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Bet on Platinum's Fall Is Anti-Euro Wager

By CAROLYN CUI

Some hedge funds have found a new venue to wager on a worsening outlook for Europe: the platinum market.

In recent months, a number of money managers have ratcheted up their bets on a decline in platinum prices to the highest level ever in the futures market. The rationale is simple: Platinum's main use is to scrub pollutants from the tailpipe emissions of diesel-fueled cars, and Europe is by far the world's largest market for those cars.

Enlarge Image

Reuters

Platinum's use in diesel-fueled cars, which are popular in Europe, is giving money managers another way to bet on a European contraction.

"When you start thinking of ways to play the European contraction, you don't want be in the euro, because it gets so crowded," said Kathleen Kelley, a former fund manager at Kingdon Capital Management, who is launching a new fund in the fall. "I'm looking for commodities that are more specific to the euro zone, so [platinum is] an obvious one." Ms. Kelley predicts platinum prices could fall another 20% to 30% by year-end.

New car registrations dropped 7.4% in European Union countries in the first half, according to the European Automobile Manufacturers' Association. Fewer car sales mean less demand for the platinum used in catalytic converters. Europe accounted for about a quarter of demand for the metal in 2011, according to Johnson Matthey, a precious-metal refiner.

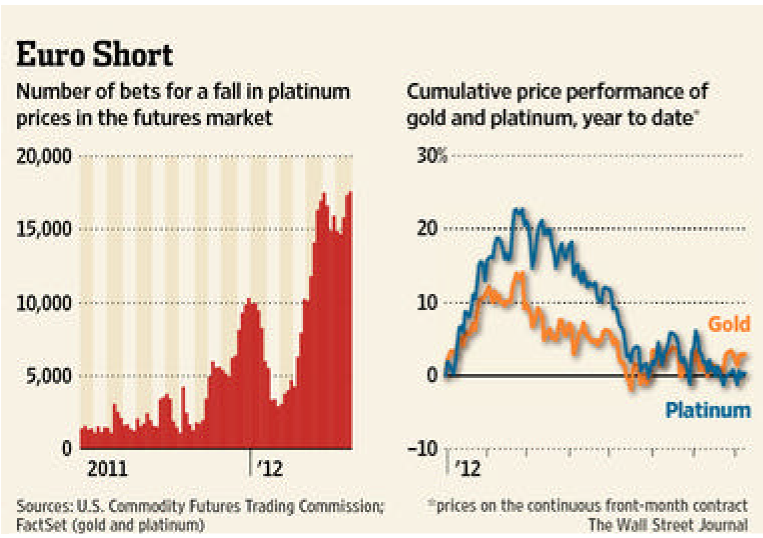
So far, the trade paid off. Platinum has dropped 18% in price since the end of February. On Wednesday, the front-month futures contract for August delivery inched down 20 cents to $1,408.70 a troy ounce on CME Group's New York Mercantile Exchange. Prices had hit a seven-month low of $1,382.30 on July 24.

Hedge funds have been scrambling for alternatives to bet on a further weakening of Europe's economy and on rising uncertainty about member nations' commitment to the euro zone. Currency and sovereign-debt markets already are swarming with traders. The platinum market, which until recently was relegated to commodity specialists, is luring a broader range of investors.

At a "Delivering Alpha" conference in New York recently, Ms. Kelley recommended a bet against platinum, citing slowing auto sales in Europe, to a room packed with pension-fund managers and other institutional investors.

Since the end of February, speculative investors, which include the hedge funds and other money managers, have expanded their bets on falling prices fivefold to a record 17,584 contracts valued at $1.2 billion as of July 31, according to the U.S. Commodity Futures Trading Commission. These positions now account for a third of the $3.7 billion platinum futures and options market, up from a weekly average of 12.6% since 1995, when the data became available, according to the CFTC.

"These are extremely short positions," said Wiktor Bielski, global head of commodities research at VTB Capital, referring to the bearish bets that futures traders employ. While funds also have increased bullish bets on platinum this year, the rise was muted by the spike in negative bets.



The growing interest in the platinum market underscores the changing nature of commodities investment. Commodities have attracted funds that also trade stocks and bonds. By lumping them into the basket of so-called risk assets, commodities are driven more and more by macroeconomic trends, instead of changes to supply and demand.

Platinum supplies are expected to outstrip demand this year, said Johnson Matthey, meaning the market will remain in surplus for the year amid falling demand.

In another sign of how the influx of fund money has skewed the market, platinum, which typically trades higher than gold, is now $204.20 cheaper per ounce than the yellow metal. Another indicator, the "platinum-gold ratio," has recently fallen to the lowest level since 1985, according to Barclays.

Dwight Anderson, a portfolio manager at Ospraie Management LLC, a commodities fund managing $1 billion in hedge-fund assets, recommended selling platinum and buying palladium in May at a hedge-fund gathering, arguing that auto makers would gravitate toward less expensive palladium, which also is used in catalytic converters. A spokesman for Ospraie declined to comment.

In Toronto, Blackheath Fund Management Inc., a $42 million hedge fund, was betting against platinum in April based on market sentiment, said Christopher Foster, the firm's chief executive. The fund is now looking for a better entry point to sell platinum again.

Given the steep fall in platinum prices since February, some analysts are starting to anticipate a turnaround. An unexpected improvement to Europe's economic outlook or any decisive monetary-stimulus measures by central banks could trigger a sharp rally as traders are forced to buy futures to close out open bets, some say.

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Reuters

Platinum is down 18% from February. Here, a conveyor belt carries ore at a Zimbabwe platinum mine.

An anticipated decline in supplies also could influence prices. Many miners are barely breaking even, and some producers are scaling back in response to falling demand. The curtailing of supplies could eventually help absorb the supply glut and support prices.

In June, Aquarius Platinum Ltd., the world's fourth-largest producer of platinum, announced it would halt operations at its Marikana mine because of low prices.

Many mines are losing money now, said R. Michael Jones, chief executive of platinum producer Platinum Group Metals Ltd. PLG -0.12% "It's unsustainable," he said.

But lower prices also have triggered more platinum consumption outside Europe—and not for cars. Shanghai Gold Exchange reported a 4% increase in platinum buying for the first seven months of this year, attributed largely to Chinese jewelry makers, according to Johnson Matthey.

Interest from financial investors has been piqued, too. Globally, four major bullion-backed exchange-traded funds had a 2.8% rise in holdings from a year earlier.

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