The Complete Guide To Successful Financial Markets Trading

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The Basics Of Commodities Trading

Trading Is Best Confined To Oil And Metals

The commodities market is, without doubt, subject to a much greater degree of manipulation by major trading institutions, because of its relatively small size compared to the FX and Equities markets and the fact that a small number of banks and trading houses hold all of the potentially market-moving orders. **The degree of manipulation is even more profound in the less well-known and less well-traded of the commodities markets, particularly those centred around livestock (including lean hogs, pork bellies, live cattle and feeder cattle) and agricultural commodities (including corn, soybeans, wheat, rice, cocoa, coffee, cotton and sugar),** which, even worse for the retail trader, are also particularly subject to unpredictable weather patterns, diseases and other such Acts of God.

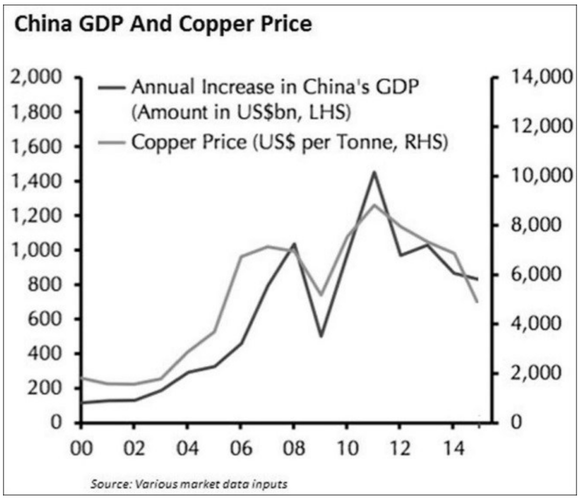
Having said that, **the other two major commodities sectors – energy (including crude oil, heating oil, natural gas and gasoline) and metals (including gold, silver, platinum and copper) – can provide excellent trading opportunities, provided that the trader rigidly employs the range of risk management techniques,** and also hedging tools for other positions in both the FX and Equities markets and for general economic market conditions, covered in depth in this book. This is why these two sectors of commodities trading – and only these two – are being discussed here.

Supply And Demand

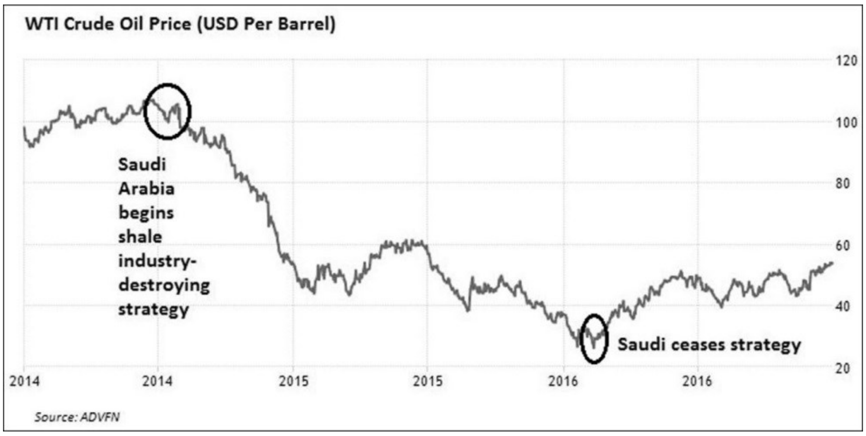
The **price of all commodities is in very large part a function of the supply and demand balance, to a degree, not present in the FX and Equities markets** (it is true that QE, as mentioned, affects FX rates and that rights issues and similar actions affect equities values, but the import of these factors is nowhere near that which supply and demand plays on commodities).

Aside from the Acts of God factors that play a role periodically in the supply and demand balance, about which the trader can do little more than ensure that he has the correct risk management tools in place for all his open positions, **there are broader economic factors that the trader can predict** and from which he can make returns over and above benchmark performance (i.e. 'alpha returns'). A case in point – from the demand side – occurred with **China's growth pattern from the early 1990s to around 2010 that was based on a dramatic expansion in manufacturing, including massive state-sponsored infrastructure projects. These utilised enormous amounts of relevant metals (copper, for example, for pipes, aluminium and so on) and vast quantities of oil and gas for power associated with such projects.**

This led to the 'metals supercycle' in which all of these metals prices shot up in one direction only for well over a decade, and **the trader would have made exponential returns simply by buying them** based on this one macroeconomic factor. **Since 2010, if the trader had read anything on China, then he would have made similar returns by selling certain metals as China switched its growth strategy to one based on manufacturing-led economic expansion to one based on consumer-led growth** as it tried to build out the middle class section of its society. At the same time, the demand for oil and gas has continued to stay steady, as the expanded middle class buys more items that need powering.



The same broad-based macro-economic play was specifically announced by Saudi Arabia in the oil sector at the beginning of 2014 – from the supply side – aimed at destroying the nascent North American shale energy industry, so again a trader simply following the news would have made alpha returns selling oil (and gas), from 2014 to when the Saudis decided that the strategy was not working.



Seeking to identify such shifts in macroeconomic policy, even if they are already underway, that will have a significant effect on the supply and demand balance in a particular commodity is absolutely key in making exceptional returns in the commodities markets as a whole.

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