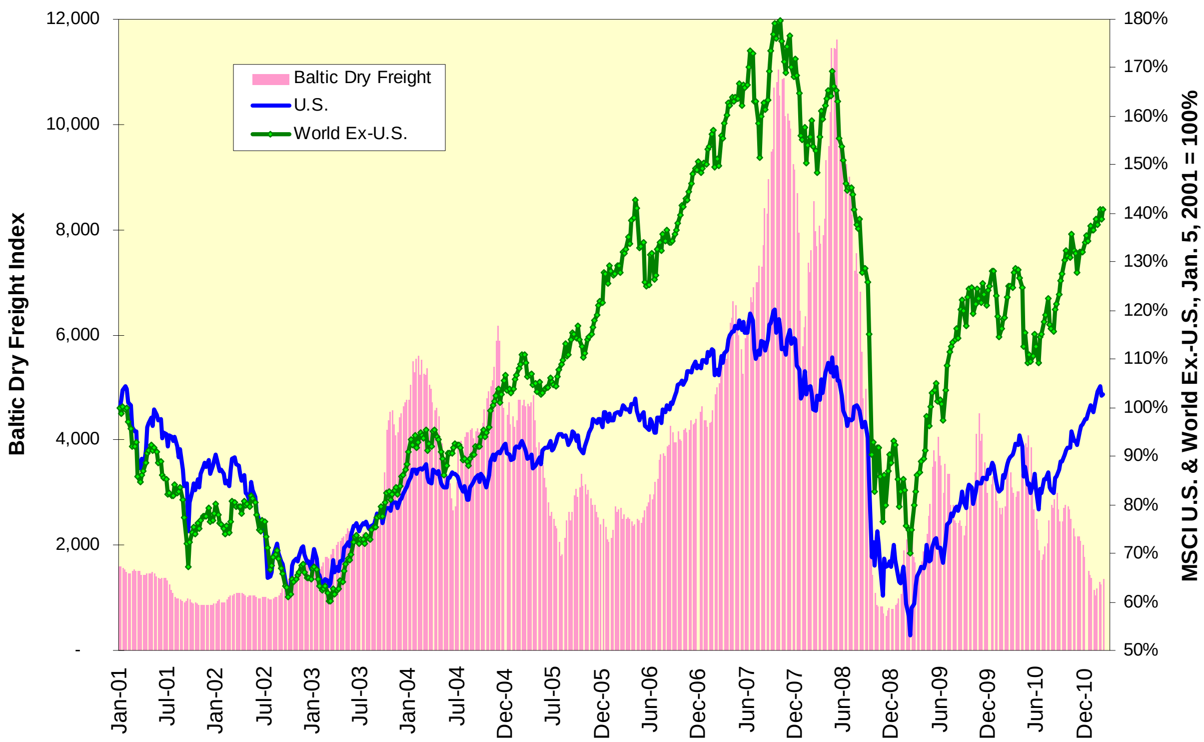
Shippers And The Baltic Dry Freight Index

Saying good-bye to an old friend is tough in any walk of life, especially if it is an economic indicator that has outlived its purpose. Such is the case with the Baltic Dry Freight index (BDI), which is actually an amalgam of three other shipping indices, the Panamax, Handymax and Capesize. I used to use the BDI regularly as an economic indicator for two good reasons. First, as the construction of new vessels and port facilities was slow, the index tended to reflect changes in demand for ocean freight. Second, as no one charters a vessel just for the fun of it, I proclaimed the BDI to be devoid of speculative content.

That was then; this is now, a statement that will be true tomorrow as well. What ruined the BDI as an economic indicator was the growing dominance of ore carriers on the Australia-to-China route after the first war on deflation commencing in May 2003 stimulated Chinese demand for raw materials. The BDI shot higher into 2004 and then started to feel the effects of supply in two areas, new ship construction and port improvements throughout the Western Pacific.

A second burst higher into the commodity peaks of 2008 – and please remember this index is for dry bulk freight, not for crude oil – was met with a spectacular collapse into the end of 2008.

Stocks Fly, Ships Sink



While stock indices, especially for the World Ex-U.S., always had something of a linkage to the BDI that disappeared during the stock market rally of the past two years. New shipping capacity has kept downward pressure on the BDI even as the world economy, particularly in Asia, continues to grow.

No one should be surprised: Higher shipping rates may not reduce the demand for shipping goods significantly, but they certainly can and do attract new supplies of shipping capacity to the market. Politicians of all stripes and in all locations should take note that markets left to their own devices will find such a lower-cost solution.

Not An Investing Indicator

The question arises whether investors can use the BDI to trade shipping firms. My instinctive answer here is, “No,” but there is no need to rely on instinct when the data are available. If we take a three-month rolling correlation of returns between various shipping firms and the BDI, we find little relationship. The BDI is, after all, an index of shipping tariffs, not of shipping profitability. Profits depend on costs, including those for labor, bunker fuel, insurance and fees. Moreover, equity markets look ahead and know what orders are on the books for new ship capacity and what the trends in ocean shipping demand are.

Three-Month Rolling Correlation Of Returns

Period Ending March 9, 2011

Ship Finance International Ltd	22.8%
Diana Containerships Inc	21.4%
Euroseas Ltd	20.2%
Genco Shipping & Trading Ltd	15.4%
Baltic Trading Ltd	12.4%
Nordic American Tanker Shipping	12.3%
Nippon Yusen KK	9.5%
S&P 500	**9.2%**
Excel Maritime Carriers Ltd	6.1%
FreeSeas Inc	4.9%
Guggenheim Shipping ETF	2.4%
Safe Bulkers Inc	0.6%
DryShips Inc	-13.0%

The range of correlation of returns over a short period tells you everything you need to know about the efficacy of the BDI as an indicator for ocean-shipping stocks.

So farewell, old friend. You served me well for a long time, and provided me with a source of amusement in listening to various amateur stock index futures day-traders use you as an indicator. But as every old salt has to retire to land, so must you.