Contributing Editor's Collection

Hilary Till
Solich Scholar, J.P. Morgan Center for Commodities, University of Colorado Denver Business School; and Contributing Editor, *Global Commodities Applied Research Digest*

This collection of four separate digest articles provides answers to the following questions:

- When has OPEC spare capacity mattered for oil prices?
- What are the sources of return for CTAs and commodity indices?
- What are the risk-management lessons from high-profile commodity derivatives debacles?
- What determines whether commodity futures contacts succeed or not?

Each article takes a different approach in answering these questions, as noted on the next page.

Hilary Till, M.Sc. (Statistics), Solich Scholar, J.P. Morgan Center for Commodities (JPMCC) at the University of Colorado Denver Business School, posing a question at the JPMCC's Research Council meeting on December 4, 2015. She is flanked (left) by Dr. Sueann Ambron, Former Dean of the Business School and Senior Advisor, JPMCC; and (right) by Dr. Thomas Brady, Chief Economist at Newmont Mining Corporation; and (immediate foreground) by Dr. Margaret Slade, Professor Emeritus, Vancouver School of Economics, University of British Columbia and Co-Chair of the JPMCC Research Council.

Original Empirical Analysis

The first article on OPEC spare capacity and oil prices examines historical data and finds that at least in the past, OPEC spare capacity has only mattered when (U.S.) crude oil inventories have been low. The article does raise the question on whether a focus on OPEC behavior will continue to be relevant if America's shale industry has replaced OPEC as the oil market's "swing producer."

Survey of Empirical Research

The second article on Commodity Trading Advisors (CTAs) and commodity indices surveys empirical research on the long-term drivers of return for futures programs. From this survey, one can find strong evidence that there are persistent returns in futures programs due to momentum, roll yield, and also due to rebalancing. Further, a CTA investor may also require that a program's dynamic trading strategies produce returns that have options-like payoff profiles; and institutional investors expect commodity index programs to provide diversification for their balanced equity-and-bond portfolios.

Industry Case Studies

The third article on commodity derivatives debacles uses case studies to infer key risk-management lessons. Each of the case studies did not involve complex mathematical issues; instead, they can each be summarized as fundamental control problems. Large commodity derivatives trading companies must emphasize (1) compliance with regulatory rules and laws; (2) the valuation of derivatives instruments by third parties independent of front-office personnel; and (3) the imposition of position limits in all electronic trading systems.

A Complex System Modeled as a Competitive Game

The fourth article on futures contract successes and failures treats the futures markets as a competitive game. Specifically, futures trading can be seen as a game where the competing players, the hedgers and speculators, each have sufficient economic reasons to participate. The referee of this game, the government authorities, has the power to stop the game, if there is not a convincing economic rationale for a futures contract's existence. Therefore, a futures contract can only succeed if it responds to a hedging need, and if speculators are able to manage the risk of taking on hedger positions. In addition, if one cannot make a convincing case that a contract serves an economic purpose, then the contract is at risk to either being banned or being heavily curtailed.

Common Theme

The goal with each of the four digest articles that follows is to provide both industry participants and policymakers with useful insights on the frequently opaque, but always dynamic, commodity markets.