



Ferrous futures likely to go mainstream: Gross

by: Grace Lavigne

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NEW YORK — Ferrous futures contracts have not been widely adopted by the metals industry yet, but if progress in the copper and aluminium markets is any indication, then it is only a matter of time, according to hedging consultant John Gross, who serves as president of metals management consulting firm J.E. Gross & Co Inc.

In the late 1970s and early 1980s, the global copper market was just as unattuned to futures as the ferrous market is today, Gross told American Metal Market.

“Copper was trading on Comex, but at the same time, various producers were publishing ‘producer prices,’ or the price at which they sold copper,” Gross said. “There wasn’t a strong or consistent correlation between Comex and the producer price; each producer had their own view of the market.”

In that environment, merchants developed an edge over domestic producers by supplying consumers with copper from overseas nations such as Chile and Peru that was priced based on Comex or London Metal Exchange contracts, according to Gross.

“Companies were hedging, and the Comex market could make a significant change from one day to the next, price-wise,” he said. “Some producers would follow Comex, and others wouldn’t, so when there was a wide spread between producer and Comex prices on occasion, people took advantage of that.”

In response to increased competition from merchants, copper producers tweaked their pricing structures, allowing customers to purchase a certain percentage of their supply

needs based off of a producer price and another percentage off of a Comex-plus price, according to Gross.

This enabled producers “to maintain their relationships with the customers and at the same time continue their producer-pricing scenario,” he explained. “They were trying to hang on to the producer prices for as long as they could.”

By the mid- to late-1980s, producer prices had been phased out, although “it took a great deal of time,” Gross said.

“Although terms such as ‘producer price,’ ‘market price’ and ‘transaction price’ are still used in various dealings today, the mining companies stopped quoting their own individual prices for copper many years ago,” he noted.

A similar evolution also occurred in the aluminium market, according to Gross.

“The producers didn’t participate at first, but in time it all came around,” he said. “It’ll come around for ferrous contracts, too.”

Why hedging is essential

Producers and consumers of steel should be looking at futures markets as a tool to manage price risk exposure, particularly in light of recent increases in steel prices and a heightened level of volatility following the imposition of Section 232 tariffs and quotas, according to Gross.

As a consultant, Gross has discovered that some companies with fixed costs on the sell side have no plans in place for how to manage potential price increases on the

buy side. Such a scenario can lead to bankruptcy, he said.

“Companies need to have a centralized function to manage the buy, sell and futures sides of their business as it relates to price risk management,” he said, suggesting that companies should have at least one overarching strategy that can tie together all facets of pricing.

Hedging offers protection not only against rising prices, but also against falling prices. That feature is especially important for companies that rely on or are considering asset-based lending, which typically means borrowing against the value of inventory, he explained.

“A particular advantage in using the exchanges to hedge is that the exchange stands behind and guarantees every contract,” Gross continued.

A physical contract with a supplier could be voided if that supplier were to declare bankruptcy; if the buyer had locked in prices via hedging, however, the metal could still be obtained from another source at market price using the hedged funds.

Companies don’t need to hedge all of their supply needs and can adjust their investments according to market trends, providing flexibility, Gross noted. For example, a steel producer might hedge 25% of its scrap requirements; if scrap prices start trending upward, the producer can add an extra 10% to its hedge, he said. If prices move down, the producer can stop forward buying or close out a portion of the hedge.

“People often make the mistake of thinking that hedging is speculating – that’s a problem,” Gross said. “Hedging eliminates risk, while speculating or doing nothing invites risk. Compa-

nies have to be proactive in managing their price risk exposure.”

Mount Pleasant, Texas-based Priefert Steel told American Metal Market last month that recent volatility in the steel market has led more of its customers to ask for fixed prices, creating new opportunities for suppliers to take advantage of hedging solutions. Common questions and answers about ferrous futures hedging include what hedging is and how it is useful, how futures contracts are settled, and how the underlying indices are assessed, among others.

American Metal Market’s Midwest No 1 busheling index underpins CME Group’s US Midwest busheling ferrous scrap futures contract, and American Metal Market’s Midwest shredded steel scrap index serves as the basis for the Nasdaq Futures Inc US Midwest shredded scrap futures contract.

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