Should we blame the speculators?

Before pointing a finger, David G Stack, Managing Director of commodities consulting firm Agrimax, challenges preconceived ideas and definitions of who the speculators actually are

In some ways this is like trying to find a medical doctor guilty of malpractice. To proceed successfully we must try to find either some kind of negligence or conduct considered to be outside the generally accepted code of practice of the profession. This of course presumes that we are pursuing an individual engaging in some kind of rogue behaviour and not an entire profession. Today, with the world's greatest economic decline at our feet, we are looking for answers and someone, or some group of people, to blame.

The view of what constitutes speculation and its impact on market processes varies widely among academics, politicians, the media and the general public. Academics generally view speculators as a group of individuals who trade primarily based on an individual asset's standalone, expected risk–reward trade-off. In contrast, in the public, the mass media and the political arena, speculators are often considered less important or less noble than other market participants who trade financial futures or commodities solely as an indirect (e.g. hedging) part of their ordinary business activities. Whatever the separation between hedging and speculation, the popular concern is the degree to which either hedgers or speculators have direct influence on market prices above and beyond their primary market functions.

Within the trading community, speculation is viewed primarily as activity in markets which you do not fully understand and have not made a sincere and professional effort to apply the customary analyses and perform the due diligence required by your organisation to put money at risk. At this point we note the successful operation of names like Tiger Capital run by Julian Robertson and Centaurus run by John Arnold. Both were highly successful and effective funds for their investors, which ultimately made a sufficient return on investment to close their doors to outside investors. There are many more examples of successful speculators, some of whom are household names like Warren Buffett and George Soros, just as there are those like the infamous Amaranth Advisors, which closed with spectacular losses and did not return the expectation to their shareholders. By the naïve definition in the preceding paragraph they were all speculators. So is our definition lacking?

Clearly it is too narrow and simple. The Utility which over-hedges or under-hedges its exposure is speculating. The Pension Fund which tries to protect its pensioners and invests in new markets is speculating. We don't mean new markets in the sense of ones being discovered, but more importantly ones in which they have little or limited experience. A regulator which hypothesises on markets and market players it does not understand is speculating. The oil company which drills wells in the expectation of finding oil is speculating. The same oil company speculates when it under-invests in infrastructure or environmental safety. As a matter of record Milton Keynes ran two hedge funds and widely engaged in highly leverage activity. In short, speculation is rife and commonplace.

A speculator by some definitions, Warren Buffett with President Obama