

# ICS Wool Risk Tool V1.1

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The ICS Wool Risk Tool has been developed by Independent Commodity Services Pty Ltd to assist producers, brokers and advisers in commercial decisions by quantifying upside and downside price risk for the major Australian wool micron price guides.

If you have any questions regarding the ICS Wool Risk Tool please contact Andrew Woods at Independent Commodity Services Pty Ltd. Email [ic-s@ic-s.com.au](mailto:ic-s@ic-s.com.au) or telephone +61 (0) 2 69215887.

## 1.0 Disclaimer

Independent Commodity Services Pty Ltd

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AFS Licence No 223519

The information contained in this manual is to provide assistance in understanding the analysis generated by the ICS Wool Risk Tool. It is not intended to constitute advice for a specific purpose. Before taking any action in relation to information provided in this manual, you should seek independent advice from a qualified professional. The information is obtained from a variety of sources and Independent Commodity Services Pty Ltd is not liable for any loss or damage whatsoever that may arise from the use of the information or for any error or mis-statement contained in this manual.

## 2.0 Introduction

The ICS Wool Risk Tool allows you view the historical price risk for a given micron indicator for a nominated delivery period. Price risk has a downside and upside component which the model provides.

The ICS Wool Risk Tool uses long-term price data for the major micron indicators in Australian dollar terms. You can select between the main eastern MPGs (micron indicators), delivery period up to 24 months (2 years) forward, to sell or buy and finally a preferred range of projected prices.

<b>Choose any combination of ....</b>			
<b><i>MPG</i></b>	<b><i>Delivery Period</i></b>	<b><i>Action</i></b>	<b><i>Preferred Range</i></b>
18	1 to 24 months forward	Sell	98%
19		Buy	90%
20			80%
21			
22			
23			
24			
25			
28			
30			

The micron indicator and delivery period are self explanatory (for example you may be interested in looking at the risk of delivering 19 micron wool in 11 months time.) As a producer you will be mainly interested in the sell side, the downside risk. However if for example you are contemplating holding physical wool then you may be interested in the buy side, upside risk.

Generally it is advised to use the 80% preferred range (the model assumes there is a 10% probability that the market will exceed the projected high and a 10% risk it will exceed the projected low.)

### 3.0 Operating the ICS Wool Risk Tool

❶ After choosing the ICS Wool Risk Tool icon on the ICS website ( [www.ic-s.net.au](http://www.ic-s.net.au) ) the following screen will appear.

A range of selectors is shown on the left hand side of the page. These selectors allow you to drive the tool.

Active Web Tool

**Selectors**

Indicator  
❷ 21

Delivery  
❸ Oct-07

Action  
❹ Sell

Preferred Range  
❺ Middle 80%

Updated  
27/10/2006

#### ICS Wool Price Risk Tool

Delivery	Oct-07
Current Spot 21 MPG	808
Historic Price Rank 1991+	71%
Current Forward Bid	873
Historic Price Rank 1991+	82%

Preferred Range	Middle 80%
Projected high: +24%	1002
Projected low: -15%	687
Sell Target (or higher)	877
ICS Risk Model Signal	Neutral

Spot Price	-150	-50	808	+50	+150
Sell Target (or higher)	818	802	877	922	833

The ICS wool price risk tool provides projections for a combination of nominated delivery period, indicator, confidence level and action. These are chosen by using the selectors on the left hand side of the page. The model output is shown in the tables which are summarised in the graph. The model projects a range of prices and provides sell/buy targets developed from back testing of data.

Disclaimer: This information is to assist you in endeavours in the raw wool market. It contains a range of data on the current wool market. How you act is entirely your decision and

- ❷ The first selector is the micron indicator selector.
- ❸ The second selector allows you to specify a delivery period up to 24 months forward.
- ❹ The third selector allows you to choose between buying and selling.
- ❺ The fourth selector allows a choice between different projected price ranges. The 80% preferred range is the one recommended for use and is the default level shown. Basically the preferred range tells you what probability the ICS Wool Risk Tool calculates there is that the actual market will exceed the projected high or low.

1 To select a micron indicator left click on the down arrow on the right hand side of the indicator selector. A drop down box will appear offering a selection of indicators. To view more indicators drag left click on the side slide of the drop down box and move it up or down. When you have found the indicator you need, left click on it to select it.

Active Web Tool

### ICS Wool Price Risk Tool

**Selectors**

Indicator

21  
18  
**19**  
20

Delivery

Oct-07

Action

Sell

Preferred Range

Middle 80%

Updated

27/10/2006

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1 To select the month of delivery repeat the process for the micron indicator selector on the delivery month selector.

Active Web Tool

### ICS Wool Price Risk Tool

**Selectors**

Indicator  
19

Delivery  
 Oct-07  
 Oct-07  
 Nov-07  
**Dec-07**  
 Jan-08

Action  
Sell

Preferred Range  
Middle 80%

Updated  
27/10/2006

Delivery	Oct-07
<b>Current Spot 19 MPG</b>	950
<b>Historic Price Rank 1991+</b>	44%
<b>Current Forward Bid</b>	1005
<b>Historic Price Rank 1991+</b>	59%

Preferred Range	Middle 80%
<b>Projected high: +42%</b>	1349
<b>Projected low: -15%</b>	808
<b>Sell Target (or higher)</b>	1135
<b>ICS Risk Model Signal</b>	Neutral

Spot Price	-150	-50	950	+50	+150
<b>Sell Target (or higher)</b>	1051	1176	1135	1173	1265

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The Action selector allows you to choose between buying and selling. If you are a farmer looking to hedge wool then choose the 'Sell' selection.

The Preferred Range selector should be mostly left on 80%. This tells the tool where to select the projected high and low from, as the probability of the actual market exceeding the high or low is the confidence level selected. If you choose the 98% level then you incorporate some of the extreme historic moves in the market into the calculations.

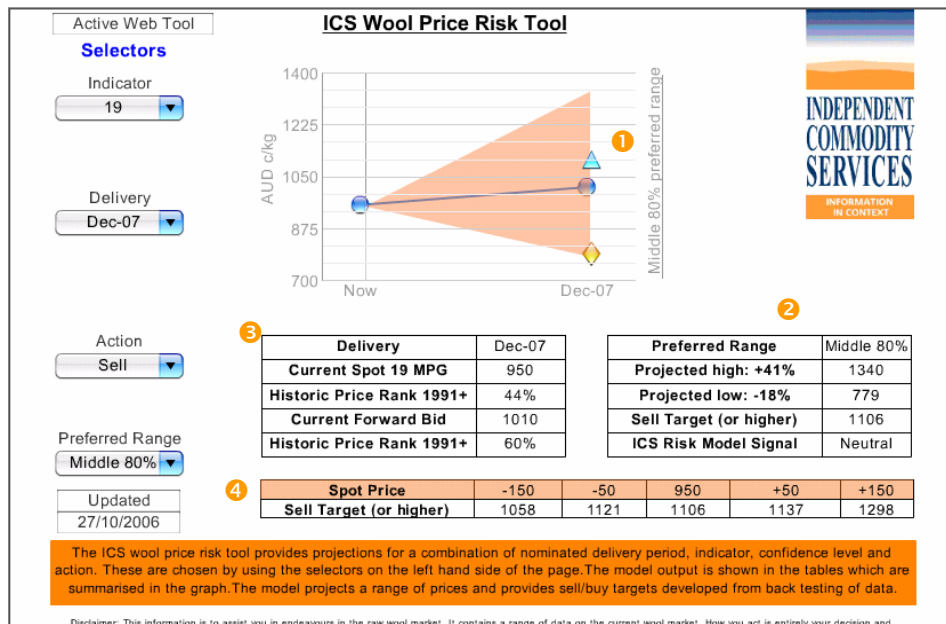
The ICS Wool Risk Tool automatically adjusts the output whenever a selector is changed.

## 4.0 ICS Wool Risk Tool Output

Having adjusted the ICS Wool Risk Tool selectors (in this example to the 19-MPG, delivered in December 2007, selling and using the 80% preferred range) the output is ready to read.

1 The first thing to look at is the graphic. If you run the mouse icon over the graphic titles and price levels will show up for the current price, forward price, sell target and buy target. The sell and buy targets have been developed by back testing the ICS Wool Risk Tool.

The pink shaded area in the graphic shows the projected range of prices for the selected indicator. The tool anticipates that the probability of the price (in this case the 19-MPG in December 2007) exceeding the projected high (1340 shown in the middle table 2) will be 10% and the probability of the market exceeding the projected low (779 shown in the middle table) will be 10%, leaving an 80% probability that prices will be within the projected range.



The tables in the lower section of the page shows the key numbers of the output. The projected high and low are shown in the right hand table 2, along with the sell or buy target, the size of the price move to the projected high and low and the risk model signal (buy, sell or neutral.)

In the middle table 3 the current auction (spot) price of the indicator, the forward quote and the historic rankings (nominal) of these prices since 1991 are shown.

The bottom table 4 shows a range of risk model targets for a variation of spot (current auction) price levels for the selected indicator. This table provides a “sensitivity” analysis for the model targets.

## 5.0 How to use the output

So what does it all mean?

1. The ICS Wool Risk Tool gives a sell or buy signal when the forward market is providing opportunities above ICS Wool Risk Tool selling targets or below buying targets. This is designed as a quick way to monitor the wool market for selling and buying opportunities.
2. The ICS Risk Model supplies historic nominal price rankings from 1991 onwards for the auction indicator and the forward indicator.
3. The ICS Wool Risk Tool provides potential hedging targets. The market may not be at a level that is satisfactory. However it is wise in some instances to level 'good until cancelled' (GTC) orders in case of sudden price moves. The challenge always is to judge where these GTC levels should be pitched. The ICS Wool Risk Tool helps by providing targets. By providing targets for a range of indicator price levels above and below the current price, the model allows to you to test whether the model target for the current market will be still valid if auction price levels change.
4. The ICS Wool Risk Tool provides an objective assessment of risk in the wool market, for the main indicators. This is a great improvement on simply using historic price rankings. This assessment of risk provides a vastly improved context for assessing selling decisions such as holding wool in store or selling forward.

## 6.0 Frequently asked questions

### How does the wool risk tool work?

The ICS Wool Risk Tool uses (heavily manipulated) long-term historic price data, adjusts for seasonal price patterns and uses OECD leading economic indicators (CLI). The model takes current conditions for an indicator (long term price rank, and OECD CLI direction and finds markets with similar conditions from the past 40 years. It then looks at how prices changed for the nominated time horizon, 1 to 24 months, which allows a projected price range to be developed. From the projected price range the model calculates selling and buying targets. Ultimately the ICS Wool Risk Tool works because of mean reversion in the market, aided by the OECD CLI as a proxy for swings in demand cycles.

### How reliable are the signals?

On most reports you will read that 'past performance is not necessarily a guide to future performance' which is very true. However the ICS Wool Risk Tool through back testing has shown to be quite good at generating successful buy and sell signals, particularly for longer timeframes of 9 months and more. The effectiveness of the model drops as the more the timeframe drops below 9 months. On the 1 to 2 year timeframes back testing in the model has been around 80% successful, which is very good but you need to keep in mind that at least 1 in 5 signals will be wrong.

### If it so good why is available on the Internet?

Most traders and exporters operate on short time horizons. The ICS Wool Risk Tool is not designed for short term trading and does not work particularly well for this purpose. It works much better in the longer term, which fits with the timeframes involved with farm production decision making.

### Why are there no very fine micron indicators included?

There is limited historic price data for indicators under 19-micron. The lower the micron category the more limited the historic data available. This prevents the long-term data required for the ICS Wool Risk Tool from being developed. There are some ways to link fine micron types to the long-term risk model (which are used by ICS) but that is beyond the scope of these web tools at present.