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By Wilson Sy

Big Short by Big Shot

We have been writing about the Russian invasion and its impact on stocks, bonds, currencies and commodities. We also explained how it exacerbated persistently high inflation globally. While a lot of attention has been given to the surges in oil and gasoline prices, these pale in comparison to nickel's meteoric rise. We are witnessing history in the making.

War and nickel

Russia is widely known to be an oil and gas producer. It is the 3rd biggest oil producer in the world and accounts for about 10% of global oil production. It also supplies about 40% of the EU's natural gas needs. What is less commonly known is that Russia accounts for nearly 20% of global production for Class 1 nickel. Not only is Class 1 nickel needed for electric vehicle (EV) batteries, it is also the only type of nickel that is deliverable to the London Metal Exchange (LME). With the ongoing war, EV demand rising and Class 1 nickel in short supply, a perfect storm hit the nickel industry.

Who is Big Shot?

When someone talks about nickel or steel in China, the name of Xiang Guangda always comes up. He is the founder of Tsingshan Holding Group, one of the world's largest nickel and stainless steel producers. However, in Chinese commodity circles, Xiang is also known as "Big Shot" – a man who places big bets based on his view of commodity prices. He helped drive nickel prices sharply higher in 2019 by buying large chunks of the LME's inventory of the metal. In 2021, he went short nickel as Tsingshan unveiled a method to convert lower grade nickel to battery-grade, Class 1 nickel. This caused nickel prices to drop 32% over 3 months as markets feared both an oversupply and Big Shot's growing short position. Such was the level of Big Shot's influence in the commodity space, especially for nickel.

Nickel gains 250% in one day, hits $100,000/ton

Unfortunately, Big Shot's big short turned out to be anything but profitable. As Russia-Ukraine hostilities intensified, prices of commodities produced by those countries surged - one of these was nickel. A mad rush to secure nickel supplies from LME was exacerbated by speculators, culminating in a one-day 250% gain for nickel prices as it hit a record high of $101,365 per ton. Bulk of this dizzying move occurred in an 18-minute period on March 8. The magnitude of the surge plunged the industry into chaos.

Short squeeze

While rising prices benefit those who are long nickel, it spells catastrophe for those on the other side of the trade – and this is where Big Shot and Tsingshan lay. Part of the reason behind the parabolic move was the need for Big Shot, Tsingshan and other institutions to cover their short positions. The unprecedented short squeeze in the nickel market caused their losses to balloon into the billions of dollars.

LME suspends trading in nickel

Faced with a historic rise in nickel prices and the mayhem it created, the LME convened a group of metals and legal experts with the power to issue emergency rules for the market. With clients facing repeated margin calls and Tsingshan's gargantuan short position of around 150,000 tons, it was clear that banks and brokers were also at risk. Various reports identified some of the banks, such as JP Morgan, BNP Paribas and Standard Chartered. With many industry players faced with an existential crisis, the 145-year old commodity exchange's credibility was also at risk.

LME cancels $3.9B in trades

In a bid to bring back stability and save many industry players, the LME decided to suspend trading on March 8. In an unprecedented move, they also canceled all trades above $48,000/ton. Though this averted bankruptcy-inducing margin calls, the measures taken were widely panned by fund managers and commodity traders who disagreed with the move to cancel trades amounting to $3.9 billion as this was tantamount to bailing out Big Shot.

Glitches mar resumption of nickel trading

To reopen the market in an orderly fashion, the LME unveiled a series of measures, including a 5% floor and ceiling for nickel prices. With the nickel market shut for 7 days, it bought Big Shot enough time to secure collateral and negotiate margin financing. Unfortunately, when nickel trading finally resumed on March 16, it was hit with glitches ranging from the electronic market not opening on time to off-limit orders getting done. This was further exacerbated by the lack of liquidity.

Limit down, limit up

In the succeeding days, as nickel kept hitting limit down with barely any trades, the floor and ceiling was expanded to 8% and then to 15%. It was only on March 22 that a semblance of normalcy was seen as many trades started to get done. As the metal struggled to find a floor, industry experts and even LME CEO Matthew Chamberlain stated that they expect nickel to stabilize at a level similar to where Shanghai nickel futures were trading. Upon hitting that level, nickel hit limit up of 15% on Wednesday and Thursday last week.

Big Shot covers shorts

Amidst these wild moves, there were news reports that Big Shot and Tsingshan were slowly covering their short positions. Friday also saw wild swings at the open, with nickel price rising by 9% then falling as much as 7% in just the 1st hour of trading. What was happening in the nickel market was clearly one for the books.

Nickel saga continues

With the Russia-Ukraine war hitting the 1-month mark, sanctions have wreaked havoc not only on Russia's economy but on global supply chains. This inflation spike makes everyone part of the collateral damage wrought by the Russia-Ukraine conflict and the Western response to it. Until such point that the situation stabilizes, we can expect high volatility and elevated commodity prices. In the meantime, the nickel saga continues.

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