END OF YEAR ISSUE 2007

The Promise of Carbon Markets

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The Big News in Energy and Commodity Markets in the Immediate and Mid-term Future is the impact of global warming. Managing climate change and the environmental impact of carbon emissions will be an important factor in the markets moving forward.

Much of the current conversation in the energy markets is focused on the rise of the market for carbon emissions. A number of key traders have already announced their belief that carbon is set to become one of the biggest and most significant markets in the world; and at Triple Point, we absolutely believe this to be the case. 2007 has already seen a significant amount of maneuvering here, with a number of notable mergers and acquisitions among key players. This movement is putting in place the necessary infrastructure, and that will continue to develop.

However, trading in carbon emissions will not explode in 2008. The recent UN Bali talks ended on a somewhat mixed note, and here in the US, the political will is still a bit lacking on the whole subject. What we will see instead next year is a gradual increase in the number of regional trading schemes.

All this means that cap-and-trade carbon schemes are some way off in the future. Instead the most notable impact of global warming will be seen in the development of renewables, particularly biofuels, which will expand greatly and will be a key feature of 2008.

The focus on biofuels will bring agricultural commodities into the energy markets and will broaden the number of players involved: familiar fossil-fuel majors will be joined by agricultural producers, chemical giants and the smaller pure-play renewable companies. It will also widen the scope of energy-buying teams within organizations, who will now have to incorporate agricultural commodities into their calculations.

We also expect to see a growing presence for agricultural feedstocks and their refined products on global exchanges. Ethanol is already traded on the Chicago Board of Trade and palm oil on the Malaysian Derivatives Exchange. The number of exchanges worldwide accepting derivatives and options in renewable fuels will continue to grow throughout 2008.

The result of all this is that opportunities in many of the commodities markets will develop which are similar to those seen in the deregulated energy markets. As a consequence, the demand for trading capabilities will increase and will include those firms that have traditionally procured agricultural commodities simply as supply-chain staples.

The need for trading capability for agricultural commodities will be given extra impetus by the complex interrelations and correlated prices between these so-called energy crops and other fuel sources. And just as volatility affects the wholesale markets for fossil fuels, so price fluctuations are now seen in agricultural commodities. Thanks to the current tight demand and supply situation, volatility for both corn and wheat is already approaching 35 percent and is set to remain, if not increase, over the next 12 months.

Naturally, organizations will be looking to future proof themselves against the arrival of carbon markets by incorporating carbon emissions trading capability into their systems. But there will also be a far greater demand, from broader sources, for technology that enables trade of multiple assets – including all aspects of the so-called energy crops – with the capacity to handle aggregated risk management strategies. Overall, sophisticated, real-time, scenario-based decision support tools to optimize decisions will become increasing essential to more and more organizations.

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