PGDM-IB, 2019-21
Geopolitics and Risk Analysis (IB-403)
Trimester IV, End Term Examination: September 2020

Time allowed: 2 Hrs 30 Min Roll No: ………………….
Max Marks: 50

Instruction: Students are required to write Roll No on every page of the question paper, writing anything except Roll No will be treated as Unfair Means. All other instructions on the reverse of Admit Card should be followed meticulously.

SECTION A – (10 marks * 3 questions) = 30 Marks

A1. Identify and discuss about two major geopolitical risk factors of 2020-21. (10 marks) (CILO1).

OR

A1. Discuss geopolitical and economic significance of a) strait of Malacca (think that the strait could blocked for some reason!) b) Sagarmala project (10 marks) (CILO 1).

A2. How do Offshore Financial Centres impact other nations and their economies. (10 marks) (CILO-2).

OR

A2. What is negative country-of-origin association in international business and how to deal with it? (10 marks) (CILO 2)

A3. Identify two contentious issues between India and US and their (likely and/or actual) impact on Indian businesses. (10 marks) (CILO 3).

OR

A3. How do strategic and economic issues between India and China generate geopolitical risk for Indian companies? (10 marks) (CILO 3).

SECTION B – CASE STUDY (2*10=20 Marks) (CILO 2 & 3)

[**Case: The Significance of Commodities Market in the Financial World**]

B1. Why do commodities have a tendency to behave contrary to conventional asset classes? Explain. (10 marks) (CILO 2 & CILO 3).

B2. What factors are the commodity prices sensitive to? Discuss. (10 marks) (CILO 2 & CILO 3).

The Significance of Commodities Market in the Financial World

bt businesstoday.co.om/Issues/CAUTIOUS-OPTIMISM/The-Significance-of-Commodities-Market-in-the-Financial-World

The commodities market represents one of the oldest type of trade in civilization with origins traced back to BC4500 when the Sumerians – a civilization from the land that is now known as Iraq – first used clay tokens to represent the future delivery details of their crops and livestock.

Ever since, the commodity market has evolved as traders aspired to a more standardized, organised and uniform trading system to encapsulate the information contained within the prices of their products. It was from here that modern day futures markets developed. Today the commodity futures market is one of the most liquid, advanced, and efficient markets.

Commodities are classified into four key groups: agriculture, livestock, energy and metals.

Producers, dealers and market speculators who wish to capitalise on price movements trade these commodities. Over the last decade commodities have become an increasingly popular asset class for investors. This paved the way for the financialisation of the commodities market with the creation of exchange traded funds and commodity indices that allowed the asset class to be easily accessible by all type of investors.

When comparing commodities alongside other financial asset classes, commodities carry a rather distinctive and peculiar character. Commodities are known for their high volatility, zero yield and, in some cases, negligible counter party risk. They have a tendency to behave contrary to conventional asset classes (cash, bonds, equities, property), hence their widespread use as a diversification tool within an investment portfolio by fund managers.

To present an insight into the commodities relation with other financial assets we ran a correlation matrix with equities, Treasury Bills, real estate and US dollar currency index. As we expected, we found an explicit negative correlation with the US Dollar Index. Since all commodities are priced in dollars, the appreciation of the dollar translates into a decline in commodity prices. For example, the crude oil price drop of 48.8 per cent over the last five years may partially be explained by the 25.7 per cent appreciation of the dollar over the same period.

Expectation of an interest rate hike has recently subsided, with the latest statement from the US Fed indicating a lower likelihood of interest rate increases in our view, which we expect will weaken the dollar. Our view is supported by the low inflation expectation and lackluster labour market in the US coupled with the muted economic growth in emerging markets. We observe that the dollar has already started to weaken by more than three per cent in the year to date, while Bloomberg Commodity Index has risen by more than 11 per cent over the same period.

The idea that commodities bring real diversification benefit to investment portfolios is well supported by the presented correlation matrix that illustrates the relatively low correlation with equities and properties and nearly zero correlation with Treasury Bills, reaffirming the need for core allocation to this asset class in most investment portfolios.

Omani equities show an unexpectedly low level of correlation with the Commodities Index – which is counter-intuitive given the perception that the local market is largely sensitive to oil prices. We find that during periods of sharp oil price decline the MSM Index moves in parallel with oil prices nevertheless divergence is observed during other periods.

Return outlook

Commodity prices are sensitive to a number of factors depending on the type of commodity – as an example crude oil is sensitive to geopolitics, agriculture to weather, copper to economic cycles while precious metals like gold are impacted by inflation and inflation expectations.

The impact of the US Dollar, inflation, industrial production, geopolitics, monetary policies, economic cycles etc on commodity prices gives investors grounds to speculate on price direction based on a variety of themes. Speculators add a layer of complexity in valuing commodities as a traditional asset, and price discovery evolves in unpredictable ways because It is not based solely on demand-supply dynamics.

From a long-term historical perspective, commodities under-performed other asset classes through the period in review (December 31, 1995 to December 31, 2015). Bloomberg Commodities Index declined nearly 25 per cent during the period, with a volatility of 11.8 per cent compared to 130 per cent returns earned in MCSI World Index with a volatility of 12.3 per cent. The unexpectedly low volatility figure for the commodity index may be attributed to a durable and persistent downward trend as opposed to multi-direction price action.

In considering returns from the asset class, it is important to note that commodities, unlike equities and bonds, do not offer dividends and/or interest income and it may be argued they don't need to, seeing as they generally do not carry counter-party risk and hence do not need to offer any inducement to investors to hold these asset classes.

Traditionally commodities and in particular gold have remained a safe haven asset for investor during times of uncertainty and market turmoil. During the global financial crisis from July 2007 to December 2008, for example, the precious metal rallied 35.7%.

Nowadays commodities markets present several opportunities to investors: inflation hedging, portfolio diversification and capital gain potential.

Outside the realm of financial investment, changes in commodity prices have a very real impact on the real economy. They can affect entire segments of an economy, and can spur policy action (in the form of subsidies, tax changes, or other policy shifts) and social and behavioural action (in the form of substitution, innovation, or other actions that influence the supply- demand dynamic).

To illustrate, earlier this year, the Oman government budget was adjusted by cuts to subsidies and other government spending in response to the effect of lower oil prices on fiscal balances. Another example is during the rally of gold, most jewelry makers were forced to renovate their design to create more light weight pieces of jewelry.

In conclusion, the importance of commodities to modern-day portfolio investors is underlined by this quote from Jim Rogers "The price of a commodity will never go to zero. When you invest in commodities futures, you're not buying a piece of paper that says you own an intangible piece of company that can go bankrupt." – Jim Roger.