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Spot market strength is driving curve

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From Mr Brett Ladendorf.

Sir, Javier Blas reports ("Brent's futures flip rolls up profits for crude investors", February 28) on how speculators are initiating Brent crude oil calendar spreads, perpetuating the backward situation across that futures curve.

I would add to his insightful article that the asset yield of Brent, a yield analogous to a stock dividend yield or interest earned on holding a bond, is greater than the sum of storage, transportation and insurance costs. This generally means that a supply and demand imbalance exists.

Mr Blas points out that Brent oil is in strong demand. Current owners of the physical good want to hold on to barrels over longer periods of time because they are earning this asset yield, also known as a "convenience yield", and expect the value of this good to increase in value over time. But higher near-term prices attract producers to sell now rather than in the future.

Under more balanced supply and demand conditions, commodity markets gravitate towards contango form. Under these circumstances the market will demonstrate a flatter term structure as companies pursue a precautionary demand for storage and build inventory. Refineries and energy infrastructure companies become more willing to buy and store.

But not according to the current spot market and indicative yields, as independent exploration and production companies, energy multinationals and Swiss traders are induced to sell now, refineries are induced to refine now, and spread traders wager that this trend continues. Once refineries delay their purchases and asset yields come down to earth, margin clerks will come knocking!

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