# Commodity Market (PUN009)

A commodity market is a place for investors to trade in commodities like precious metals, crude oil, natural gas, energy, and spices, among others. Currently, the Forward Markets Commission allows futures trading in India for around 120 commodities. Trading in commodities is great for investors seeking to diversify their portfolio, as these investments often help with inflation.

**Commodity exchanges in India:** India has 22 commodity exchanges that have been set up under the Forward Markets Commission. The following commodity exchanges are popular choices for trading in India-

1. Multi Commodity Exchange of India (MCX)
2. Indian Commodity Exchange (ICEX)
3. National Multi Commodity Exchange of India (NMCE)
4. National Commodity and Derivative Exchange (NCDEX)

**Commodity futures contract:** The 'commodity futures contract' is the assurance that a trader will buy or sell a certain amount of their commodity at a pre decided rate at a certain time. When a trader purchases a futures contract, they are not required to pay the whole price of the commodity. Instead, they can pay a margin of the cost which is a predetermined percentage of the original market price. Lower margins mean one can buy a futures contract for a large amount of a precious metal like gold by spending only a fraction of the original cost. Suppose you bought a gold futures contract on MCX at Rs. 72,000 for every 100 gm. Gold's margin is 3.5% on MCX. So, you will be paying Rs. 2,520 for your gold. Suppose that the following day, the cost of gold increases to Rs. 73,000 per 100 gm. Rs 1,000 will be credited to the bank account you have linked to the commodity market. Assume that the day-after, it drops to Rs. 72,500. Accordingly, Rs. 500 will be debited from your bank account.

Types of Trading Strategies in a Commodity Market: There are two core drivers of -or trading strategies within- a commodity market: **speculators** dealers constantly examine the costs of commodities in addition to forecasting the expected price changes. For instance, if a speculator predicts that the price of gold was to increase, they purchase the commodity futures contract. If the cost of gold subsequently grows, the trader will then sell the contract for a higher price than they bought. If the speculator anticipates that the rate of gold will decrease, they sell their futures contract. Once the prices lower, speculators buy the contract again for a lower price than what they sold it for. This is how speculators make profits in both cases of market change. Hedgers: Those who produce or manufacture commodities typically 'hedge their risk' by trading in a commodity futures market. For instance, if the prices of wheat fall during the harvest period, the farmer will face a loss. The farmer can hedge this risk by entering a futures contract. In this case, when the price of his produce falls in his local market, the farmer can offset this loss by making profits through the futures market. The opposite situation is when the cost of wheat increases during the harvest period. At this time, the farmer would encounter losses in the futures market. However, these losses can be compensated for by selling his produce for a higher cost in his local market.

**Benefits of commodity market: There are several benefits of commodity market to market participants:**

1. **Contributes to portfolio diversification:** The commodity market provides an avenue for diversifying investment portfolios. By including commodities in their investment mix, individuals and institutions can reduce their exposure to risks associated with traditional asset classes like stocks and bonds.
2. **Mitigates risk:** Commodity trading allows market participants to hedge against price volatility and manage risk effectively. Hedging involves taking offsetting positions in the futures market to protect against adverse price movements in the physical market. This helps participants, such as farmers, producers, and traders, to safeguard their interests and stabilize their revenues.
3. **Boosts investment in the agricultural sector:** The commodity market plays a vital role in promoting investment in the agricultural sector. By providing a platform for price discovery and trading, it incentivizes farmers to produce more efficiently and enhances their income prospects. Increased investment in agriculture leads to improved infrastructure, technology adoption, and overall development of the sector.
4. **Facilitates price predictability:** The commodity market enables market participants to anticipate future price movements. Through the trading of commodity futures contracts, participants can gain insights into market sentiment and expectations. This price predictability helps various stakeholders, including farmers and processors, in making informed decisions related to production, procurement, and pricing.
5. **Enhances aggregation and financing in the agricultural sector:** The commodity market facilitates the aggregation of commodities from various sources and enhances their marketability. Farmers and producers can sell their produce directly to buyers in the market, eliminating intermediaries and obtaining better prices. Moreover, commodity trading platforms often provide financing options, allowing farmers and traders to access credit based on their commodity holdings.

**Key things to note about commodity trading in India:**

- – The prices of commodities are affected by a plethora of reasons. Similar to investing in stocks, it is important to prepare in advance by understanding these factors and learning strategies you can employ before you start trading in commodities.
- – While you get higher leverage with commodity trading, the risk associated with trading in commodities is also higher as market fluctuations are common.
- – Regularly monitoring the market is necessary. If you are a trading beginner, consider taking the help of a commodity market expert who can inculcate you into the process, and keep tabs on market fluctuations. Commodity trading in India is a great way to beat inflation as the costs of commodities grow in areas where inflation grows. However, commodity futures contracts are highly leveraged, making them risk-prone. Regularly monitoring the commodity market is essential, no matter which trading strategy one chooses.

A few traditional examples of commodities include grains, gold, rubber, oil, and natural gas. With changing times, there have been new types of commodities which include financial products such as foreign currencies and indexes being exchanged in the marketplace. Commodities that are traded are typically sorted into four broad market categories.

1. Bullion: Gold, Silver
2. Metals: Aluminium, Brass, Copper, Lead, Nickel, Zinc.
3. Energy: Crude oil, Natural Gas.
4. Agricultural commodities: Black pepper, Cardamom, Castor seed, Cotton, Crude palm oil, Mentha oil, Palm olein, Rubber.

# Thank You…