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UNIT Monash: Week Seven Newsletter

Hey <<First Name>>!

The focus of this newsletter is to introduce you to the commodities asset class. We hope that you take away valuable insight, ultimately providing a strong basis if you are interested in diversifying your investment portfolio to include commodities

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Check out the week seven newsletter below for the details!

Weekly Info Wrap

Introduction to Investing in Commodities

In the finance world, commodities are considered a major asset class that is traded to achieve profit. In the conventional world, they are part of our everyday lives.

<u>Conventional-World-Use of Commodities:</u>
Commodities are the raw materials humans use to create a liveable world. Humans use **energy** to sustain themselves, **metals** to build tools, and **agricultural** products (including livestock) to feed themselves. These three commodity classes are the essential building blocks of the global economy. We use these raw materials to create other products we use in practically every area of our lives without a second thought.

In the mornings, when we get up and get dressed, we may use the commodity of **cotton** when we get dressed in our clothes or the commodity of **gold & silver** when we put on our jewellery. At breakfast, we may consume the commodity of **wheat, sugar, or coffee** through the products we buy, and we cook our breakfast using the commodity of **natural gas** supplied to our house by our energy supplier.

<u>Financial-World-Use of Commodities:</u>
The financial world created a 'commodities exchange', where these commodities can be traded for various reasons. Producers and suppliers might buy or sell what is known as a forward or futures contract for these commodities, to secure their earnings and not be subject to unexpected circumstances.

<u>An example would be:</u> A farmer raising corn can sell a futures contract on his corn, which will not be harvested for several months, and gets a guarantee of the price he will be paid when he delivers; a breakfast cereal producer buys the contract and receives a guarantee that the price will not go up when it is delivered. This protects the farmer from price drops and the buyer from price rises.

<u>Commodity Pricing:</u>
Commodity pricing is determined by using the primary model of price determination in economic theory, Supply and Demand. It's usually the supply of a commodity that changes, which consequently changes the price. Oil is an example of a commodity that has its price influenced by an intergovernmental organisation known as OPEC. If the supply of a commodity goes down, its price goes up. Countries that rely on oil for income intentionally decrease production (if agreed by OPEC), which drives the price of oil up, and increases cash coming in for oil-rich countries.

Unlike stocks, the value of a commodity **can never and will never** fall to zero. Simply put, wheat, gold, or any other commodity for that matter will never lose their value.

<u>Interesting Price Determinations of Specific Commodities:</u>

- Gold is a known safe haven for investors, and its price can be seen increasing during tough economic times.
- Gold is inversely related to the US dollar, as the value of the US dollar goes down, gold's price increases.
- There is a strong link between the demand for oil and the rate of global economic growth because oil is an essential input into many industries. When you take China, for example, as the economy expanded, the demand for oil rose.
- The demand for oil usually increases during the summer, which increases its price.
- Weather plays a significant role in price changes in agriculture commodities, as it affects supply.

Click here to see what prices commodities are currently trading for.

Weekly Global Breakdown

Australia

Cooling trade tensions have helped the Australian share market bounce back, with technology stocks posting the most significant gains on Friday. The major indexes were both up, with the S&P/ASX 200 index and broader All Ordinaries rising 0.52 per cent and 0.47 per cent respectively. However, as expected, the ASX had a slow start this morning given the SPI futures pointed to a 7-point loss at open.

In other news, the RBA has left the cash rate unchanged at record lows of 1.00 per cent. The Reserve had previously cut the rate in June and July resulting in 14 rate cuts since November 2011 with cuts in the future not ruled out entirely and will be done "if needed". The property market is showing signs of recovery and thanks to tax cuts and lower borrowing costs; consumers are feeling more confident.

Despite this, slow wage growth and elevated mortgage debt remain headwinds to the consumer. Recent data highlighted that consumer spending only rose by 1.90 per cent in the 2018/19 financial year – the slowest annual growth in over five years, indicating that consumers are cautious and that we are likely headed towards the later parts of the business cycle.

Although challenges remain, for now at least the market seems optimistic thanks to easing global factors.

US

The week started on rocky footing as trade-war worries re-emerged. However, US equities managed to pose a second consecutive week of gains, with investors seeming optimistic about the situation. The S&P500 closed 1.79 per cent higher, which leaves it 2.00 per cent off the 26 July record high; and the Dow Jones Industrial Index rose 1.49 per cent. The CBOE Volatility Index (VIX) further decreased to its lowest level since late July.

This optimism follows US Federal Reserve Chair Jerome Powell's downplaying of the prospect of a recession, stating that the Fed will "act as appropriate" to sustain the US economic expansion. However, an inverted yield curve has historically preceded most recessions in the US. Thus, with the current flat and inverting yield curve, it may be too early to discount the possibility of a recession occurring in the near future.

Asia

The Asian market had the best week as global tensions seem to ease down. China's benchmark index had its best week since June with the Shanghai Composite Index and CSI300 Index rising 3.90 per cent despite the unexpected fall of its exports, imports and trade surplus. The Hang Seng Index jumped more than 4.00 per cent.

This optimism is a culmination of global factors. Reports that Chief Executive Carrie Lam would formally withdraw the extradition bill stimulated not only Hong Kong stocks but also global. Chinese Premier Li Keqiang's released a statement that the State Council would implement cuts to bank's requisite reserve ratios and reduce real borrowings cost to possibly the strongest easing measure taken by the Chinese government so far this year. This combined with news that US and Chinese government officials will re-negotiate in October has allowed the Asian market to soar above others.

However, it is important to keep in mind these are just temporary speculations, whether or not they will be executed in the future should be taken into account.

Europe

European markets have been optimistic, posting one of its best weeks since June with investors feeling more at ease as the US-China tensions subdue and the prospects of having a disorderly Brexit receded. The pan-European STOXX 600 index was up 1.91 per cent thanks in part to investors moving out of defensive stocks into cyclicals.

UK Prime Minister Boris Johnson lost a series of parliamentary votes, decreasing the chances of there being a no-deal exit on the 31st of October. This does not remove the chances of it occurring altogether; however, in the meantime, it seems to be enough to satisfy investors.

New to markets? Got Questions?

As we mentioned in previous emails - we started UNIT Monash with the vision of educating the student community in investing and trading to one day strive for financial independence.

We want to create a new concept of peer-to-peer communications about investing and trading. There's a lot of value in sharing experiences, having opinions and shedding light on new ideas. Feel free to get in contact with us via Facebook if you have any enquiries about investment, trading or our upcoming events or if you would like to provide any feedback.

Regards,
UNIT Monash

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