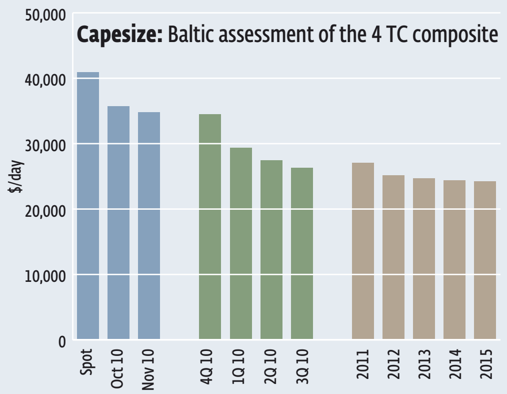

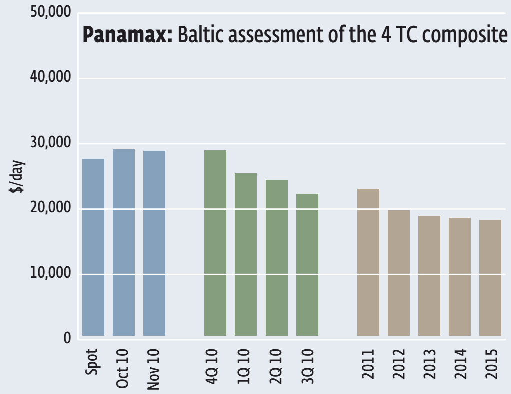

[Source: Baltic Exchange data]

$180-200Bn

annual turnover for the physical dry market, according to Georgi Slavov, head of dry bulk research at ICAP Shipping

Raw material markets to focus on spot contracts

NY panel forecasts profound changes for freight trading

The picture of the physical shipping market emerging from speakers at Capital Link's conference on freight markets – aimed at the derivatives business but, by necessity, delving into the market for real ships – was one of profound change. For shipping people, the message was very simple: raw material markets (where traders are increasingly 'financial' players) are moving away from long-term contracts.

Georgi Slavov, who heads dry bulk research at ICAP Shipping, put the annual turnover for the physical dry market at $180-200Bn. Slavov, and other speakers, emphasised that shipping arrangements for raw materials are in the midst of shifting towards the spot end of the freighting spectrum.

One presentation, from the Chicago Mercantile Exchange (CME), dealt with undeveloped derivative markets in raw materials that are moving in seaborne trade. The CME, a large financial institution that has absorbed multiple exchanges, is now providing a venue for traders of swap contracts in iron ore (China pricing).

According to the presentation, "irrevocable changes are under way in raw material pricing". More specifically, it was suggested that "spot pricing will become the new paradigm in raw material pricing", aided by a new crop of derivatives offered by the CME (and others).

Not trading yet, but on the drawing board, are contracts tied to prices of metallurgical coal and ferrous scrap, both important ingredients in steelmaking. The movement to floating prices for steelmaking raw materials, and away from a world of contracts priced according to annual benchmarks, should logically lead to more spot shipping – creating more exposure to volatile prices.

One speaker described a virtuous circle by which the ability to trade forward freight agreements would encourage more activity in the undeveloped raw material swap markets, which, in turn, would bolster activity levels in the 'paper' freight markets.

Such rosy scenarios are still subject to conjecture. The FFA market, which ought to provide an outlet for managing all the freighting risk, has shrunk in size from its 2008 peak (when it rivalled the physical market, with turnover of about $200Bn), to a turnover of around $30Bn.

Panellists alluded to difficulties in hedging an entire ship over a lengthy time period, as traders (including growing participation from the financial realm) have traded FFAs equating to blocks of 5-10 days' employment.

The physical market was again gathering momentum, with the four timecharter composites pegged by the Baltic Exchange at $41,000/day for Capes and $27,000/day for Panamaxes. The increased volume of physical period fixtures is evidence of renewed optimism felt by timecharter operators.

Charterer Classic Maritime took a 2010-built Capesize for 4-6 months (with delivery in the Atlantic) at a very healthy $45,000/day. A spate of Panamax fixtures for similar periods have been transacted at rates approaching $28,000/day, with Asian deliveries. Period deals of one year's duration have been done in the mid-$20,000s/day.

Slavov's panel, including representatives from Euroseas, Navios and broker Pasternack, Baum & Co, could not explain precisely why the paper market has shrunk from its size two years earlier, but did offer a few suggestions.

In the wake of the 2008 financial crisis, a seemingly positive impact has been the move towards cleared transactions. Clearing, which shifts financial risk from individual counterparties to a central entity, also requires cash-intensive margining. In his remarks, ICAP's Slavov said: "Part of the reason why FFA volumes are lower now could be clearing. In the over-the-counter market, it was possible for investors to amass speculative positions, and for shipping interests to hedge cheaply".

Reflecting the cost of posting margins, FFA synthetic pricing is discounted from the physical rates. The Calendar 2011 Cape assessment has inched above $27,000/day; the analogous Panamax valuation is in the mid-$24,000s/day. Nevertheless, research presented by Slavov showed a high correlation (78%) between one-year physical timecharters and synthetic hedges, despite the less robust liquidity, by Euroseas and others. F