Simona Gambarini
Associate Director – Research Analyst
research@etfsecurities.com

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Platinum and Palladium – Fundamentally undervalued

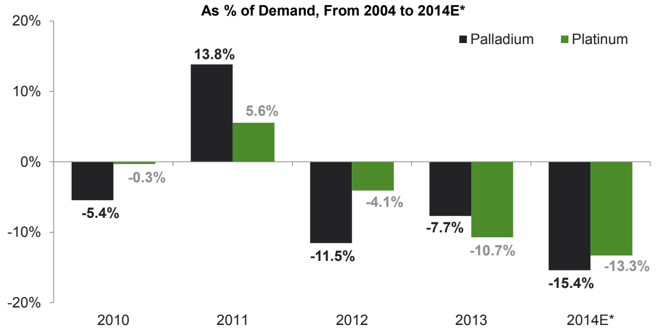
Despite falling 2.5% since the beginning of the year, precious metals are the best performing commodity sub-sector year-to-date. Contrary to our expectations, PGMs ("Platinum Group Metals") lagged behind, with platinum falling by almost 8% and palladium decreasing by 2.5% over the period. The strong appreciation of the US Dollar against major currencies, particularly against the Euro, did not bode well with commodity prices that tend to be negatively correlated with the US currency. Going forward we expect PGM prices to recover, as sentiment improves and investors return to focus on tighter fundamentals.

The extensive use of platinum and palladium in vehicle catalytic converters makes their demand particularly sensitive to economic, industrial and market conditions at a global level. Fears of a Greek exit from the Eurozone, the biggest consumer of platinum for catalytic converter purposes, coupled with expectations of higher production, prompted an 8% fall in platinum price since the beginning of the year. Palladium also suffered a loss during the period, as a strong US Dollar and negative sentiment towards commodities, weighed on the price of the metal.

South Africa holds the biggest proportion of the world's platinum and palladium resources, which are mainly located in the Bushveld Igneous Complex. South Africa is well known for the elevated level of worker activism and government intervention in the mining industry, which have substantially affected production in the past, with 2014's 5-month strike further corroborating this issue. While production of both platinum and palladium is expected to recover in 2015 following a disastrous 2014, social tension could mount up once again in June when wage agreements in South Africa expire.

With supply expected to remain tight, PGM ("Platinum Group Metals") markets are expected to remain in deficit in 2015.

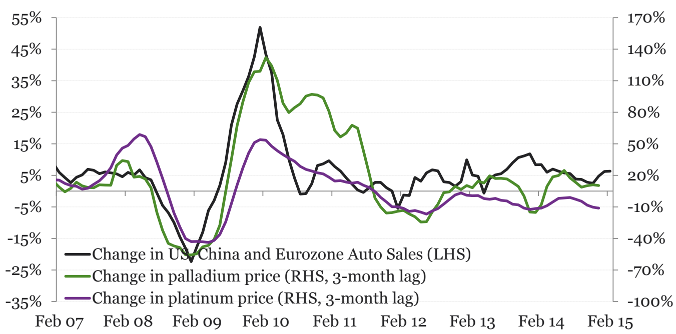
Palladium in a Deficit for the 3rd Year in a Row
As % of Demand, From 2004 to 2014E*



Source: Johnson Matthey, GFMS, ETF Securities
* JM forecasts as of November 2014

However, demand fundamentals are expected to continue to favour palladium over platinum. While persistently low prices are likely to spur Chinese jewellery demand for platinum from the middle of this year, autocatalyst demand from Europe, the biggest diesel market, is likely to underperform its Chinese and US's peers as the Eurozone continues to be plagued by low growth issues. China, the biggest single contributor to platinum demand, imported 22% less platinum in 2014, as jewellery demand faltered. However, this demand component tends to be particularly sensitive to prices and should therefore recover in 2015. Meanwhile, palladium is expected to benefit from strong auto sales in the US and China, the two biggest markets for gasoline cars. The China Association of Automobile Manufacturers expects auto sales in the country to rise by 8% to 21.3 million vehicles in 2015 while a combination of a large drop in oil prices, increased availability of auto loans and aging automobiles on the road will buoy auto demand in the US.

Strong Auto Sales to Support PGM Prices
3mma of YoY Change, Monthly Data, From February 2007 to February 2015



Source: Bloomberg, ETF Securities

We expect palladium to continue to outperform platinum. While we believe that platinum price will eventually return to trade above the US$1,300oz level as Chinese demand recovers and Eurozone auto subsidies kick in, palladium appears to be in a better position to benefit from a pick-up in China and US economic growth, the two biggest global auto markets.

Important Information

The intelligent alternative

ETF Securities (UK) Limited
3 Lombard Street
London
EC3V 9AA
United Kingdom

t +44 (0)207 448 4330
f +44 (0)207 448 4366
e info@etfsecurities.com
w etfsecurities.com