners, a privately held crude gathering pipeline owned by Harold Hamm. KMI, with pipelines criss-crossing the country, will now be spending $3billion to gain a presence in the Bakken region. Hopefully, those pipes will be moving crude oil from the region. But, for how long? That's the $64,000/day question.

Zigging and zagging around the markets has been the mantra for many shipping companies, certainly in the private space. And, even in the public space, Paddy Rodgers from Euronav has voiced a preference for the spot market (fixed through the medium of commercial pools), with some period covering as necessary. Tankships- the George Economou company presently on the road with its IPO, has said that, over time, a spot tanker chartering posture will bring better returns. Last year saw client meetings with numerous investors- looking primarily for "value plays" in the tanker space. Translated, they hope to invest, and ride the market upward. Stylistically, my pearls of wisdom (philosophically aligned with Mssrs Rodgers and Economou, at least as far being spot) fell on many deaf ears. Yes, there is industrial shipping (which implies stability and multi-year charters), but many of the listed tanker and drybulk companies are really not playing that game. Those who do play have looked in a different direction- the limited partnership structure and actual MLPs. And that's a different investor conversation.

All of this is provides the backdrop to the quote of the week, where the CEO of Drewry Shipping, a well known consultant and market analyst, Mr. Arjun Batra, was reported to have told an audience at a conference in Singapore, "For us in shipping this is the end of the commodities super-cycle…" This declaration from Drewry, which knows a thing or two about industrial commodities- including iron ore- discussed extensively at this particular event, is not as ominous as it appears at first glance. But, while waiting for the next cycle (which might take decades to set up, if Mr. Batra is indeed accurate in his assessment), investors need to get a sense of the zigs and zags (or, what tanker analyst Jerry Lichtblau referred to as stalactites and stalagmites). Those investors who simply position for the next big move up might get bedsores in the interim.

As far as the dry side, early February saw levels that were unsustainable over time, with the forward curves in the swaps market upward sloping (just like the contango curves in oil). Thus, the spot hire of the five vessel Capesize composite, at just over $6,700/day (reflecting fronthauls and backhauls) was less than assessments for later months. Going out into the distant future, anticipated hires inch up above $16,000/day- slightly below the breakeven (daily operation plus financial requirements) for modern ships bought at reasonable prices. Closer to the present, the lineup for 2015 stood at a little over $8,700/day (Q2), slightly under $10,500/day (Q3) and then reached a crescendo with the Q4 priced just below $14,400/day.

Panamaxes present a similar forward contour, with the four voyage composite just barely nudging above $3,400/day. Such a level could not prevail for a lengthy period of time, therefore, forward timecharter hires are stronger. For 2015, Q2 and Q3 ended January priced around $7,100/day, with an uptick to $8,100/day, for the Q4 position. The 2016 Calendar contract was also worth around $8,000/day; subsequent years see the assessments inch up towards $10,000/day out into the 2020 – 2021 and 2022 positions.

Supramaxes, always a smallish corner of the market dominated by bigger vessels, is also showing an upward sloping curve- with the spot composite's $5,400 / day (above Panamaxes - as happens in extraordinarily depressed markets) yielding to Q2 and Q3 hires assessed at $7,900/day, and then Q4 at $8,700/day. Further out, the pattern of a steady upward rise to a minimally acceptable hire finds the curve easing upward towards per diems around $9,300/day.

For now, a mood of pessimism has set in; the Capesize levels stand in marked contrast to the failed expectations of the recent Q4 of 2014. Before the air was sucked out of the market's sails (in late 2014), optimists were still able to bid positions upwards to circa $25,000/day. But, even in the absence of the big cycle, there is plenty of money to be made- it's just that there will be numerous bounces. Unlike MLP investing (which has siphoned off the charter cover segment), investors in shipping shares will need to pay close attention to the market's vicissitudes, and may need to trade in an out more frequently.