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A Marginal Tale

How much should a case of Lynch-Bages 2010 go for if someone was to put this wine for sale on the market right now? If you are a potential buyer, how much should you pay for a case of this wine?

In this report, we aim to address the two questions raised above. Here, we assume that the seller is interested to sell her or his goods on an exchange platform that is higher up in the supply chain than the end consumer. As such, the potential buyers will include brokers, traders, wine merchants, wine investors and wine enthusiasts who have access to such an exchange platform.

One fundamental parameter that plays an important role in the trade price at which a trade transaction can be completed between a buyer and the seller is the expected margin the buyer would make if she or he goes on to sell the wine to another entity further down the supply chain.

Here, we determine our expected margin using the listed daily average merchant prices and the trade price at which a transaction takes place, data of which are obtained from Liv-Ex. The listed daily average merchant prices reflect the prices an end-consumer, at the bottom of the supply chain, would pay for a case of such a wine. Correspondingly, the expected margin is the difference between the listed daily average merchant prices and the trade price at which the Liv-Ex transaction took place.

We shall look at the expected margins made against different listed daily average merchant prices, from June 2015 until the end of November 2015, for four different wines: Lynch-Bages 2010, Carruades de Lafite 2010, Montrose 2010 and Haut-Brion 2010. The first three are wines which are traded heavily by volume on the Liv-Ex platform. While Haut-Brion 2010 does not trade heavily by volume, it still remains one of the top five most traded Bordeaux 2010 by value.

The average expected margins for these wines are 18.8% for Lynch-Bages 2010, 15.8% for Carruades de Lafite 2010, 15.6% for Montrose 2010 and 15.6% for Haut-Brion 2010. The large average expected margins for Lynch-Bages 2010 is one of the many reasons behind why it is still one of the top five most traded Bordeaux 2010 by value.

Lynch-Bages 2010

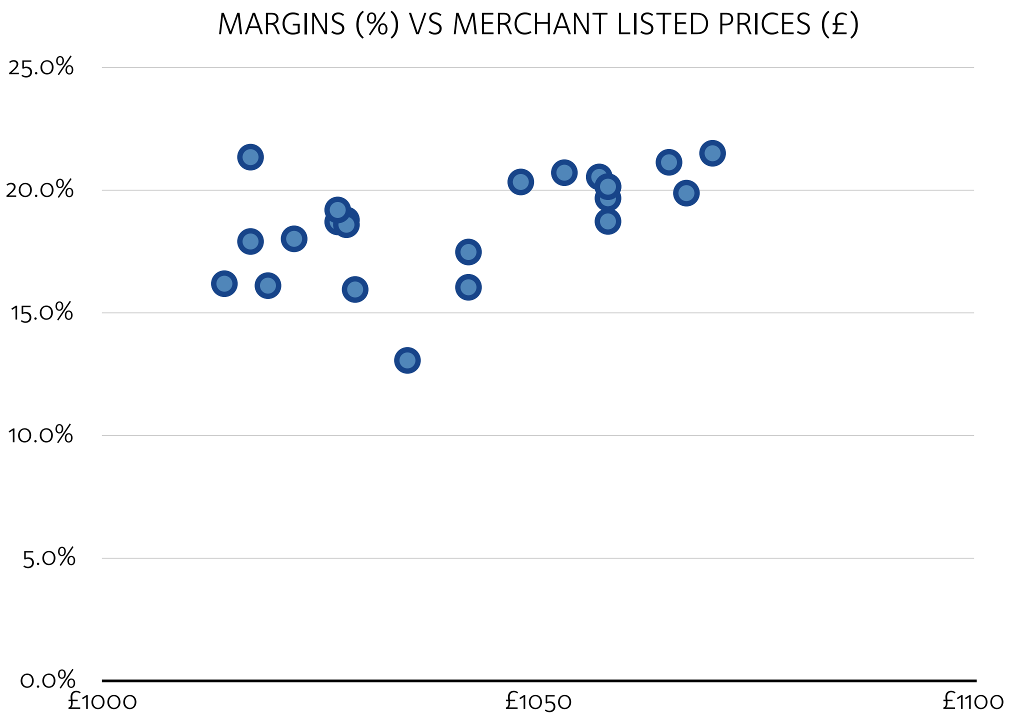

Figure 1: Expected margins (%) against listed daily average merchant prices (£) for Lynch-Bages 2010 between June 2015 and November 2015.

Supply and the market sentiment for Lynch-Bages 2010 have been very healthy in the months leading up to November 2015 (see previous report, 'A Tale of Two Liquids'). As expected, trading activity has been largely healthy for this wine. The expected margins against listed daily average merchant prices between June 2015 and November 2015 are shown in Figure 1.

From first inspection, it is clear that there is no distinctive trend apart from a cluster of points mostly within the range starting from 15% up until 22%. Higher listed prices are observed to fetch higher margins and is independent of time, at least within the time period specified.

The large variability in the margins reflect the lack of general consensus at which the trade transaction can be completed. We do not have access into the detailed mechanism behind the transaction and can only presume that various factors are at play depending on the entities involved.

The need for cash liquidity at the seller's end could easily force a deal through at high margins for the buyer. An opportunistic buyer who is looking to maximise his margins could also easily hold out against the buyer if she or he is in no desperate need to replenish the inventory.

Alternatively, a buyer can complete a trade deal at low margins if he or she needs to restock very soon. Such wines could be in high demand lower down the supply chain.

Carruades de Lafite 2010

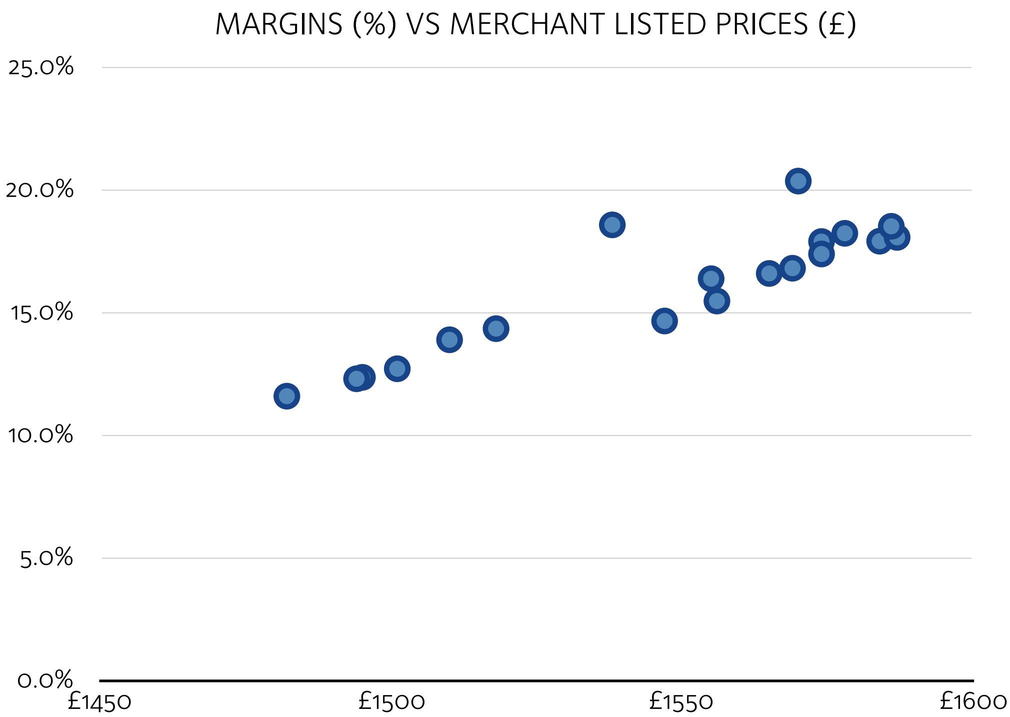

Figure 2: Expected margins (%) against listed daily average merchant prices (£) for Carruades de Lafite 2010 between June 2015 and November 2015.

Again, supply and the market sentiment for Carruades de Lafite 2010 have been very healthy in the months leading up to November 2015 (data not shown here but available upon request). Healthy trading activity took place between June 2015 and November 2015.

Figure 2 shows the expected margins (%) against listed daily average merchant prices (£) for Carruades de Lafite 2010 between June 2015 and November 2015. There is distinctive linear trend for Carruades de Lafite in that the margins get smaller as the listed daily average merchant prices decrease.

This is a clear indicator of higher demand down the supply chain for Carruades de Lafite as its case price decreases. Trade transactions can be completed at lower margins much more easily as traders supplying the lower echelons of the chain feel the need to replenish their stock in order to satisfy the demand. This is especially important if they intend to preserve their market share.

Wines with such trends could reflect three things: its market liquidity, its competitiveness in the market and the transparency of its prices. We expect healthy trading activity for these wines (subject to supply and market sentiment) as a result of them being able to meet these three conditions described. A wine with a clear linear trend can be deemed to meet these conditions better.

Montrose 2010

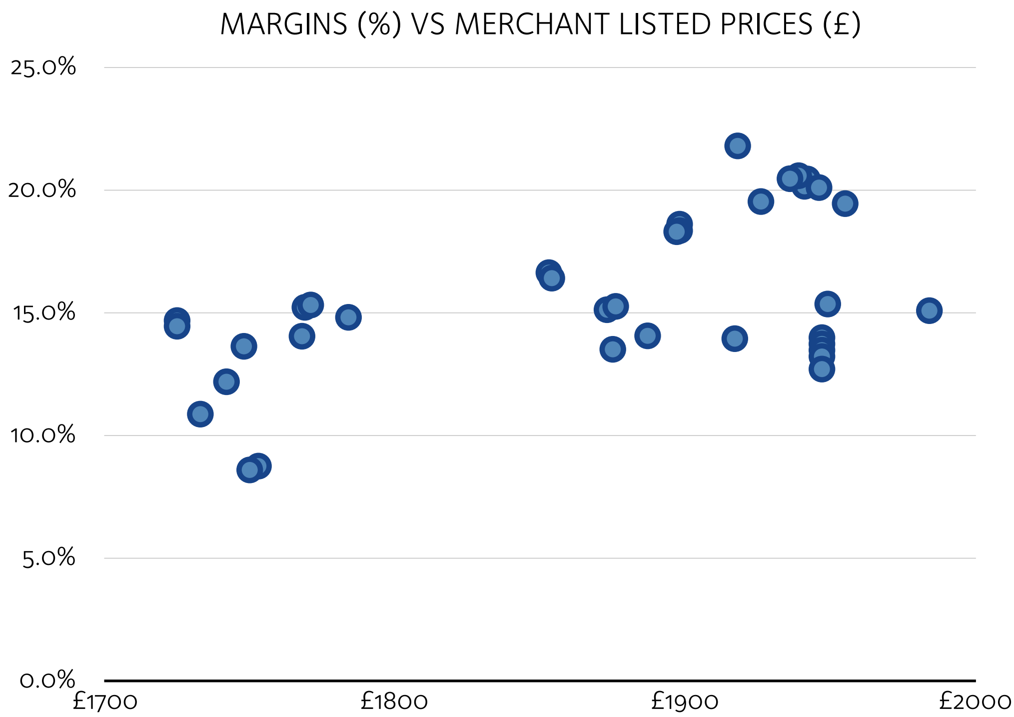

Figure 3: Expected margins (%) against listed daily average merchant prices (£) for Montrose 2010 between June 2015 and November 2015.

Montrose 2010 exhibits one interesting feature: two distinctive clusters are present in Figure 3. We believe that this is time-dependent. Between June 2015 and 18th August, 2015, the listed average merchant price for a case of Montrose 2010 was below £1800. The expected margins of the trade transaction in this period are all contained in the left cluster.

On the 18th August, 2015, the listed price shot up to £1853 and has remained above that value since. This led to the formation of the second cluster on the right.

The sudden increase in prices is likely to be a reaction to the high demand for Montrose 2010 down the supply chain. Up until the 18th August, 2015, trade transactions were completed at expected margins below 15%. Two of the few trades just before this date took place at expected margins below 10%, again indicating high demand and possibility some difficulty at which some traders have to replenish their stocks. As such, the price jump on the 18th August, 2015 is a reaction from entities higher up in the supply chain to contain the high demand for this wine.

The expected margins in the right cluster range between 13% and 22%. This is more in accordance with the distribution of the expected margins previously observed for Lynch-Bages 2010 and Carruades de Lafite 2010.

Haut-Brion 2010

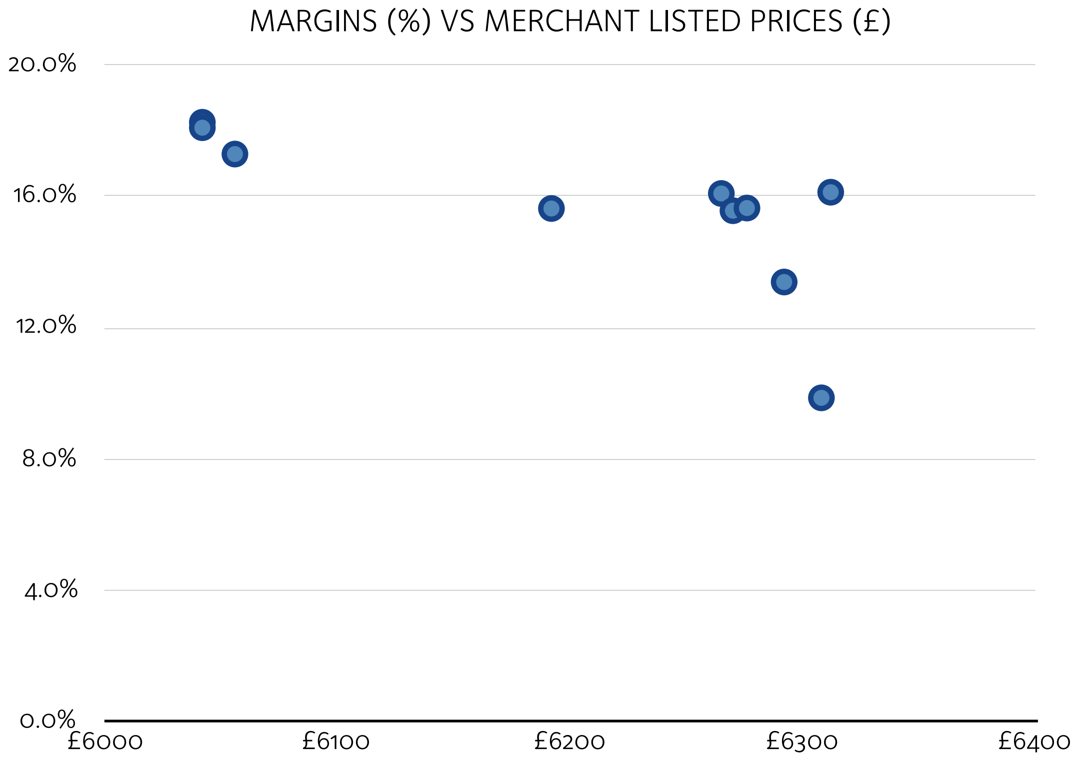

Figure 4: Expected margins (%) against listed daily average merchant prices (£) for Haut-Brion 2010 between June 2015 and November 2015.

Haut-Brion 2010 exhibits little, if no distinctive trend at all. Most of the trade transactions are completed at an expected margin of 16%. Its demand is not sensitive to prices. We believe that the trading activity for Haut-Brion is strongly influenced by its supply. It is a wine that does not receive regular supply compared to the previous three. Furthermore, its demand and trading activity is highly susceptible to massive stock injections (see previous report, 'A Tale of Two Liquids'). The trade that took place at an expected margin of 10% is for a half of wines and is deemed to be an anomalous trade, i.e. one that doesn't reflect the trade transactions for this wine in general.

Discussion and Summary

In this report, we have looked at the expected margins made against different listed daily average merchant prices, from June 2015 until the end of November 2015, for four different wines: Lynch-Bages 2010, Carruades de Lafite 2010, Montrose 2010 and Haut-Brion 2010.

We note that there is often a large variability in the expected margins which reflect the lack of general consensus at which the trade transaction can be completed. We can only presume that various factors are at play depending on the entities involved.

We did however note that at least two wines studied here, Lynch-Bages 2010 and Carruades de Lafite 2010 exhibit a trend in which the expected margins become smaller as the listed average merchant prices decreases. The trade transactions can be completed at lower margins much more easily as traders supplying the lower levels of the chain feel the need to replenish their stock in order to satisfy the demand and preserve their market share.

Wines with such trends could reflect three things: its market liquidity, its competitiveness in the market and the transparency of its prices. We expect healthy trading activity for these wines (subject to supply and market sentiment) as a result of them being able to meet these three conditions described. A wine with a clear linear trend can be deemed to meet these conditions better such as Carruades de Lafite 2010.

Some wines, such as Montrose 2010, can experience distinctive listed price jumps if their demand continues to remain high down the supply chain and traders find it difficult to satiate this demand at low expected margins. This will give rise to two clusters, one for before and one for after the price jump as observed in Figure 3. It is worth noting that this price jump is simply a reaction from traders supplying the lower levels of the supply chain. Traders do not seem happy to complete transactions at expected margins less than 10%.

Finally, there are wines like Haut-Brion 2010 which exhibit little, if no distinctive trend in the distribution of their expected margins with listed average merchant prices. The demand for such wines is not sensitive to the listed price, instead is more susceptible to supply and stock injections, previously described and discussed in the report ‘A Tale of Two Liquids’.

In summary, there is no correct price at which a trade transaction should take place. Several factors are at play at all times. Nonetheless, greater insight into the price at which trade transactions will take place can still be obtained through careful understanding of these factors using previous wine trading data alongside a good feeling for the wine’s supply and its market sentiment.