Ux Weekly®

7 | MAY | 2007

VOL 21 | NO 19

A WEEKLY PUBLICATION OF UxC

UXC.COM

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U Futures: Fact and Fiction (and Some Observations)

During the past week, we held two seminars on uranium futures in conjunction with NYMEX in advance of this week's launch of the uranium futures contract. Judging by the attendance of these seminars, and the coverage in the press related to the introduction of this product, there is considerable interest in this development. However, there also appears to be a fair amount of confusion and even misinformation surrounding the uranium futures contract. The intent of this cover is to address these issues and provide additional information/observations about the futures contract. A brief summary of the first day's trading is given on the market page (see page 9).

Financial vs. Physical – One of the biggest sources of confusion, which is somewhat a product of misinterpretation that is perpetuated by other sources, relates to the nature of this contract, which is financially settled, and does not involve physical delivery.

One example of this is an online news service that conducted a survey on NYMEX uranium futures. In that survey, it asked the question: "Over the next twelve months, do you plan on trading the new physical uranium futures, soon to be available on the NYMEX?" (emphasis added) The contract does not involve physical delivery, and nowhere in the NYMEX releases announcing the contract has anything but a financially settled contract been mentioned.

Another example of this is a press release by another on-line service, U_3O_8.biz. It states, "The new NYMEX futures market will involve financially settled contracts that are separate from the physical uranium market. Traders won't take possession of the commodity, but they can take title of it and receive exposure to its price."

The first sentence of this statement is essentially correct but the second is not at all correct. The second statement is true of the physical or cash market for uranium – traders can take title to uranium but cannot take possession of it – this can only occur at licensed facilities. When entering into a financially settled futures contract, you do not take title to uranium, but rather take on a financial obligation relating to your position in the transaction.

While uranium futures is financially settled, it should also be pointed out that even where there is a physical futures market, less than 1% of the contracts actually result in deliveries. Thus, the purpose of futures contracts – physical or financial – is transference of price risk.

UxC's Role in Futures Pricing – Another misperception relates to UxC's role in future's prices. Likely because the trading symbol for the contract is UX (note that both letters are upper case), there is the belief that we determine or that we and/or NYMEX determine the futures prices. This is not true; the market sets the prices according to prices at which sellers are willing to sell and buyers are willing to buy.

Our role and the reason that the trading symbol is called UX is that the futures contracts settle on the Ux U_3O_8 Price, which we will continue to report as we always have. NYMEX's role is that it provides the platforms on which uranium futures trading takes place.

Futures and Price Volatility – In some circles, there is a perception or at least the inference that the introduction of a futures market in uranium will increase price volatility, which in the current market could imply having uranium prices increase at a faster rate than the rate that they have been increasing. Increased volatility does not simply mean that uranium prices will increase after the launch, since price has been under upward pressure for a considerable time now and expectations have been that price would continue to increase with or without a futures market (see discussion of forward price curve below).

Volatility relates to the rate at which price changes, whether this is an increase or decrease, it is interesting to note that, measured by the 20-week rolling price, the average annual volatility (looking one year out based on historical performance) has increased to 36% recently from less than 10% during the first two-thirds of 2006. Thus, price volatility measured in this manner increased dramatically during the later part of 2006 and the first part of 2007, or before the announcement of the uranium futures contracts. As a point of reference, the 30-day historical volatility for natural gas and crude (these products are priced daily, not weekly, and both have well established futures markets), is 31% for each commodity.

Relationship of Futures Prices to Cash Prices: The Forward Price Curve – One of the key developments of a futures market is the development of a forward price curve, which has been absent from this market. Although NuclearFuel provides estimates of prices at which they believe spot transactions will take place over a forward two-week period, this is not the result of any market activity. (As a point of reference, NuclearFuel's most recent estimate of this price range, and one that predated the launch of the futures contract, was $115-$130.)

There has been an implicit forward price curve incorporating the expectation of higher prices for some time. This is why spot suppliers have opted for selling on a market price basis, believing that the spot price will be higher in the future. This has been a negative development when it comes to price discovery in the cash market because it has resulted in far fewer fixed-price offers that can serve as a basis for determining price. This has resulted in the price behavior where price stays flat for a while and then jumps up when fixed-price offers/deals are made. The mother of all of these price jumps occurred last month when the reported price soared $18, and then held this level for four weeks.

It is our belief that the advent of a visible futures market can only improve upon the current situation. It should reveal the forward price curve – in fact, this is one of the two reasons for futures contracting, the other being risk transference (hedging). The development of a forward price curve should make sellers more willing to sell on a fixed-price basis, for two reasons. First, there will be an indication of what future prices are on a monthly basis. Second, sellers will be able to hedge their position to the extent that the futures market is sufficiently active.