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Risk Asymmetry and Market Behavior (Page 2)

Price Risk and the Spot Market - Price risk is not just confined to the long-term contract market, but it is also manifest in how traders and other suppliers approach the spot market. In an environment where the spot price is increasing and is notably below the long-term price, traders are more likely to be buyers than sellers. Any potential seller of spot material runs the risk that price may appreciate considerably in the upcoming months, so offerings may be limited or prices sought for deliveries further out in time may be higher than what can be accounted for by just the cost of money. It is easy to see in this environment why offer prices have continued to increase.

Price Risk and Investor Behavior - The prism of risk is also an instructive way of viewing investor participation in the spot market. Investors are clearly willing to take on price risk in return for the chance to sell uranium at higher prices in the future. This risk could be considerable, given the relatively illiquid nature of the spot market, and some in the industry believe that this participation will lead to increasing price volatility. (In Again, we are dealing in the realm of price risk, not supply risk. The uranium that investors are buying consists of inventories that are being transferred from one group to another, and will eventually find their way back into the market. Thus, the situation with the investors is unlike that of China, which is building a number of reactors and, as a big consumer of uranium, is competing with utilities for future uranium supply.

The Bull Back in 2003 - The last time we presented bullish and bearish covers on consecutive weeks was in November 2003 when the spot price was $12.75, or about half of the current level. In a "bullish" editorial entitled "The Party's Over" (The Ux Weekly, Nov. 3, p. 1-2), we presented the basis of why price would move much higher. Although the editorial engaged in a bit of hyperbole, for the most part it laid out what we will believed were compelling arguments why price was likely to move much higher.

One of those arguments was contained in the following paragraph:

For those who think that this [the price rise] is just a

Up until that time it seemed like producers and utilities were largely at an impasse when it came to contracting for deliveries in 2006 and later, resulting in large unfilled requirements beginning in 2006. Now, contracting focus is being shifted out to beyond 2010, and in some cases to 2015 and beyond. As a way of compensating for price risk for delivery in those later years, base-escalated prices in long-term contracts are stepped up to higher levels than are being sought for delivery in earlier years.

The point is that the further you go out in time, the higher the risk premium because the greater the uncertainty with respect to the market situation. This is understandable - a lot more can happen with respect to supply and demand in ten years than in five years. How successful will the Chinese nuclear power program be? Will more HEU be blended down following the end of the current deal? Will enrichment capacity be expanded significantly? Will producers expand output in a timely manner?

There are still a number of utilities that believe that some respects, it already has.) This has reportedly sparked worries on the part of uranium producers about what might happen to price once investors decide to liquidate the inventories that they are building. However, producers can insulate themselves from this risk to some degree if they are successful in tying market price contract to long-term prices instead of spot prices.

transitory phenomenon, ask yourself the following question: What's going to happen to make the supply situation better the next year, the year after that, or the year after that?"

In hindsight, not much has happened to improve supply prospects since then. In fact, that same statement is pretty much applicable today, despite the fact that prices have increased considerably over the intervening 18 months. The difference is today that this price/supply uncertainty is reflected in the terms and conditions of long-term contracts whereas it was largely not addressed at that time.

price will "roll over" and they are better off waiting to cover in the future, or, if they cover now, they are signing market price contracts. Either way, they are taking on an increasing amount of price risk. Of course, in the case of those that are not signing contracts, they are taking on supply risk as well.

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