Wags, rags and Recency bias

Contributed by
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It's been too painful to write anything about drybulk over the past few weeks- but maybe all the pain and "left for dead" sentiments are serving as a contra-indicator. The subject of market psychology, with tinges of behavioral economics, is full of examples where prices of particular stocks, or commodities, took a bounce off a bottom and then kept moving higher, albeit in extremely volatile setting with steadily higher lows along a chart. There's nothing to indicate that anything of this type is happening, yet, in the drybulk space. But, it's worth noting that scrapping of Capesize bulk carriers has been one of the top memes in the shipping trade press. With a different media dynamic than we've had in previous years, good news (and bad news) travels much faster than it used to.

The punditry (yours truly included) has been taking note of "young" ships being scrapped; consider the widely reported transaction early this month where K-Line (one of the big Japanese stalwarts) sent a 2000 built vessel to the breakers. One local wag had suggested that 75 Capesizes might be scrapped in 2015. One leading shipping rag, which hosted a conference on Ship Demolition, reported on one speaker's arithmetical extrapolations- with 25 large Capesize deleted from the rolls during Q1, then we could 100 removals over the entire year- which would equate to something like 18 million dwt. (deadweight tons) dwt. Consider that one leading analyst has been projecting overall bulk carrier scrapping of 32 million dwt during 2015- ouch. But, unfortunately, deliveries of tonnage are still likely to be on the order of 60 million dwt- even after considering that infamous "slippage" always mentioned by owners. The new deliveries will bring the total fleet size to around 750 million dwt. after netting out the deletions. So, we still have a situation where oversupply dominates.

One famous quote, actually from tanker man Craig Stevenson (then with OMI Corp), at a CMA conference several years back, stays in my mind- "You can't scrap your way to prosperity." This rings in my mind every time I have a discussion with folks, as happens frequently lately, on these types of supply and demand statistics. But, at this juncture, it's not really prosperity, ie a booming bull market with hires in la-la land- as we had in the glory days for Capesizes in 2007, that we are looking for- a "reversion to the mean" would be just fine. Philippa Huckle, a Hong Kong based money manager (and not-so-secret student of investor psychology) wrote,in a recent blog, that: The problem is that investors who don't recognise regression will suffer from the psychological flaw which Behavioral Economists call 'Recency Bias', which is the tendency to expect that what has most recently happened is likely to happen next."

One that struck me, two weeks ago, at the Capital Link MLP Conference, was a discussion of forward curves in the oil markets by Richard Robert, from Vanguard Natural Resources. In his slides, Mr. Robert showed the "forward strip" at various times in the oil market history; basically- when the spot oil price is high, the forward curve (reflecting expectations) is high. Conversely, when spot oil prices hit a bottom, the forward curves also slide down. For example, in late 2013- when spot prices were around $110/barrel, the futures prices were all well above $90/barrel. By late January, 2015, when WTI was down at $44/barrel- the forward curve was wandering around $50s and low $60's several years out.

Assessments of the value of Forward Freight Agreements (FFAs), which are financial swaps tied to bundles of time-charter routes for different size ships, are available from the Baltic Exchange. These have consistently shown reversion in action- in the longer term, assessments have been pegged around $15,000/day - $16,000/day, give or take, for the Capesizes. Such levels represent the approximate breakeven cost (considering technical operation and financial costs- for a reasonably modern ship). At any point in time, the curve will start at the spot levels (on the left side of a graph) and work up towards the longer term level. A few years back, before the S & P market had cratered, a higher financial component infused into the daily breakevens had kept forward assessments at $17,000/day to $18,000/day. Back in 2010- the forward points coalesced around $20,000/day. The Capesizes attempted to rally, in late 2014 (on hopes of a repeat of the year earlier strong end of the year), but the more distant parts of the curve (on the right) did not move very much. There's been a noticeable absence of period commitments- charterers, mainly operators who would hope to profit on spikes upward, only see doom and gloom, and won't risk locking in beyond around a year. In the past month, I found four Capesize period deals, all for around a year- Asian deliveries were worth $10,000/day; deliveries in the Atlantic Basin were getting closer to $12,000/day. With the nearby portions of the forward strip exceeding $10,000/day only in Q4 2015, such charters are not for the faint of heart.

But, no guts- no glory. Circling back to the beginning of the article, what types of things might shift the dynamic in the market, so that gutsy charters by the likes of Dreyfus or Rio Tinto might pay off in a big way? Certainly, on the demand side, a massive Chinese ore buying binge, with incremental material sourced from Brazil (with long voyages) rather than Australia (with short voyages) might help. But so far, low ore prices have not induced buyers to build up their stocks (contrary to what's happened in oil). On the supply side, there have been murmurs from owners who are trying to repel the tide of over-supply. Earlier in the year, the Supramax sector so owners Clipper and Thoresen look at pooling. In the Capesize sector, where reports of ships in warm layup are frequent news fodder, a group of owners including Bocimar and Golden Ocean talked about setting up the cleverly-named "Capesize Chartering Ltd." The list of members includes Star Bulk, which provides a segue to another weapon in the owners' quiver- real consolidation in the form of merging companies. And, with the Oaktree angle, there is always the hint that more consolidation could be coming especially with recent management changes at the top of one major New York based drybulk player (also in the Oaktree portfolio).

In pure economic terms, where they are maybe 3,000 vessels in the relevant fleet, a company going from 60 or 70 vessels up to 120 ships does not convey much impact. In psychological terms- if nuanced correctly by those spinning company images (yes, with changed media- there are new weapons to inject radial velocity into shipping market developments), further consolidation might bring about a slight jolt. This won't be a reversion to the norm. But, it might be just enough to get the wags and writers for the rags wondering about whether such a move could bring about a glimmer of daylight to what's been a dark and dismal place.