

# CHANGE: TRAMP Shipping in the Early 21<sup>st</sup> Century

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*Tramp shipping, long described as a commodity, has changed in many ways in the last few years, and has emerged as an industry now recognized by investors. However, it is also being used by the trading and financial communities in ways never before seen. This paper tries to show how that came to be.*

## KEY WORDS

Tramp shipping; geographic shift; criminalization; ship finance; virtual charterers; industry governance

## INTRODUCTION

The business of tramp shipping has greatly changed in the last ten years or so. This paper attempts to “connect the dots” by tracing the changes that have had the greatest impact on the industry.

## WORLD TRADE GROWTH

Trade volume has been expanding over the last fifty years. The amount of cargo carried by ships has tripled over the last ten years and increased even more dramatically over the last five years (see Fig. 1). The demise of the former Soviet Union was marked by lengthened trade routes, which increased again when China was admitted into the World Trade Organization (WTO).

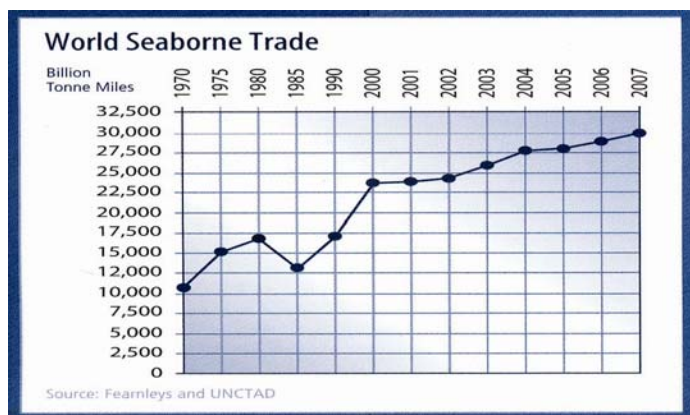


Fig 1. Growth in world sea-borne trade (1970-2007).

## SHIFTING GEOGRAPHY

Shipping has been shifting from a Euro-centric industry toward Asia for decades. Notwithstanding Japan's historic position as a major shipping nation, the real shift toward the Far East started in the late 1980's as the former British colony, Hong Kong, approached the date for transfer back to China in July 1997. Beijing's prominence in tramp shipping has grown as China's appetite for imported raw materials for Chinese factories increased. However, not only has control of much of the

world's cargo and a significant slice of the world's fleet shifted to Asia, but there is now also a growing shift to the east in the soft maritime services such as finance, insurance, law, dispute resolution, and ship management.

## NEW SHIPOWNERS

For years the profile of the typical ship owning company was that of a closely held, often family-based, organization. Mergers and acquisitions among shipping companies started with container lines in the 1990s. The move toward publicly owned and traded tramp owners started later. As you will see, the near explosive move toward public ownership is only about 5-6 years old.

The trend started with an urgent need to lower operating costs as rates bottomed out in the 1980s. The search for new sources of equity started about a decade ago. Both changes are discussed later in “Financing of Ships.”

**Competition.** Joint ventures among tramp ship owners started at least 45 years ago as a way to save on expensive marketing costs. The impetus to form pools of similar sized/types of vessels marketed by a single entity came as mergers among major oil and mining companies, manufacturers of steel and aluminum, and others gave the cargo side greater leverage in the freight rate negotiating process. Two years ago the Competition Directorate of the European Commission found that Liner Conferences restricted competition and followed that idea into the tramp sector as they evaluated the potential of shipping pools to inhibit competition in all phases of maritime transport.

**Management.** In shipping, the word “management” has several meanings. There is the management of the enterprise (the owning company), commercial management of the fleet and physical management of the individual ships. Changes in the management of the companies themselves, taken from the view point of investors, investment houses and Wall Street analysts, have produced some dramatic results.

Twenty-first Century management personnel are generally better educated, more financially aware and have, by and large, a higher tolerance for risk, possibly enabled by risk management tools that their predecessors did not have at their disposal.

## OPERATIONS

**Crews.** There is a critical shortage of educated, trained and experienced seagoing personnel at a time of extraordinary fleet and trade expansion. Besides the ever present wage issue, crew issues include training, training standards, quality of life at sea, shore leave for seafarers and perhaps most frightening, the criminalization of vessel officers and crew for accidents that involve the environment.

**Public Image and Share Prices.** Publicly owned companies' share prices are vulnerable to negative publicity and subject to the investing public's perception of the company's management. For publicly owned ship owners, an oil spill, grounding, collision or any operating accident, all of which usually involve crew actions, quickly results in a decline in share price.

Crews have always been an integral part of the vessel. Essentially they were the engines of galleys, and the engineers of sailing ships. For centuries they were a "cost", but now, as a result of the 24 hour news cycle and a vigilant financial press, they are not only a cost, but also an owner's asset, liability and partner.

Recruitment, training and retention of seafarers has been a concern for decades but now the shortage of educated, trained and experienced mariners (licensed and unlicensed) is rapidly becoming critical for both high seas and brown water (inland rivers and waterways) operations. Today the issue goes beyond numbers. Owners now want officers with critical reasoning skills.

The shortage of experienced professionals ashore is also a concern but once again critical reasoning, added to the combination of education and at sea experience, is proving to be hardest to find.

## FINANCING

Until about twenty five years ago ship building loans were secured by multi-year time charters or contracts of affreightment with major oil companies, large trading companies or industrial giants such as steel or mining companies whose operations depended upon shipping. Not so today, and that is a major reason why shipping companies have gone to Wall Street.

**Recent history.** As shown in Figure 2, the 1980's were cruel to ship owners and their banks. The losses incurred by lenders forced banks to reconsider their lending policies toward the shipping industry. Required equity for new ships doubled from 20% to 40% or more, and interest rates for shipping ventures rose abruptly. The Bank for International Settlements (BIS) based in Basel, Switzerland expressed its concern about some banks' shipping loan portfolios and their reserve positions. This issue re-emerged as the DOTCOM bubble was recognized in 2001, and it accelerated the BIS analysis of required bank reserves for losses leading to the Basel II rules of today.

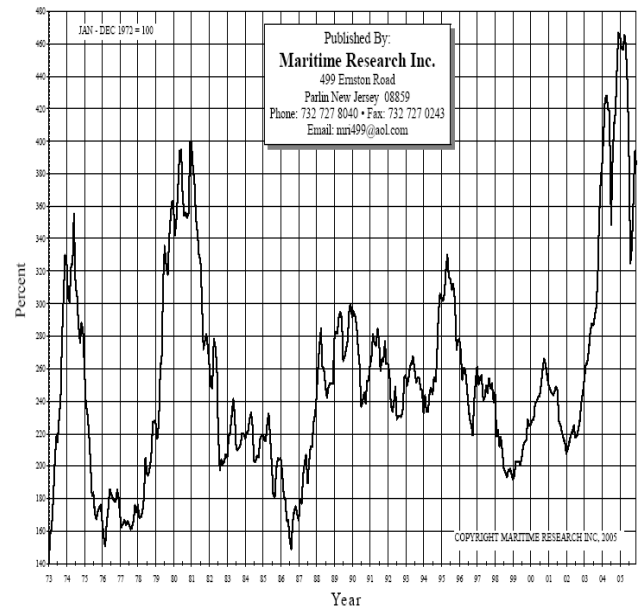


Fig 2. Cyclical nature of tramp shipping: general freight index (1973-2005).

**Oil Pollution Act of 1990.** The defining event that altered the old ship finance model was the March 1989 EXXON VALDEZ accident and the ensuing Oil Pollution Act (OPA) of 1990. Oil companies reassessed whether they wanted to be ship owners at all. Should they face trashing of their stock prices after an oil spill, or assume control of the ships they use? Many simply got out of transporting their own oil altogether.

Following a chronic over supply of ships, one or two year time charters or contracts were adequate for both the oil and dry cargo side's risk control needs of the time. Major charterers felt that there was sufficient capacity afloat and at the building yards and continued to eschew long term charters and contracts of affreightment. Without the security of long period cargo commitments, most banks withdrew from ship lending for all except their longest known and best customers.

As demand for dry cargo shipping started to perk up (1988-90), and freight rates started to move accordingly, ship builders aggressively sought new orders. Owners' memories of the overbuilding of the early 1980s that caused rates to crash had faded. Banks started to relax their lending rates, at first only for their vetted and quality owners. However, equity requirements remained higher than before the crash.

Without access to bank financing, in the late '80s some Norwegian owners started to use tax leveraged leases (KSSs) which spawned some shady deals. They were followed by closed end self liquidating investment funds similar to real estate based projects. That was short lived and mergers were next (see Fig. 3).

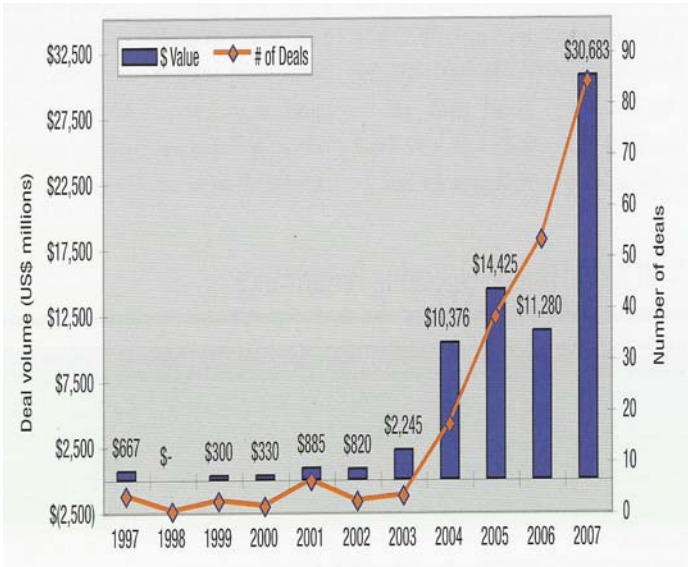


Fig 3. Increases in mergers and acquisition (1997-2007). Source: Marine Money, Jan 08.

**Markets Rebound.** As the former Soviet Union disintegrated (late 1991 through 1994 or so) China became a more active trading nation, both driving and being driven by the brief appearance of the so called Tiger Economies of Southeast Asia. New trade routes added significant ton-miles to world trade statistics (Figures 1 and 7).

As a result ship owners wanted to order new ships, but without the security of period time charters, and after being burned in the 1980's with non-performing ship loans, the banks were wary of lending to the shipping industry or had simply left the shipping market.

Several approaches were tried in response to the need for equity. Collateralizing ships' mortgages like real estate loans appeared about the same time as the shipping equivalent of junk bonds, and Norway's tax leveraged leases called KS's. The junk bonds were almost universally bad investments, and the KS schemes proved to be either poorly managed or were "get rich quick" scams. Older ships with high maintenance costs eventually doomed the companies. (Germany learned from the Norwegian KS experience and today's KGs have been used to finance many hundreds of ships, especially container ships.)

Wall Street had participated in shipping junk bonds from about 1996-98 and was properly chastened after a spurt of defaults, but rising freight rates and vessel values produced new thinking on how to finance shipping in the 21<sup>st</sup> Century - public equity.

Enter the really big changes – Globalization and China after WTO. As shown in Figure 4, globalization begot real interdependency among nations, resulting in increased trade worldwide, and soaring freight rates.

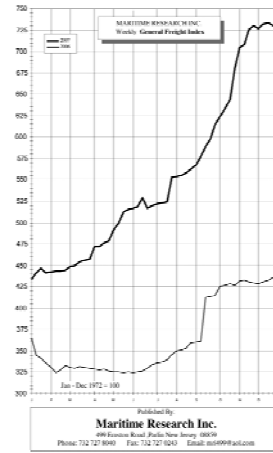


Fig 4. General freight index: 2006-2007.

**Shipping IPOs.** As shown in Figure 5, the ship finance market blossomed as rates rose (see Figures 2 and 4). Public investors rushed to participate in the shipping boom. Share prices went up. As a result ship owners today can generally be characterized as "cash rich." The historically high freight rates since 2003 have allowed ship owners to pare down their debt or leverage their asset base. For those companies wanting to order new ships, the traditional finance route was still available for solidly structured deals even if banks had their own concerns for a downturn in 2009 or later.

It appears that Wall Street and the Capital Markets became more comfortable with shipping and therefore brought in new risk-tolerant investors and lenders that were (and still are) keen to take a slice of the shipping pie in a time of low returns for traditional investment sectors.

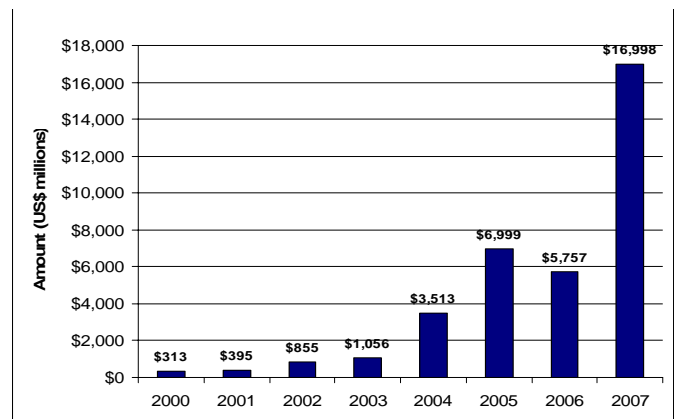


Fig 5. Shipping equity and equity-linked offerings in public markets (2000-2007). Source: Marine Money and Citi Group.

Despite the fact that a majority of the shipping industry is still privately owned and managed (see Fig. 6), these increases in public investment have already had an impact on the industry and I will return to this theme later.

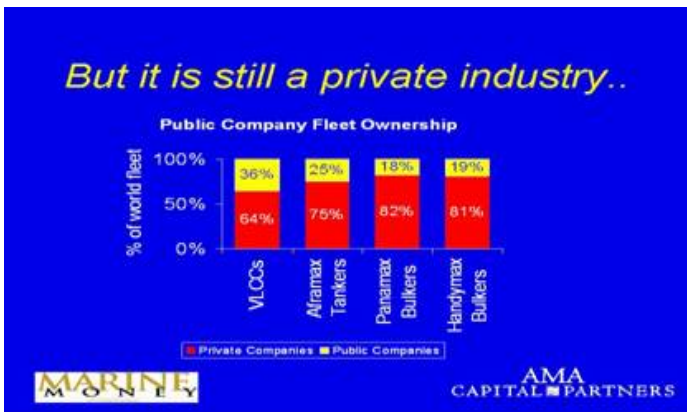


Fig 6. Non-public fleet ownership

While Figure 6 illustrates that most of the tramp fleet is still in the hands of private owners, public money has been driving the industry in new ways including how traditional business functions like brokerage are being handled.

**Disintermediation.** A Wall Street Journal article in early January 1998 introduced “disintermediation” to define how electronic commerce would put seller and buyers together without layers of middlemen. Applied to shipping, it was first thought of as cutting out the broker. As a form of economic Darwinism it has worked, but not quite the way the pundits of the time expected.

Shipping companies never had large staffs, but still managed to cut some levels of management and supervision, or outsource functions not considered core. The fundamental idea was to gain “competitive advantage” in a hyper-competitive global economy. This was before derivatives became broadly useable tools.

Ship and cargo charter brokers and ship sales and purchase brokers had long ago extended their activities into ship finance as a service to the ship owner to be. What is new today is that the finance people have extended their businesses into shipping on many fronts and in some ways are threatening to eclipse the brokers and traditional charter market experts. New jobs have been created in shipping, but they have mostly been in the area of financial services.

## FREIGHT MARKETS

The Webster Unabridged Dictionary defines freight as the “compensation paid for the transportation of goods.” A secondary definition is “that which is loaded for transportation” – i.e. cargo. Through common misuse of the word, the secondary definition has become the accepted primary meaning.

Liner (a.k.a. - Container) Shipping is considered a “common carrier” and thus is regulated by governments, very much as railroads were after the robber barons disrupted the rules of competition in the early 19<sup>th</sup> Century. So called Tramp Shipping is contract carriage and has never been regulated by governments.

There is no single overarching freight market. The “market”, such as it is, consists of hundreds of micro-markets that are ship size, characteristics, place and time specific. Most people are not familiar with the idea of “freight” as a commodity that can be traded. Nonetheless, today freight is traded in person, over the phone, and on a bourse or exchange, as well as online, where the transaction can even be made automatically by computers.

**Freight Market Drivers.** The supply of ships versus the demand for ships has been thought to be the foundation of tramp shipping rates, but there is more to supply-demand, and there are other inputs:

### I. Supply and Demand are Multi-dimensional

As stated above supply and demand are ship size and type specific as well as place and time specific (i.e. – are the required size and type ships available when and where they are needed?).

### II. Expectations – the unacknowledged mover

It is “expectations” that define whether a buyer or seller sees the present and future price for a commodity or product as rising or falling. Obviously, this real or simply perceived trend upward or downward may be viewed differently by ship owners and shippers. The elasticity of these expectations and the degree of asymmetry between those of the freight buyer and ship owner contributes to the determination of a negotiated freight rate (and as we see in the post sub-prime mortgage debacle, the same goes for real estate.)

Forty years ago, graphics of trading routes like the one shown in Figure 7 were often used to illustrate the idea of front-hauls, backhauls or how the use of OBOs (oil-bulk-ore carriers) might turn the ballast legs of most tanker voyages into revenue producing time. Today this world view of sea lanes is being used to highlight the many geographic and geo-political bottlenecks inherent in seaborne trade today. I have introduced this graphic not only to reintroduce all of those ideas, but also to link them to the remaining pair of freight market drivers that are related to commodity prices – economic geography and port congestion. These, in turn, determine the distribution of vessels around the world and thus influence both supply and demand for ships... and thus both spot and forward freight rates.

### III. Sourcing and economic geography - a pricing puzzle for shippers

In the world of commodities and industrial raw materials the closest source to the buyer is not always the lowest cost supplier. Beyond qualitative issues of the commodity or raw material, there are specific limitations that describe the size or characteristics of ships that are suitable for certain load or discharge ports. There are seasonal aspects such as ice or river depths related to rainy seasons, or cargo growing and harvest times related to hemispheres. All of these factors may influence the sourcing decision that favor sources more distant rather than the closest. Economies of scale (i.e. - the ability to use larger and therefore more economically sized vessels) might offset the cost of the longer distance, but the longer distances will still

result in more ship-days for the fleet which, in turn, influences the real supply of ships available. Sourcing decisions impact ship supply and ship owners do “game” that fact.

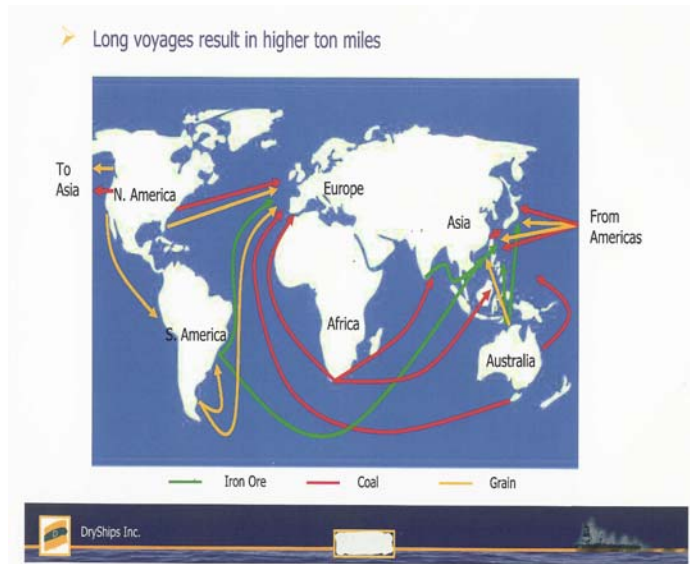


Fig 7. Illustration of trading routes.

#### IV. Port Congestion

If voyages take longer than reasonably expected, fleet efficiency figures plummet and the supply vs. demand balance becomes cumulatively unreliable as the delays continue. The resulting disruption leads directly to increases in voyage freight rates and time charter per diems. However the delays not only impact the trade route that is congested, but also have a domino effect on all those trade routes which intersect with that route, whether they are backhauls, triangulations or round-the-world trades. The run up in rates all started in 2003 with a series of separate port congestion events in Brazil, Australia and China. The cost of port congestion has immense ramifications for demurrage bills as well as fleet utilization.

These last two freight market drivers (economic geography and port congestion) continue to disrupt the supply-demand equation often with unexpected impact on rates.

### FREIGHT MARKET DYNAMICS AND TRANSPARENCY.

The National Association of Securities Dealers’ definition of a perfect market is one where all the buyers and sellers are known and all of the material or commodity to be sold or bought at the time of the trade can be known and accounted for. This is called “transparency”.

Shipping/Freight Markets have never been “perfect”! Ship owners have always tried to hide the real number of ships available in a loading area in a specific period of time, and charterers have always tried to hide the scope and timing of their demand.

Trading requires fast, accurate information flow among buyer and sellers that goes beyond the cargo (ship requirement) and ship (availability). Knowledge of actual transactions is needed to determine the “expectations” of the parties. Both parties often try to hide details or have actually used mis-information on actual transactions to gain a trading advantage for fixing following ships or cargoes, or to mislead customers or competitors as to actual costs. We will see later that things like this are making markets more opaque than ever.

Before the Information Revolution shipping trade publications not only published detailed daily transactions, but they actually canvassed ship owners, broker and charterers everyday for clues to unreported fixtures and to verify details of those that were “floated” in the market either to hide the identity of the parties or to actually spread misinformation. An un-noticed result of fast and cheap global communications has been the disintermediation of those that kept the industry honest. Today, only about 20% of all the charter transactions around the world get reported and still fewer are accurately reported. This compares to 40% twenty years ago.

The most reported transactions (fixtures) are those involving large ships and tankers possibly because they carry the highest volume cargoes of oil, iron ore, coal and grain. Of course there is the added fact that these ships tend to be owned by publicly traded companies, and the rates or trends link directly to the raw material/commodity prices.

**Government regulation of competition and transparency of markets.** Governance of the shipping industry, first focused on safety, then security, recently the environment, and now there are concerns for competition among carriers and market transparency both with unknown consequences.

Financial disclosure regulations like Sarbanes-Oxley in the US, while expensive to implement, have had some beneficial effects. Regulations dealing with the environment have resulted in greater operational care but threaten the functionality of the fleet by criminalizing accidents. Now we have the beginnings of regulations to create greater transparency in the marine transportation system itself which has always been notoriously opaque.

The European Commission proposed withdrawal of Liner (containers) Shipping’s exemption from anti-trust under the Conference system granted decades ago. On October 18, 2006 the Commission passed EU Regulation 1419/06 that repealed the exemption effective October 2008. It also resulted in the European Commission being asked by the member states for guidelines with regard to shipping pools and their possible breach of EC Treaty provisions dealing with competition, and in particular Article 81.

Tramp vessel services were considered by the industry to have been “immune” from the application of EC competition law. In reality it is now felt that the Commission has always had a duty

to ensure that the PRINCIPLES of Articles 81 and 82 (regarding competition) of the EC Treaty were applied to tramp shipping services. The ultimate issue seems to be how to regulate transparency in markets, which we will see later, has never really been tried in tramp shipping. The dawn office raids on IACS and three of its members in February 2008 seem to be one more step in the same direction.

## RISK MANAGEMENT

There are two types of risk management tools – physical and paper.

### *Physical hedges*

#### a) Contracts of Affreightment (COA)

The drawback to this risk management tool is that it is inflexible because it is specific to a named port or ports, the materials to be carried, annual cargo tonnage commitments, schedules and terms of carriage.

In a time of inflationary commodity prices the concept of commercial impossibility (to perform) is often inserted into a sales/purchase contract. A COA only contains a Force Majeur clause that speaks of acts of God or political intervention that make performance according to the letter of the COA temporarily impossible. If any of the factors in the sales contract change, the charterer's options under a COA are restrictive and changing them or adding to them is often very costly.

#### b) Time Charter (T/C)

If the cargo interest cannot interest a ship owner to carry his forward cargo commitments (COA), or to carry them at rates that are acceptable, the only other option is to take a ship on charter for a period (time charter). Among the reasons to seek this type of coverage are:

- a) The Cost and freight (C&F) sales contract(s) extends far into the future.
- b) The C&F sales and prices are made for future execution
- c) A volatile freight market at the time of sale or expected volatility in the near future.
- d) Multiple/optional sourcing or discharging ports
- e) Short declaration notices in the sales contract for options
- f) A sales contract giving the buyer options to cancel the purchase over commercial issues.
- g) Changing commercial climate that signals rapid changes in commodity prices.

There are many more. The ultimate argument in favor of T/C is that controlling a ship or ships gives the seller options, and in a rising freight market, minimizes risk of freight losses.

However, if the time charter market declines, the cargo interest would then be left with the same risk of loss on the market value of the ship as a ship owner. Something better was needed to manage risk.

**Paper Hedges.** A “paper hedge” is a financial instrument or contract that locks in a future price for any tradable commodity, material or service. It is used to offset some or all of the risk

that has been undertaken in the physical sale or purchase of that commodity, material or service. Paper instruments can be bought or sold just like pork bellies, soy beans, orange juice or even foreign exchange

Early attempts to make shipping markets more like those for other commodities failed to engage the ship owners. The paper hedge for bunker fuel oil prices in the late 1980s caught on very slowly. Those ship owners and operators that did use bunker hedging often classified the job as a treasury function, thus losing the trading intelligence aspect of bunkers as a “market” connection.

## THE INFORMATION AGE POST DOT-COM ERA

During the decade between the introduction of the struggling bunker hedge contract and the Internet boom, several financial products were introduced to enable some kind of a Freight Futures Contract. Indices were introduced by a number of organizations but a workable derivatives market failed to catch on. Later, in the 1990s, the Baltic Exchange Indices became the basis for a derivatives market that more recently has become the foundation for the increasingly important Forward Freight Agreements (FFAs).

**Online trading.** The idea that charter transactions could be carried out faster and more efficiently, in vogue at the turn of the millennium, lost traction as the DOT.COM bubble deflated, but the idea did not die. It appears now that it was just put on hold while the commodity traders worked out unified terms of sale and transport. From that idea though came a realization that the commodity “shipping” itself could be, and needed to be traded as a futures contract.

**Derivatives.** Derivatives are risk management tools, the value of which is derived from the value of an underlying asset. In shipping the underlying asset is the freight rate for a specific physical trade route. The most fashionable derivative is the Forward Freight Agreement (FFA) which is a contract between two parties to physically deliver a specific cargo (commodity, size, ports and route) at an agreed time in the future.

**FFAs.** The FFA Contract gives ship owners, ship operators, and traders with forward freight commitments a risk management tool in addition to Time Charter. It also gives shippers/charterers an alternative to Contracts of Affreightment – initially for six to nine months and now up to two or three years on some routes. Since it is a risk management tool it is not meant for speculators, but in a world of fast money, there are speculators in this market and periodically they get caught with the wrong bet and the results threaten the market. Speculators add depth and liquidity to a market, but also bring additional volatility to a market that FFAs are meant to aid in controlling.

The FFA market is now a \$60+ Billion/year market and could easily double in a few years – faster and larger if freight rates spike again. The FFA market has uses that go beyond the freight markets and can influence prices for other commodities, second

hand ships and even shipping companies. In 2007 former Federal Reserve Chairman, Alan Greenspan, offered the hypothesis that the Baltic Dry Index was a leading indicator of global economic growth. That has been shown to be inaccurate, but some investors in shipping still use it as an indicator.

**Spot Rates.** Traders have always had to consider that many ships that may be shown as open for cargoes may already be committed to contracts of affreightment or previously arranged charters with broad or optional layday spreads. However, now, with the proliferation and deep pockets of the “virtuals” that I describe below, owners are more than ever continuously measuring the spot market in search of arbitrage opportunities. Furthermore, traders now have to consider the effect of future rates, as suggested by the FFA market, on spot rates.

Today supply vs. demand is simply a determinant of TREND.

**Forward Rates/** The individual Indices used to price FFAs are based on a series of proforma voyages over specific routes for a specific cargo size or ship class. In its simplest form each index can be used to infer future rates along the specific routes, and when weighted for route importance and the routes averaged, they establish a basis to measure expectations for future rates in general for each ship size or class. Further weighted and averaged, in aggregate they yield an index of general shipping market sentiment toward the future.

In an economy where commodity prices exhibit an inflationary trends, it is assumed (i.e. - “expectations”) that the price of a commodity (which also includes shipping) will be more expensive in the future than today (i.e. - the spot price). In a deflationary economy, a situation the world has experienced for the two or more decades ending about 1998, the spot price is usually higher than the future price. An example would be the inverted yield curve we have experienced in the market for US Treasuries over the last few years.

In 2007 some charterers tried to get owners to discount rates for future cargoes with the argument that China’s demand for shipping would not last, and there was a huge order book for ships to be delivered soon so that the very high rates seen for the past three years would not last. The owners did not buy that idea and therefore most of the reported transactions (fixtures) have been for ships and cargoes in spot positions. This was already a trend created by the FFA market, but when combined with the continued strength in commodity prices, a quite robust shipping market continued ... for almost another year.

## NEW TRENDS, NEW PLAYERS

For those who follow freight markets you will have noticed that up until fairly recently most transactions have been time charters. There are several developments that dictate that type of charter:

1. Owners had pricing power – In a time of rampant port delays and rapidly escalating fuel prices that cannot be adequately hedged, owners were able to put these risks on the charterers.
2. Traders, especially those in commodities that demand tight dates for Bills of Lading, and Letters of Credit, must have greater control than they might otherwise have under a voyage charter or even contract of affreightment.
3. The time charter operators (i.e. - those that take and execute contracts of affreightment) until recently took ships for short periods because those rates were often lower than longer period rates (a perfect example of “backwardation” of markets).
4. Time charters make it easy for a shipper, or trader/charterer, to hide the real cost of transportation under C&F sales in order to protect a list FOB price.

**The “ENRONIZATION” of commodities and shipping.** Starting in the mid 1990s a new thought process of how to price energy arose. Instead of pricing to cost (i.e. - the actual cost to acquire the energy and deliver it plus a profit margin) energy was priced to market (whatever price that would sell). For the record, it is a well known fact that energy prices are almost price inelastic. That is, it takes a really significant change in price (up or down) to change demand for it.

You may recall that US electricity traders, operating in a deregulated market, successfully “gamed” their market by first quietly buying up as much of the available supply as they could control without seriously disturbing that market. Then they held back some supply to high demand markets and/or temporarily rerouted some supply away from the high demand market. In the short term they lost some money. However, demand for electricity remained strong and thus the price for it in an unregulated market soared to never before seen levels. I call this ENRONIZATION. This same pattern is now the pattern in other energy sources, agricultural commodities and even some metals in high demand such as copper and aluminum.

**The “Virtuals”.** There have always been trading companies that acted as intermediaries in all of these markets, but they were never as well financed or as aggressive as the new players – Hedge Funds and Private Equity Funds. The same tactics used in electricity were often used in such a way as to disrupt well disciplined commodity markets including self regulated trading exchanges. Metals, as a commodity, are an example. Unlike the traditional trading companies that seldom paid for the cargo until they took physical ownership as the cargo was actually loaded aboard a ship that they provided, the Funds often pay for and take ownership while still in the shipper’s storage area at the shipper’s port. By deferring shipment for a strategic time of their own choosing, the Funds (NOT the actual miners or producers) can set the spot price. While these new players produce nothing and hold relatively small stakes in each commodity, material or metal, they can become a dominant force in pricing. They become “virtual” shippers or charterers

and the producer has lost control over the price of the product, material or commodity.

Not unlike the new cargo players, some Funds have taken ships on time charter, not so much as a physical hedge against rising rates, but to take a stake in the actual shipping markets. This is not quite the same as those merchants and Funds that have used the freight markets as a trading surrogate for the commodities that the ships actually carry, but the effect is the same.

As on the cargo side, traditional trading houses often take positions on shipping (i.e. - ships on period time charter or even buy and operate ships for their own account). However, as in the cargo case above, the Funds are far better financed and their game plan may not just focus on hedging but on actually controlling short term rates for a specific trade route where they may or may not also have a cargo interest. They become “virtual owners” as far as the market is concerned.

There is more though. Some of the Funds have also become ship owners in a physical sense for more or less the same reasons as those for taking ships on time charter. However, physical and time charter ownership gives them greater market control. For example, they could use their T/C fleet to raise expectations for future shipping rates, at least for a short period. Given the right conditions they also can create a synthetic market based on those forward rates to influence second hand prices for their owned vessels.

## CONCLUSIONS

**Market transparency.** The missing element in the market place for freight derivatives is true transparency. Yet no one has yet complained. Apparently everyone has been making money – some more than others. Owners were (actually still are on a relative basis) doing well and so too most energy, materials, commodities and process industries. Money interests held large positions in ships, freight and cargoes, PLUS they earned fees on all the financial transactions that were spawned by the unprecedented freight boom. The recent banking restructuring has changed that but probably not for long.

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It is clear that the direction shipping has taken in this decade has been shaped by globalization and investors’ perception of the industry.

As previously mentioned, the European Commission (EC) has started the process that does away with Liner Conferences, but that law also restricts the exchange of customer information among carriers. It is too soon to evaluate exactly how the EC will pursue their stated objective of making the marine transportation market more transparent. On the liner side the United States started in this direction in 1998 (Ocean Shipping Reform Act – or OSRA – of 1998) and seems likely to follow Europe’s example, at least in the area of Conferences. Preliminary results of our Ocean Shipping Reform Act (OSRA) point toward more volatile liner rates and shippers assuming more of the liabilities formerly borne by carriers.

**Momentum.** A key word in today’s freight market seems to be the one that marked ENRON’s rise and fall – “momentum”. As long as the global economic drivers (Brazil, Russia, India and China) continue in their headlong quest to modernize their economies, notwithstanding the periodic dips in rates and increased volatility of both dry and tanker rates, I think this bull market can continue for some time.

Today’s very positive cash flows and profits are not enough to keep Wall Street involved. As they say, “past performance may not be indicative of future results”. Steady growth is not sufficient to keep share prices up and definitely will not raise share prices. It seems that the “street” is more forward looking than shipping. Public companies must keep doing deals that at least make them look dynamic otherwise the share price will stall in a narrow trading range. This drives public shipping firms to continue to make deals, buy and sell ships, refinance debt, spin off parts of the company as stand alone entities, merge or acquire - even when the deal may or may not be well timed.

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