BRIGHT MARKET
— INSIGHT —
INDEX & REPORT for the GLOBAL PULP & BIOREFINERY INDUSTRY

This is why BMI believes in a strong pulp market in 2014

Despite the market’s concerns over a significant injection of new market pulp capacity, Bright Market Insight is standing by its belief in a strong pulp market during 2014.

“We expect a balanced market for the rest of 2013, and a strong price rise for both NBSK and BHK/BEK in 2014, with a new record high of over USD 1,000. We don’t think we’ll see prices dipping until March 2015,” says Leonard Johard, the architect of the forecast model and editor of the Bright Market Index, in this interview.

Why is it that, in monthly forecast after monthly forecast, Bright Market Insight retains its positive view of the pulp market for 2014?

“We are extremely confident about our forecast model, which has proven highly accurate over time. Historically it has a hit rate of 86 percent on forecasts over an 18 month horizon. The Bright Market Index is a unique proprietary forecast model for pulp based on artificial neural networks (ANN). The model distinguishes itself by including a large amount of fundamental data and taking into account the frequencies of market fluctuations. This makes it unique in the commodity market."

Most other analysts believe there is going to be a downturn – at least in the price of BHK – as a direct consequence of the overcapacity that is expected to flood the market in 2013 and 2014.

"The Bright Market Index takes the opposite view. We expect a balanced market for the rest of 2013, and a strong price rise for both NBSK and BHK/BEK in 2014, with a new record high of over USD 1,000. We don't think we'll see prices dipping until March 2015."

How does the model account for the capacity changes happening in the market – particularly in 2013 and 2014.

"Based on the data we input, our forecast focuses chiefly on expected supply and demand over the next 6-30 months. Our forecast model is a self-learning system that has learned how prolonged capacity changes have historically affected market prices."

But the market has never seen such sizeable capacity increases before, has it?

"No, that's right, but on the other hand the global market and global demand have never been as great as they're expected to be during 2014 in particular."

What input data is most affecting the model's price forecasts at the moment?

"It's mainly imports to China."

Do you think increased demand in China will be able to soak up all the new capacity?

"Yes, mainly there, but also in other places around the world. And don't forget that a large amount of old capacity is also being shut down. We're on our way to a new economic upturn. If it hadn't been for the new capacity that is gradually being released into the market, the strong price rise would probably have appeared in the autumn. We're also seeing increased demand in markets such as tissue, board and viscose. In addition, there are certain indications that the downturn in the printing paper market is at least temporarily set to level out slightly. This may be a cyclical change rather than a structural change."

How right have you been before?

"When all the other market analysts were talking about the Asian locomotive in 2011 and the absence of anything that could negatively impact on prices, in May that same year we issued a press release warning of a buck in the trend and a drop in prices starting in the summer. No-one believed us. As far as they were concerned, the sky was the limit. They were wrong and we were right. Just over a year later – in autumn 2012 – we again issued a press release that we had reached the bottom and pulp prices would rise by the autumn. Again, no-one believed us. But again we were right. And I promise that when the market reaches its peak in March 2015, nobody will believe us about the expected new drop in prices. That is the psychology of the market, and what makes our pulp forecasts so unique and valuable."

What happens if you're wrong?

"We will humbly conduct an analysis and perhaps add new input data to the model. But we've been right so far."

Which input data are used?

"Bright Market Index uses five different input data. These are pulp prices, inventories, deliveries, import China and Euro/USD."

Why are not more and other input data used?

"We have during the development of the model tested a wide variety of input data, but chosed to retain only those that have a significant impact on the accuracy of forecasts. To keep the model as clean and manageable as possible, we have decided to clear all input data that not have a significant impact on the future prices."

How does Bright Market Index work?

"Bright Market Index's model identifies patterns from the historical price trend and its fundamental factors. They are then used to make a price forecast for the future.

The model finds trends in historical data and makes very accurate price trend forecasts in a range of 10–30 months."

What sets Bright Market Index from other mathematical models?

"All purely statistical models have one primary source of error: that the model is designed to fit the historical trend too specifically instead of finding patterns and being representative of the future. Unfortunately, it is more the rule rather than the exception for economic forecast models that this source of error is not taken up. Oftentimes, their historical accuracy is based entirely on the model fitting the history, and the results thus become totally deceptive.

Bright Market Index offsets this with a method that automatically prevents it from happening. More sophisticated regularization automatically prevents the model from identifying improbable and far too detailed patterns in rate fluctuations. Together with the flexibility of the neural networks, this provides a very good forecasting ability. Machine learning has outperformed competing economic models in almost all scientific studies on real markets.

How accurate is Bright Market Index?

”Bright Market Index forecasts indicate the correct price directions over 80% of the time for all time horizons longer than 6 months. For comparison purposes, it may be noted that the price is on the rise 58 percent of the time in a 12-month range. The model is also able to identify whether the price will increase or decrease in nearly 80–85 percent of cases where long-range forecasts are made. In a 24-month range, the forecast is very close to the actual price trend. The forecast model achieves its best results in an 18-month range.”

How credible are the forecasts?

”All results presented are cross-validated, which fully offsets the effects of any overfitting of the results. This means that the set of data is divided up into separate time periods of 1,5–2 years each. The results are then simulated in each time period through a model that has been built up solely on the basis of data from the other periods. The graphs presented are combinations of the tests on each individual time period and thus represent the estimated results for entirely new data.

Cross-validation is a very strict test that few statistical models pass. The test is also fully proportional to the difficulty of making forecasts into the future based solely on historical data. We therefore do not expect the results to be overestimated due to overfitting.”

How unique is the research behind Bright Market Index?

”Bright Market Index develops its products in contact with the absolute cutting edge in the field of research and strives to make a break-through in it. Thee company has developed algorithms surpassing the latest scientific articles and has specifically customized them for its markets.

This makes it possible to avoid the problem of selecting variables altogether by allowing networks to select themselves what is relevant and explore loosely correlated variables, without disrupting the prediction on a large scale.”