April 30, 2014

> ***"For true success ask yourself these four questions: Why? Why not? Why not me? Why not now?"***
> ***— James Allen***

The commodity market is the most important market in the world. Every one of us interacts with it each day, whether we acknowledge it or not—getting us to work in the morning, at our jobs throughout the day and again in the evening at the dinner table with our families. The market is worth hundreds of trillions of dollars, and every single person in the world taps it multiple times each day. This sounds like a tremendous opportunity.

For centuries, banks were a critical part of the value chain within the commodity markets. *Why?* They brokered hedges, lent money for infrastructure, owned physical assets and even speculated on prices. The banks and the commodity producers (drillers, farmers, miners, merchants, etc) worked closely together to keep the supply chain running smoothly, but not anymore… *Why not?* Here are some recent headlines:

"Barclays Said to Join Commodity Exodus" – NYTimes, April 2014[1]

"Mitsubishi UFJ to Withdraw from Commodity Business" – Bloomberg, Feb 2014[2]

"Natixis to reduce commodities market business" – Reuters, Feb 2014[3]

"Fed to release plan to limit banks' commodities activities" – Bloomberg, Jan 2014[4]

"JPMorgan quits physical commodities business" – CNBC, Jul 2013[5]

"BofA-Merrill Lynch shuts European power and gas trading desk" – Reuters, Jan 2014[6]

"Deutsche Bank quits commodities, but keeps index funds" – Reuters, Dec 2013[7]

"Barclays stops speculative agricultural commodity trading" – Bloomberg, Feb 2013[8]

"Morgan Stanley to exit some commodities markets" – Reuters, Jun 2013[9]

"UBS said to plan closing oil, base metals, agriculture trading" – Bloomberg, Oct 2012[10]

Despite the incredible opportunity for profit, the banks cannot get out of this space fast enough. Changing regulation and market structure are forcing them to walk away from the

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1 http://dealbook.nytimes.com/2014/04/21/barclays-poised-to-announce-exit-from-commodities/?_php=true&_type=blogs&_r=0
2 http://www.bloomberg.com/news/2014-02-07/mitsubishi-ufj-securities-to-withdraw-from-commodities-business.html
3 http://www.reuters.com/article/2012/02/23/natixis-commodities-idUSL5E8DN5XX20120223
4 http://www.bloomberg.com/news/2014-01-13/fed-said-to-release-plan-to-limit-banks-commodities-activities.html
5 http://www.cnbc.com/id/100900230
6 http://www.reuters.com/article/2014/01/07/us-boaml-commodities-powergas-idUSBREA060K620140107
7 http://www.reuters.com/article/2013/12/05/us-deutsche-commodities-idUSBRE9B40P820131205
8 http://www.bloomberg.com/news/2013-02-12/barclays-stops-speculative-agricultural-commodity-trading-2-.html
9 http://www.reuters.com/article/2013/06/20/ms-commodities-idUSL5N0EW3LN20130620
10 http://www.businessweek.com/news/2012-10-31/ubs-said-to-plan-closing-oil-base-metals-agriculture-trading

biggest and most important markets in the world. Pressure from regulators, rising capital requirements, conflicts of interest, reputational risk and the growth of transparent, exchange-traded products are just a few reasons banks are retreating from commodities.

The Commitment of Traders (COT) reports released by the Commodity Futures Trading Commission (CFTC) confirm the headlines.[11] The COT reports show the open interest of futures and options broken down by banks, commercial producers and speculators.

The banks' percentage of open interest across commodity markets including energy, metals and agricultural products is near a multi-year low.

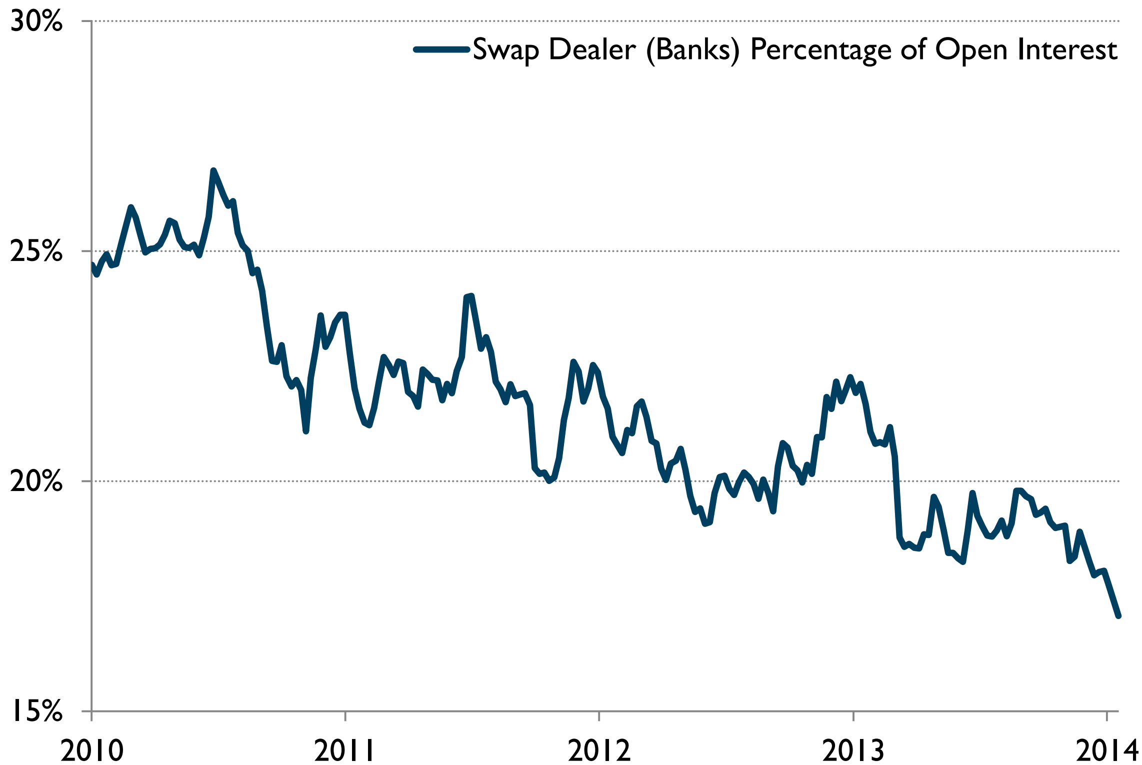

Figure 1: The percentage of total open interest by swap dealers (banks) in the commodity markets, as reported in the weekly Commitment of Traders (COT) reports published by the CFTC.

The four biggest players by open interest are collapsing to a smaller portion of the overall market, even though open interest and volumes are growing. Liquidity providers and other traders able to warehouse risk successfully are picking up the slack.

[11] http://www.cftc.gov/marketreports/commitmentsoftraders/index.htm

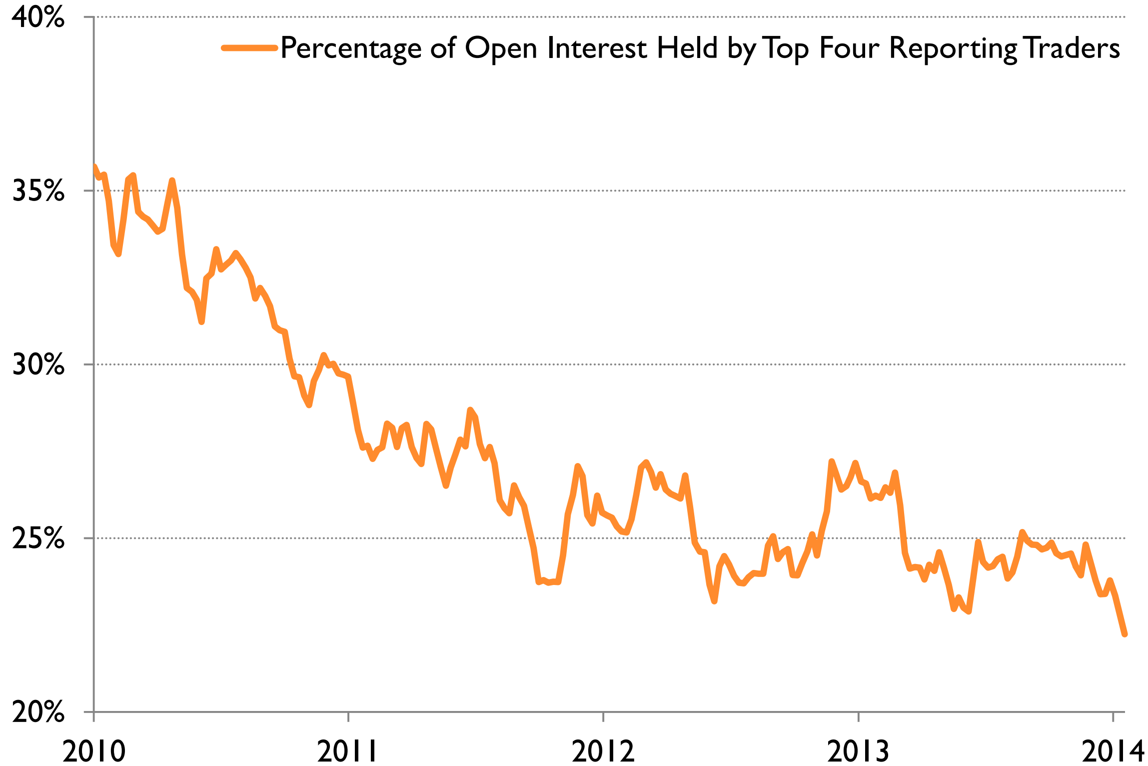

Figure 2: The percentage of total open interest by the top four largest traders by open interest in the commodity markets, as reported in the weekly Commitment of Traders (COT) reports published by the CFTC.

We believe the retrenching of the banks from the commodity space presents an incredible opportunity. *Why now?* There are few who focus solely on systematic risk transfer at a time when electronic demand for options and futures trading is only increasing.

With a great deal of uncertainty around the Fed's next steps and the recent pickup in volatility, hedging demand is very high. More market participants are hedging electronically on the exchanges than ever before. Hedge fund and proprietary traders are filling the void that banks are creating by leaving the industry. This will provide a tailwind to businesses with infrastructure in place to capitalize on new opportunity.

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