Meal ticket for commodity traders ends

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FULL TEXT

An old joke in the commodities world was that futures traders never took holidays between the fifth and ninth business days of each month.

Why? Because that is when money tracking commodity indices sell expiring futures contracts and replace them with new ones. Front-running the so-called "index roll" became a monthly meal ticket for active traders.

"I loved doing that," a multibillion dollar commodity fund manager recently told me. "Those were the good old days."

Those days are now over. Commodity investors have become wise to the weaknesses of basic indices and have shifted to a mix of strategies with varied roll dates and commodity holdings. The shift makes it tougher for hedge funds and other active commodity traders to beat the market.

Less than a decade ago, when commodities were still a novel asset class, many investors stuck a toe in the water with swaps linked to indices such as the S&P GSCI or Dow Jones-UBS. The widely advertised roll periods on these indices - between the fifth and ninth business days of each month - meant a predictable monthly torrent of trading. For active traders it was a no-brainer to, say, sell January oil and buy February before $200bn worth of index money did.

Front-running had costs. A recent academic paper* estimates exchange traded funds that track crude oil paid about 4.4 per cent a year to execute roll trades because of settlement prices that diverged on roll days from preceding days.

Now only about half of commodity index investments follow traditional products, down from almost 100 per cent in 2005, according to Barclays' latest commodity investor survey. The rest are in "enhanced" products, which take a wider array of positions, or strategies that can buy or sell commodities with equal ease.

Barclays sees "fading" returns from a strategy of trading ahead of standard index rolls.

"We're in three months at the same time and we roll almost every business day," says Oscar Bleetstein, a director at Credit Suisse, of one his commodity index products. "What is there to gain?"

For commodity hedge funds, this presents yet another challenge at a time of middling returns.

And for US regulators who have just filed a court appeal to preserve their rule limiting speculative positions, the new diversity of index strategies suggests that the market may be solving on its own the problem of a single trader or strategy becoming so big that it distorts prices.

* 'Predatory or Sunshine Trading? Evidence from Crude Oil ETF Rolls', by H Bessembinder, A Carrion, K Venkataraman and L Tuttle

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