Complexity and interconnectedness of global market

The robust growth of emerging market economies (EMEs, such as Brazil, Russia, India, and China), beginning in the 1990s, "propelled commodity markets into a supercycle". The size and diversity of commodity markets expanded internationally, and pension funds and sovereign wealth funds started allocating more capital to commodities, in order to diversify into an asset class with less exposure to currency depreciation.

In 2012, as emerging-market economies slowed down, commodity prices peaked and started to decline. From 2005 through 2013, energy and metals' real prices remained well above their long-term averages. In 2012, real food prices were their highest since 1982.

The price of gold bullion fell dramatically on 12 April 2013 and analysts frantically sought explanations. Rumors spread that the European Central Bank (ECB) would force Cyprus to sell its gold reserves in response to its financial crisis. Major banks such as Goldman Sachs began immediately to short gold bullion. Investors scrambled to liquidate their exchange-traded funds (ETFs) and margin call selling accelerated. George Gero, precious metals commodities expert at the Royal Bank of Canada (RBC) Wealth Management section reported that he had not seen selling of gold bullion as panicked as this in his forty years in commodity markets.

The earliest commodity exchange-traded fund (ETFs), such as SPDR Gold Shares NYSE Arca: GLD and iShares Silver Trust NYSE Arca: SLV, actually owned the physical commodities. Similar to these are NYSE Arca: PALL (palladium) and NYSE Arca: PPLT (platinum). However, most Exchange Traded Commodities (ETCs) implement a futures trading strategy. At the time Russian Prime Minister Dmitry Medvedev warned that Russia could sink into recession. He argued that "We live in a dynamic, fast-developing world. It is so global and so complex that we sometimes cannot keep up with the changes". Analysts have claimed that Russia's economy is overly dependent on commodities.

Contracts in the commodity Market

A Spot contract is an agreement where delivery and payment either takes place immediately, or with a short lag. Physical trading normally involves a visual inspection and is carried out in physical markets such as a farmer’s market. Derivatives markets, on the other hand, require the existence of agreed standards so that trades can be made without visual inspection.

Standardization

US soybean futures, for something else, are of not being standard grade if they are "GMO or a mixture of GMO and Non-GMO No. 2 yellow soybeans of Indiana, Ohio and Michigan origin produced in the U.S.A. (Non-screened, stored in silo)". They are of "deliverable grade" if they are "GMO or a mixture of GMO and Non-GMO No. 2 yellow soybeans of Iowa, Illinois and Wisconsin origin produced in the U.S.A. (Non-screened, stored in silo)". Note the distinction between states, and the need to clearly mention their status as GMO (genetically modified organism) which makes them unacceptable to most organic food buyers.

Similar specifications apply for cotton, orange juice, cocoa, sugar, wheat, corn, barley, pork bellies, milk, feed, stuffs, fruits, vegetables, other grains, other beans, hay, other livestock, meats, poultry, eggs, or any other commodity which is so traded.

Standardization has also occurred technologically, as the use of the FIX Protocol by commodities exchanges has allowed trade messages to be sent, received and processed in the same format as stocks or equities. This process began in 2001 when the Chicago Mercantile Exchange launched a FIX-compliant interface that was adopted by commodity exchanges around the world.

Derivatives

Derivatives evolved from simple commodity future contracts into a diverse group of financial instruments that apply to every kind of asset, including mortgages, insurance and many more. Futures contracts, Swaps (1970s-), Exchange-traded Commodities (ETC) (2003-), forward contracts, etc. are examples. They can be traded through formal exchanges or through Over-the-counter (OTC). Commodity market derivatives unlike credit default derivatives for example, are secured by the physical assets or commodities.

Forward contracts

A forward contract is an agreement between two parties to exchange at some fixed future date a given quantity of a commodity for a price defined when the contract is finalized. The fixed price is known as the forward price. Such forward contracts began as a way of reducing pricing risk in food and agricultural product markets, because farmers knew what price they would receive for their output. Forward contracts for example, were used for rice in seventeenth century Japan.

Futures contract

Futures contracts are standardized forward contracts that are transacted through an exchange. In futures contracts the buyer and the seller stipulate product, grade, quantity and location and leaving price as the only variable.

Agricultural futures contracts are the oldest, in use in the United States for more than 170 years. Chicago, centrally located, emerged as the hub between Midwestern farmers and east coast consumer population centers.

Swaps

A swap is a derivative in which counterparties exchange the cash flows of one party's financial instrument for those of the other party's financial instrument. They were introduced in the 1970s.

Exchange-traded commodities (ETCs)

Main article: Exchange-traded product

Exchange-traded commodity is a term used for commodity exchange-traded funds (which are funds) or commodity exchange-traded notes (which are notes). These track the performance of an underlying commodity index including total return indices based on a single commodity. They are similar to ETFs and traded and settled exactly like stock funds. ETCs have market maker support with guaranteed liquidity, enabling investors to easily invest in commodities.

They were introduced in 2003. At first only professional institutional investors had access, but online exchanges opened some ETC markets to almost anyone. ETCs were introduced partly in response to the tight supply of commodities in 2000, combined with record low inventories and increasing demand from emerging markets such as China and India.

Prior to the introduction of ETCs, by the 1990s ETFs pioneered by Barclays Global Investors (BGI) revolutionized the mutual funds industry. By the end of December 2009 BGI assets hit an all-time high of $1 trillion.

Gold was the first commodity to be securitized through an Exchange Traded Fund (ETF) in the early 1990s, but it was not available for trade until 2003. The idea of a Gold ETF was first officially conceptualized by Benchmark Asset Management Company Private Ltd in India, when they filed a proposal with the Securities and Exchange Board of India in May 2002. The first gold exchange-traded fund was Gold Bullion Securities launched on the ASX in 2003, and the first silver exchange-traded fund was iShares Silver Trust launched on the NYSE in 2006. As of November 2010 a commodity ETF, namely SPDR Gold Shares, was the second-largest ETF by market capitalization.

Generally, commodity ETFs are index funds tracking non-security indices. Because they do not invest in securities, commodity ETFs are not regulated as investment companies under the Investment Company Act of 1940 in the United States, although their public offering is subject to SEC review and they need an SEC no-action letter under the Securities Exchange Act of 1934. They may, however, be subject to regulation by the Commodity Futures Trading Commission.

The earliest commodity ETFs, such as SPDR Gold Shares NYSE Arca: GLD and iShares Silver Trust NYSE Arca: SLV, actually owned the physical commodity (e.g., gold and silver bars). Similar to these are NYSE Arca: PALL (palladium) and NYSE Arca: PPLT (platinum). However, most ETCs implement a futures trading strategy, which may produce quite different results from owning the commodity.

Commodity ETFs trade provide exposure to an increasing range of commodities and commodity indices, including energy, metals, softs and agriculture. Many commodity funds, such as oil roll so-called front-month futures contracts from month to month. This provides exposure to the commodity, but subjects the investor to risks involved in different prices along the term structure, such as a high cost to roll.

ETCs in China and India gained in importance due to those countries' emergence as commodities consumers and producers. China accounted for more than 60% of exchange-traded commodities in 2009, up from 40% the previous year. The global volume of ETCs increased by a 20% in 2010, and 50% since 2008, to around 2.5 billion million contracts.