Interview with Colin Waugh

Editorial Advisory Board Member, *Global Commodities Applied Research Digest*

We are delighted to interview Colin Waugh who is a commodity researcher and investor. Mr. Waugh spent much of his career in the commodity investment industry, in fund management, research and trading. Formerly, he was a Partner, Portfolio Manager and Head of Research in the New York firm of Galtere Ltd, a $2.5bn commodity-based global macro fund. A regular China visitor and event speaker over the past decade, he also maintains an active interest in digital applications in banking and financial sector reform and digital solutions for developing market financial inclusion. He is also a Director of Dublin-based Vitro Software, a global medical technology company. Waugh has also worked extensively in Africa on development and migrant-related humanitarian projects and has published two non-fiction books about African political leaders. Colin is also a member of the *GCARD* Editorial Advisory Board and has contributed several articles to the digest and its newsletter.

In this issue's interview, Colin discusses his extensive career, his recent *GCARD* article, changes in the industry, African influences, digitization in developing markets, and his advice to young commodity professionals.

How did you originally become involved in commodity research and how has your career evolved?

My first job in the investment industry was in commodity sales and trading, with a newly formed Merrill Lynch subsidiary dedicated only to commodity trading clients. The Chicago Mercantile Exchange had just launched trading in Eurodollar Futures contracts, the first ever cash-settled futures trading instrument. Although physical commodities markets were depressed, in that earlier era of high interest rates and U.S. dollar strength, trading volumes in currency markets, precious metals and Treasury contracts were growing exponentially.

I built a small but active clientele around trading these booming contracts and worked with clients following a range of approaches from technical to fundamental to hedging-based strategies. While a lot of economists still relied on supply and demand analysis in decision making, technical trading was rapidly taking off, with the publication *e.g.* a few years earlier of J. Welles Wilder's '"New Concepts in Technical Trading Systems" and the incorporation of the Elliot Wave Theory into trade decision making.

My own research work was partly trying to keep up with these various new trends and indicators that clients increasingly relied on, while developing ideas of my own, particularly in volatility-based commodity options trading, a long-short premium trading technical approach which I later launched within my own CTA firm.

In the second phase of my career, I worked in a much smaller, commodity-based global macro hedge fund in New York, which drew on these early experiences and at the same time gave the opportunity to dedicate much closer attention to portfolio management and research, with much less of the day-to-day

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client contact of my first trading assignments. Running a small trading desk at Galtere International Fund led to heading the firm's global research team, as the business grew from one million dollars managed to $2.5 billion in the years I worked there. At Galtere, there was a firm belief in top-down macro thematic investing, and research trips to Asia, Africa, and Latin America as well as London and continental Europe were an important part of my responsibilities.

After Galtere, I worked at a pure macro research firm, Lombard Street Research in London, (now TS Lombard) covering commodities for their strategy team. Interactions with clients and customers led to meetings in Asia, Australia and the U.S., as well as contributing to "Intelligent Commodity Investing" – the prescient reference work from Risk Books which brought me into collaboration with its co-editor Hilary Till – which in turn later led to involvement with the *GCARD*.

You have contributed several articles to the GCARD and its newsletter. A recent article was "Resources and Diplomacy: Commodity Signposts to a Post-War Economic Order." Can you summarize key points of this article and note any recent developments?

The article, written less than a month after the Russian invasion of Ukraine in February of 2022, focused on the commodity market – and climate change policy – implications of the conflict, on the assumption that the fighting, with or without stalemate and peace talks, would be protracted. Briefly surveying the relative vulnerabilities of major Western countries, actual as well as potential, the article speculates on the degree to which climate change goals will have to be compromised. While the base case is that major clean energy economic transformations will have to be put on hold, or severely curtailed, the article also looks at how Europe's markets got to where they are today in their dependency on Russian oil and gas. Indeed by late October, despite a government composed of a coalition including the anti-nuclear Green Party, Germany had already put on hold the closure of its remaining nuclear plants, while the U.K. parliament voted down a motion to allow wider debate and consultation before initiating controversial gas fracking operations in rural areas.

But the most difficult question to answer, and the situation likely to be the longest to evolve, concerns global, not European-centric geopolitics. How other powers with interests potentially allied as much to Russia as to the West might deploy their strategic resources – whether energy, food, mineral or military, will depend on a more complex set of factors.

Not only will it be important to keep China at worst a neutral party to the conflict and work to maintain India as a potential ally, but the poorer – and increasingly vociferous developing world may have an unexpectedly powerful role to play. For example, at the October 2022 UN Security Council vote on condemning the illegal annexation of Ukrainian provinces, India, in common with its Asian superpower rival China abstained, suggesting that there is much that could still be achieved on the diplomatic front as well as the military.

The head of the World Health Organization, Dr. Tedros A. Ghebreyesus has sharply criticized the West for its "racism" in prioritizing support for the conflict in Ukraine and ignoring suffering in Afghanistan, Yemen, Syria and his native Ethiopia. Those countries and their West African neighbors *e.g.* in the Sahel, also under severe drought-induced threat, will be more interested in negotiating to secure food rather than missiles and military alliances in the years to come.

It has already been seen how the sharp rise in the world price of wheat and other food commodities affected by the war occurred in the wake of the fighting, prompting calls for "food corridors" and a humanitarian truce – not only for war displaced, but also to save victims of hunger in North Africa and many less developed countries, whose grain supplies traditionally came from the Black Sea ports.

Overall, successful resources diplomacy will need to take account of the needs of a far wider global constituency and its complex interests, looking beyond the immediate interests of the western military alliance and the actions of its battlefield enemies.

What are some of the major changes you have experienced in the commodity industry?

In common with almost all industries, the period which my commodities career spanned was one in which the advent of the internet and digital transformation revolutionized procedures, particularly in the operations side of the business. Some of my earliest exposures to the sharp end of trading included trips to the floor of the New York and Chicago Mercantile exchange floors, where the bigger independent traders – the "locals" – could be seen occupying dominant positions at the front of the trading ring, arms outstretched, a fistful of paper waiting to be filled in either hand. Things have changed beyond recognition.

At the fund management end, technical trading was quickly overshadowed by quantitative methods which in turn gave way to AI-based decision making in a certain breed of funds. While there were headline-hitting blow-ups and brutal post-crash periods of consolidation, overall developments in the industry have ensured the development of a wider-than-ever variety of trading approaches, and undoubtedly today's commodity fund investor is more thoroughly spoiled for choice than ever before.

On a less positive note perhaps, I would point to the looming risks of the increasing "financialization" of commodity markets which threatens to distort values rather than reflect true market forces over time. Financialization became most evident during the time of the Global Financial Crisis when crude oil's futures price soon became totally detached from the reality of world supply and economic demand, first brushing the $150/barrel mark in 2008 and later dropping to below $10, or later still in the COVID era, briefly to less than zero for certain contracts.

More recently still, the outbreak of the Ukraine War sparked enormous speculation in grains, as well as European natural gas futures, arguably exacerbated wildly by short term financial flows and doing little to calm the nerves of the end-users of fuel and food, often already in very disadvantaged economic conditions. While certainly a result of natural human instincts to price protect as well as to profit, the appearance of excess in these developments has done little to enhance the value and reputation of world commodity markets.

You have worked extensively in Africa on development and migrant-related humanitarian projects. How has your work in Africa impacted your research and investments?

After 11 years in commodity trading, I decided it was time to do something totally different for a spell and so I took a two-month assignment as finance manager and administrator of an American Red Cross funded program in the Horn of Africa, where famine threatened (as it does again today) in the wake of a long drawn out civil war (as is the case again today). The work was intense and it certainly cleared out some metaphorical cobwebs that had accumulated over a decade of screen watching. Those two months in post-conflict assistance work turned into over seven years and brought me into contact with a wide range of societies working within (and often struggling under) a broad variety of different types of regimes.

Some were the African leftovers of the Cold War era and former Soviet-backed regimes across the continent were in the midst of transformation to more pro-market economies. It struck me how several were not only waiting to embrace entrepreneurship but at the same time were still condemned to operating within outdated structures *e.g.*, in agriculture, or confined to cottage industry scale of operation due to lack of capital availability.

Western governments and the IMF threw money at many of the countries they favored for development, but only in a few did it stick and in others it backfired, as sometimes the conditions that came with their cash deprived rural populations of a living. There surely could be a better approach, engaging the private sector in fostering growth.

Stock markets seemed like one answer, and at the end of my spell in the public sector, I took a few weeks and visited the embryonic exchanges in Abidjan, Accra, Gaborone, Lagos, Maputo and Tunis, as well as the flagship of the continent, Johannesburg, whose trading volumes, despite all the turbulence that has occurred in that country in recent decades, still dwarfs every other African Exchange.

In terms of resources, no investor could ask for a better endowed continent than Africa – but neither could one imagine a region with such an unpredictable financial landscape. Based on my own experience if I had to pick one area where I think African business more generally is being held back, I would pick contract enforcement, and all that that entails.

It is why many prefer to invest in African commodity businesses, but based on contracts tied to *e.g.*, English or New York law – and where they prefer to buy African companies and commodities on Western exchanges: for liquidity, transparency and above all – contract enforceability in the event things don't turn out as expected.

While Western-style organized markets in Africa suffer from barriers to scale, it is clear that other exciting business opportunities exist and I spent some years in partnership with local firms in a couple of countries trying to get business plans off the ground. However, even in some of the best resourced economies, progress is often hampered by bureaucracy and the least transparent business culture, making it uphill work for the inexperienced outsider. In the end I decided, as many others have, that Africa was well worth the investment, especially of time and engagement, and for the fortunate few, of money as well.

You are interested in digital applications in banking and financial sector reform and digital solutions for developing market financial inclusion. What progress has been made toward this end?

With the advent of mobile banking and hand-held transaction making, it has often been assumed that the biggest relative beneficiaries from technological advance would be in the developing world, unable as most are to compete with the traditional financial infrastructures of the advanced economies.

In the same way that the mobile phone itself made redundant the laying of tens of thousands of miles of telephone cables to install fixed lines, the digitization of transaction-making should offer potentially similar "leap-frogging" access to modern markets for rural, low-income populations in every corner of the world. Regardless of whether they can reach physical banks or open conventional financial accounts, consumers and vendors, as well as savers and investors could benefit from a levelling of the global financial playing field. So, to what extent has this happened in practice?

From my several years of work in half-a-dozen Sub-Saharan African countries my overall observation is that while broad progress has been made in cashless transacting, the opening up of the real opportunity which digitization potentially offers to the mass market can be impeded by a variety of unrelated factors in many economies. Despite technology-based breakthroughs and lower-cost access to communications and transaction making, traditional interests in government, banking and capital markets have often been as much obstacles as enablers.

The countries which already had existing capital markets such as Kenya and pro-technology governments, such as Rwanda, plus educational standards and adequate infrastructure have clearly embraced digitization the fastest and have benefited the most. Others, whether poorer in physical terms or due to uncompetitive entry conditions, national security motivations, or again where governments and established interests have opposed change, have unsurprisingly benefited less.

Again, ostracized by western ratings agencies and dealmakers as too risky or not worth the trouble, most have fought uphill battles to raise the necessary capital to join the ranks of global players and achieve the scale that would allow a break-out from local and national markets. Frustrations with the dollar and IMF-based *status quo* have even led to talk of replacing traditional currencies floating against the dollar with Bitcoin or other cryptocurrencies.

Yet Africa's middle class is growing rapidly, within a continental population that is set to reach 1.7 billion by 2030, and 2.5 billion by 2050, close to matching that of today's China and India combined.

What advice could you give to students and young professionals interested in the commodity markets?

Despite the financialization of markets which I talked about earlier, the commodity markets are one of the few areas in investment where practitioners really do have an investible universe which responds to a different range of factors and influences beyond the price of money. This offers opportunity beyond those available to so many others who set out on a career in financial market investing.

Individual stocks have their micro economic opportunities and crypto may yet become a mainstream asset class to match other global markets, but commodities will always have the allure of that unique mix of supply and demand, geo-politics, climate, freight, storage and so much more. As a young commodity practitioner, it is important to master all these factors that make our markets stand out, sometimes for good, sometimes for not so good.

Despite the enduring ubiquity of a risk-on, risk-off investment universe, commodities offer true diversification and in most cases the kind of liquidity that can match other markets. Learn the quirks, the twists, the tricks, and the traps, be prepared for frustration and disappointment, but extend your mind and in the end the rewards will come.

Biography

COLIN WAUGH
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Colin Waugh has spent much of his career in investment management, research and trading. He was a Partner, Portfolio Manager and Head of Research in the New York firm of Galtere Ltd, a $2.5bn commodity-based global macro fund, until 2009 when he joined Lombard Street Research (LSR) as an Associate Director for Commodities Research in LSR's Global Strategy Division. He also worked in commodities at Merrill Lynch, and was Vice President, Commodities at Shearson Lehman Brothers. He joined the Editorial Advisory Board of *Global Commodities Applied Research Digest* (*GCARD*) at the J.P. Morgan Center for Commodities in 2018. He also contributed the chapter, "Collision: Investing for the New World Commodity Order," in the bestselling Risk Book (London), "Intelligent Commodity Investing" (Edited by Hilary Till and Joseph Eagleeye). In addition, he has published two non-fiction books about African political leaders: "Paul Kagame and Rwanda" (2004) and "Charles Taylor and Liberia" (2011).

Colin Waugh's previous articles for the *GCARD* are available here.