

[2009-3-2] 'Full steam ahead to the iceberg...'

... as the London Metal Exchange pushes for Molybdenum and Cobalt to be traded on the exchange

There is nothing so magnetic as a bad idea. And the LME's, for putting minor metals such as Cobalt and Molybdenum onto a terminal market, is one of titanic proportions.

Let me first make one thing perfectly clear - I have no vested interest in Cobalt or Molybdenum. I am not a Cobalt trader and only a dabbler in Molybdenum; and then only in the occasional parcel of molybdenum sintered bars for the super alloy industry. So I have no business to lose by the introduction of a terminal market in either.

So why object? For me, the matter is just a question of principle. Essentially, I am opposed to the financialization of commodities.

To me the business of metals, and especially minor metals, is just about delivering to customers – and that is all. But apparently what I do in metals, and others like me, is not enough. To those in the LME who wish to convert our minor metals into forward markets of standardised lots we must seem so terribly passé and *old City*.

But I look back to when the City was divided up in the Square Mile, both geographically & institutionally, into a mosaic of discrete businesses who together made such a powerful whole. The coal merchants, the furriers, the corn traders, the insurance people, the discount houses, the actuaries, the deposit takers, the shipbrokers, the pawn brokers, the lawyers, the accountants and the bankers [who, when I started in the City, were divided into Merchant Bankers and Retail bankers] and finally the metal merchants.

Hidden away, next to Leadenhall Market in Whittington Avenue, from 1877 was the *London Metal Exchange* where the members of that body, as it once was, used the facility as an intrinsic part of their merchanting, mining or manufacturing businesses. It was, for a trading empire such as the British, a remarkable thing. For the miner to be able to sell forward his metals, and the metal content of minerals, mined in the colonies it was an amazing facility. For the great engineers to buy their copper on such a basis also, it was indeed entirely functional. Due to the freedoms of British society and *laissez faire* the prices were judged to be true and determined the benchmark for the trade in base metals all over the world. It allowed a producer of Lead or Zinc concentrates in far flung Australia or a producer of Copper in Northern Rhodesia to make use of this mechanism to reduce risk. If I thought for one moment that the adoption of minor metals onto the exchange in 2009 would assist me as a metal merchant to perform this function, then I would be in favour of it. But it is not towards me that the LME's adoption of minor metals onto the exchange is directed.

Of that *old City*, linked to manufacturing and production there is, as we know, almost nothing left. The prices that are now promulgated across the globe and still have such influence are no longer made from the balance of merchant and consumer transactions but from a cocktail of investment fund orders laced with super-huge Swiss-based hedging operations. And here is my basic point – those who are promoting the introduction of minor metals onto the LME are making themselves attractive to a different clientele entirely – namely the hedge fund, the speculator, the private equity firm – in fact any pension fund that can manage to swing the rules so as to be able to invest directly in minor metals which they have been prevented from doing to date. In other words the LME's aim is to create a financial instrument. One that is attractive enough to be wrapped into a portfolio somewhere as an exposure to minor metals.

If you would like living proof of the financialization I am talking about, just take a brief glance at the

profile of LME category 1 & 2 companies – ninety per cent are banks or financial institutions and a great number of those listed Bear Stearns, RBS, JP Morgan, Bank of America have not had a good financial war so far..

It seems, therefore, we have a clash of worlds. Minor metals have become attractive to outside eyes for the very good reason that so much of the modern world relies for its performance on by-product metals that were once either ignored or discarded. With the proliferation of technologies that rely on minor metals it has been frustrating to the finance gurus not to have been involved. How annoying it has been for them to stand on the sidelines and observe the multi-uses of Cobalt in batteries, catalysts, super alloys and not be able to make a profit out of it, how inconvenient that Germanium, Indium and Gallium are so intrinsic to Solar panels and LEDs and yet how tiresome to have to express an investment by taking stakes in the slow train of companies that produce the product.

Some will argue that to add Molybdenum and Cobalt to the current LME base metals of Copper, Tin, Lead, Zinc, Aluminium and Nickel is a perfectly natural development. However, even our largest minor metals, Cobalt and Molybdenum, are only worth \$1.5 bln & \$3.5 bln respectively. Not very large when compared to the markets of Copper and Aluminium....Aluminium, even at today's prices, is worth \$33 bln.

I will be clear about another matter and that is regulation. While I still see the LME as a friend to bigger, more liquid, metal markets; unfortunately, in the case of minor metals, their friendship is something that may lead us astray. That's because of the baggage that the LME will bring. Are we to have categories of membership in order for minor metal merchants to be able to trade on the LME? What levels of net worth will minor metals companies need to have in order to be allowed to participate in the LME cobalt and molybdenum markets? As the LME makes clear on its website '*the Financial Services Authority (FSA) is responsible for regulating the financial integrity and conduct of the LME members' business.*' It needs to be regulated because of the plethora of participants that could be exposed to their markets. Until now, the only parties exposed to minor metals were those who produced them, bought them and consumed them. But the moment you have a chance that someone somewhere might have been miss-sold (and you can be sure that someone will) then the whole panoply of regulation will have to be in place.

My argument is that this is all a tier of regulation that is highly undesirable in a market where members of the public simply have no business to be involved and if they were not involved they would not need protection. For me the LME showed their commitment to the trade all too clearly during the battle against REACH. While the Minor Metals Trade Association (MMTA) did all it could to lobby against these laws on behalf of our trade, the LME decided it was 'not their problem' and they let their customers hang out to dry. I know, because I was the one trying to get the LME to make common ground so that we could explain to the EU that the unintended consequence of the EU Chemical Directive would be merely to export metals business and jobs to places where the rules on the environment would be slacker. Now in the depth of the recession we can see what folly that law is and what a burden to manufacturing. But the LME had no concerns – their contracts are 'in warehouse' and the EU Chemical Directive only concerns itself with imports.

The LME clearly wants to grow their brand, otherwise why would they colonise such areas as plastics and steel? Minor Metals are just another piece to their jigsaw. The LME contracts will increase the paper risks of the business by introducing a whole new clientele for whom minor metals are going to be the newest plaything in the City.

What will be lost is harder to define - just another part of the old Square Mile when so much has already gone? A trade community with a specialization to whom you could go to obtain the most unusual elements in the periodic table from thallium to gallium and from Zirconium to Hafnium but who will be now torn between how much they will need to invest in coping with the LME rather than coping with the market.

I fear very much for the orderly trade of the market in minor metals and I would have thought that anyone involved in the finance world at all would rather be steering a course away from - and not into - danger. The menacing iceberg ahead is that the LME instrument in minor metals will provide a

route for leveraged funds to enter a market that is too small to cope. At present whatever you say about the *London Metal Bulletin* form of reporting prices, they represent the trades of un-leveraged money. The LME, in contrast, will simply provide a new conduit for the rivers of tramp money that require a recognised exchange and an apparently well-clothed financial instrument to legitimize their spending. The LME is beautifying itself for this like a sweet painted lady and it seems that as ever the prospect of a new game in town is as seductive as ever. But perhaps a few of the attendees to Metal-Pages conference tomorrow will read this and at least pause for thought.

It's not too late to get off the ship.