PROMERCIUM

To give you a better idea of what we do.

A sample hedge

Energy | Short Hedge | Protect against a price drop

Let's suppose it is August, and you are a commodity trading company holding storage of Brent Crude you intend to sell at some point in the future. This is known as a long cash (physical) market position. The current cash market price for Brent Crude oil to be delivered in December is $90 per barrel. If the price goes up during that time you will gain. But if the price goes down, you will have a loss. So you are primarily concerned about falling prices during the coming months. To protect yourself against a possible price decline, you can hedge by selling a corresponding number of barrels in the futures market now and buying them back later when it is time to sell your crude in the cash market. The ICE Brent Crude Futures contract has a contract size of 1,000 barrels. For example, to hedge 100,000 barrels, you, therefore,

> A hedge always consists of a futures and a cash market position. If properly hedged, adverse and favorable price fluctuations will net the same result.

Short hedge example
Falling Crude Prices with identical cash and futures prices

DATE	CASH MARKET	FUTURES MARKET
August	expected cash (physical) Brent Crude is $90/bbl	sell Dec Brent Crude futures @ $90/bbl
November	sell cash Brent Crude @ $85/bbl	buy (offset) Dec Brent Crude futures @ $85/bbl
change	$5.00/bbl loss	$5.00/bbl gain

Sell cash Brent Crude @	$85.00/bbl
Gain on futures position	+ $5.00
Net selling price	**$90.00/bbl**

need to sell 100 Brent Crude futures contracts. To be hedged is to have opposite positions in the cash (physical) market and the futures (paper) market. If the cash price declines to $85/bbl, the loss incurred will be offset by a gain from the hedge in the futures market. This risk management strategy is called a short hedge, because of the initial short futures position.

Further information
You can find further information in our Resource Centre "Publications" which is available online at promercium.com/publications.

Promercium is an independent commodity trading and logistics house. Every day, we source and supply commodities that enable the world's growth because access to energy underpins economic prosperity.

Find out more at *promercium.com*

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