Knowledge with Kenanga Futures

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Kenanga Futures Sdn Bhd

CPO Futures - A Case Study

Crude Palm Oil Futures (FCPO)

Crude Palm Oil or CPO is the world's most consumed vegetable oil, and forms the underlying asset for the trading of CPO futures known as FCPO. Owning to its versatile nature, CPO has one of the widest applications amongst the leading vegetable oils.

As an agriculture based commodity CPO prices are determined by a myriad of global factors. But demand from key palm oil importing countries play one of the most crucial role in determining price movement direction for FCPO. Malaysia, which is the world's second largest producer and exporter of CPO, serves as the global trading hub for FCPO, where FCPO contracts are denominated in Malaysian Ringgit and traded electronically on Bursa Malaysia Derivatives Berhad (BMD).

The top importing and exporting countries are as follow:

Top Importing Countries [1]	('mil tonnes)	Top Exporting Countries [2]	('mil tonnes)
India	4.41	Indonesia	28.75
China	2.49	Malaysia	16.73
Pakistan	1.09	Guatemala	0.81
Netherlands	0.88	Colombia	0.78
Turkey	0.71	Papua New Guinea	0.57

Sources:
1 = Malaysian Palm Oil Board (Figures from year 2019)
2 = Indexmundi (Estimate for year 2020)

FCPO contracts are traded based on the price movements of CPO and other industry related announcements and factors. Daily CPO price movements can be tracked at BMD. For more on CPO prices and trends, please refer to: https://bit.ly/30leuQZ

In general, CPO prices tend to react according to general development of world events including
- Trade & economic policies (trade levies and Government policies).
- Demand & supply from key markets (crude oils and energy consumption requirements).
- Weather events or natural disasters (el Nino and typhoon).

To know more on factors affecting demand and supply of CPO, please refer to: https://bit.ly/3l4Knp7

While it is widely used in the food manufacturing sector, there are also high demand for CPO in cosmetic and pharmaceutical industries, besides being used as the main feedstock for renewable biodiesel fuel.

Palm oil prices are also increasingly linked to the crude oil market due to its growing use in making renewable fuels. Due to the direct relationship between crude oil and CPO, the higher oil price could potentially translate to corresponding increase in demand for CPO to be turned into biofuel, leading to tighter supply and higher CPO prices.

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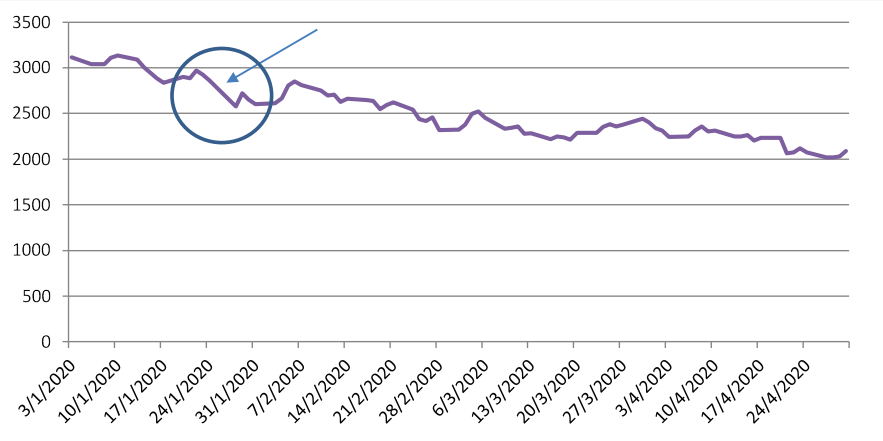
Case Study

CPO prices has generally trend higher so far in 2020, compared to the average prices in the same period last, helped by concerns over tighter supply from top producers namely Indonesia and Malaysia, and signs of increasing demand especially for biofuel.

However, in January this year, one of the most volatile price movements in 2020 was seen in the period from 22 to 30 January. The main driving factors for the volatility was geopolitical and trade policies.

In January 2020, several negative announcements or concerns on possible restriction caused a reaction in the market where imports to India dropped. It was reported in the local daily that "Malaysia's monthly palm exports to India fell to about 40,500 tonnes compared to 201,450 tonnes from the year earlier" (Source: The Star, 5 Feb 2020). Followed by that, Malaysia also imposed an export duty of 5% on crude palm oil to discourage exports and encourage domestic refining and consumption as the country has rolled out the B20 biodiesel programme.

For illustration purposes on how these factors above affect FCPO price movements, let's look at the chart below:



Source: Bloomberg

A Geopolitical and Trade Policy Led Price Movement

On 10 January, the benchmark third-month CPO futures contract hit its three-year high of MYR 3,134 a tonne, recovering over 60% from its low of MYR 1,937 seen in July 2019. However, the CPO price started to trend downwards and was down to MYR2,887 by 21 January before increasing slightly to MYR2,973 on 22 January. The volatility continued when it dropped by 13.4% from a week earlier to MYR2,575 per tonne on 28 January.

The decline was a result of increasing anxiety in the market that the fast-spreading Covid-19 in China will affect the demand for CPO. A rapid spread of the Covid-19 has led to a lockdown of cities in China, curfews and travel restriction. This would likely lead to lower usage of edible oils in the food industry and subsequently, a possible slowdown in Asia's economic activities.

At the same time, CPO prices were also coming under pressure due to the lower export volumes to India. Palm oil shipment to India has dropped almost 50% month-on month in the third week of January in line with the negative sentiment in the market. CPO prices recorded several small upward spikes between February and March 2020.

However, unable to sustain the momentum as the overall market sentiment remains bearish, resulting a decline until April 2020.

Summary of Case Study

- The bearish sentiment for CPO in January this year was due to slowing demand from key export markets weighed on edible oil prices, leading to losses in the prices of palm oil and other vegetable oils.
- Although CPO prices attempt to recover from earlier 10th in January, its gain were capped by fears over the fast-spreading of Covid-19 pandemic.

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Trading Strategies

One key point to note when it comes to futures contracts, investors can buy based on positive or negative future expectations and trends.

Futures contracts provide leverage through margin where an investor needs only put up a marginal sum of the contract value instead of the full amount of the contract value.

In this case study situation, the volatile price movement periods would have provided opportunities for the following trade positions. Here is the example of a LONG (taking a position to buy) and SHORT (taking a position to sell) trading strategies for FCPO.

Number of contacts x Price Movement x Minimum Price Fluctuation

Note: Tick refers to the minimum movement in points. For FCPO 1 tick = 1 (MYR 25)

LONG	SHORT
Open Position Buy 1 FCPO contract @ 2620 **Close Position** Sell 1 FCPO contract @ 2700 **Price Movement** **2700 – 2620 = 80 ticks**	**Open Position** Sell 1 FCPO contract @ 2710 **Close Position** Buy 1 FCPO contract @ 2625 **Price Movement** **2710 – 2625 = 85 ticks**
Trade Summary Number of contract x Price Movement x Minimum Price Fluctuation 1 x 80 x MYR 25 **= MYR 2000 (gross profit)**	**Trade Summary** Number of contract x Price Movement x Minimum Price Fluctuation 1 x 85 x MYR 25 **= MYR 2125 (gross profit)**

Going forward, is it imperative for those who are keen to get into CPO futures trading to always keep an eye on the expected news flows on key economic issues such as:

- Crude oil and other competing edible oil price movements
- US dollar strength or weakness against Malaysian ringgit
- Any possible weather and natural events that could affect the production and inventory levels of CPO

STEP 5 Contact Us

Contact us to learn more on
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