

15 March 2016

ETF Securities Commodities Research

Sentiment turns more positive for industrial metals

Summary

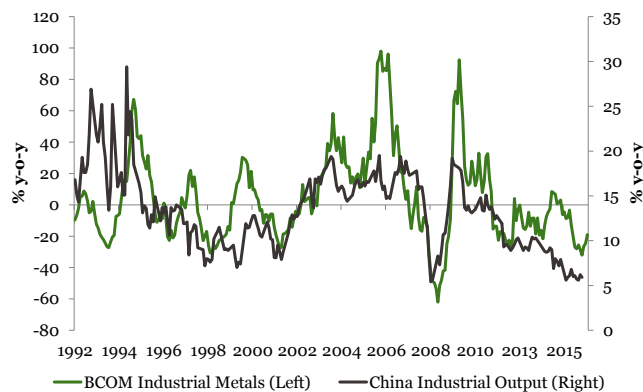
- Industrial metals have been in a bear market since 2011. But over the past few months, their prices have been rising.
- Zinc copper and nickel are likely to be in a supply deficit this year, as mining activity has been pared back and demand remains robust.
- After decelerating since 2009, Chinese industrial output appears to be forming base, providing a platform for industrial metals to shake off the negative sentiment that has beset the asset class.
- Investor sentiment, while recovering, has further improvements to make which should see the rally continue for some time.

The beginning of a recovery

After falling for most of the past five years, industrial metal prices started rising in recent months. Aluminium and lead began to head higher in November 2015, while nickel only joined the pack in February 2016. The price gains since the trough have been in the double digits across the board, albeit from a low base. However, we have by no means recovered losses that have been sustained in the down-leg of the cycle that lasted for close to five years. Industrial metal prices on average more than halved during the bear market as analysts revised their expectations for China’s demand growth.

year at the beginning of 2010, following a bounce-back in China’s industrial output after the worst of the global financial crisis was over. However, as China has progressively been targeting lower levels of growth, analysts have been revising downward the country’s industrial metal demand growth. While industrial output growth in China has never been negative, it has decelerated from close to 20% y-o-y in November 2009 to 6% y-o-y in December 2015. However, in 2015, industrial output growth has remained stable at around 6% in each month and appears to have formed a base. China’s consumption of aluminium, copper, nickel and zinc increased in 2015 according to data from the World Bureau of Metal Statistics.

China Industrial Output Growth Stabilising



Source: Bloomberg, ETF Securities

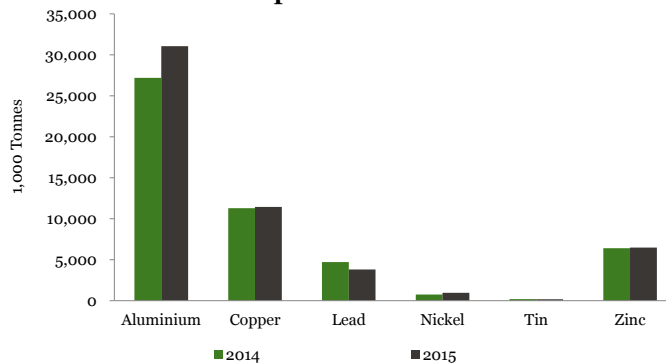
	Aluminum	Copper	Zinc	Nickel	Lead	Tin
Price recovery since trough so far	11%	16%	24%	24%	19%	31%
Days of recovery so far	106	53	56	26	106	53
Price loss in down-leg of cycle	-49%	-58%	-43%	-74%	-46%	-60%
Months of the down-leg in cycle	54	59	59	60	55	57
% of loss recovered so far	12%	12%	31%	8%	22%	21%

Source: Bloomberg, ETF Securities, as of 08/03/2016

China’s industrial output finding a base

Industrial metals prices were rallying close to 95% year-on-

China Consumption of Industrial Metals

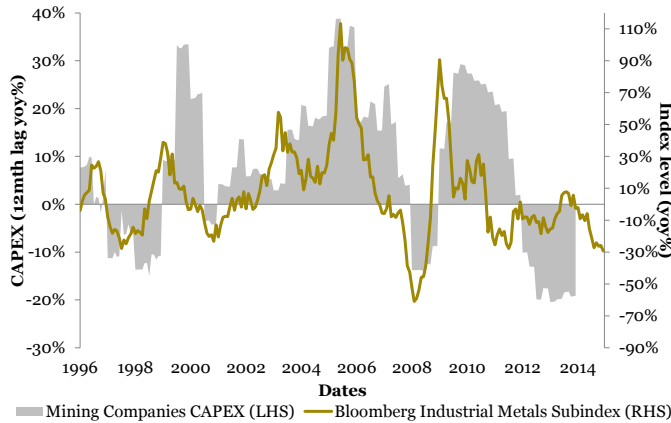


Source: Bloomberg, World Bureau of Metal Statistics

Production also being pared back

Although consumption of metals continued to rise in 2015, so did production, which meant that most metals remained in a production surplus in 2015. But supply-side destruction has commenced. Cuts in capital expenditure (CAPEX) by mining companies have been the most aggressive on record (our data begins in 1996). Cuts in CAPEX mean that depletion in currently producing mines will not be replaced by new supply and will contribute to market tightness with a lag.

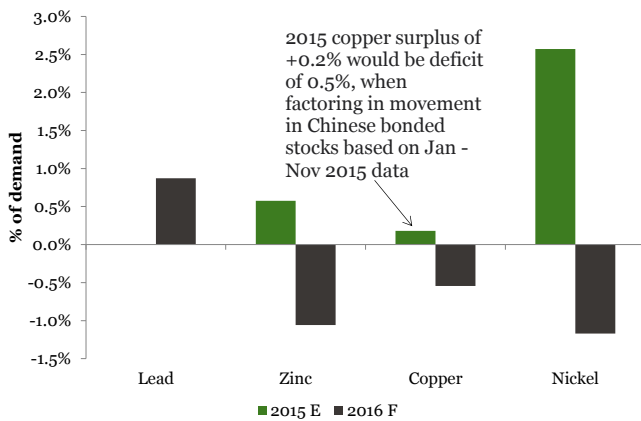
CAPEX Cuts to Drive Supply Lower



Source: Bloomberg, ETF Securities

Forecasts from the major intergovernmental metal study groups point to many metals including zinc, copper and nickel falling into a supply deficit this year as those cuts in CAPEX bite into supply. Copper may have already been in a supply deficit in 2015 when accounting for the fact bonded stocks in China were drawn on¹.

Metal Supply to Move to a Deficit



Source: International Copper Study Group, International Lead and Zinc Study Group, International Nickel Study Group, ETF Securities, Bloomberg

Markets recognising the firmer fundamentals

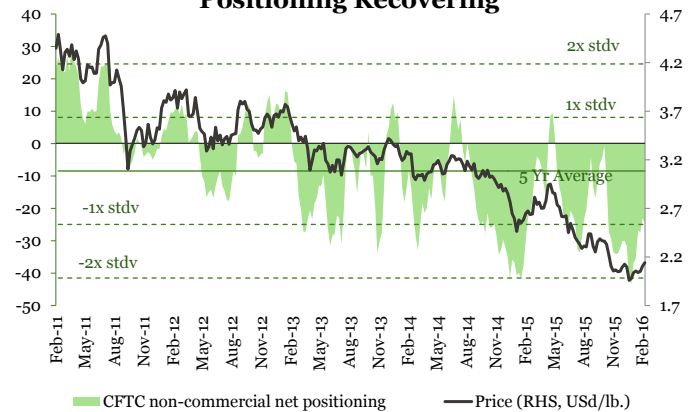
Sentiment toward industrial metals has been improving in recent weeks, judging by futures market net speculative

¹ Consumption data used by the intergovernmental agencies is based on 'apparent' consumption or disappearance and does not factor in the movement in stocks. However in China, where programmes to use stocks as collateral for financing are large, a small percentage withdrawal in stocks can signify a real increase in consumption demand. The International Copper Study Group produces an estimate of movement in bonded stocks to supplement the data on apparent consumption.

positioning. Speculative positioning in COMEX copper futures, which has the longest history of data, has been net short since 2011 and by January 2016, peak bearishness was hit with positioning falling more than 2 standard deviations below its 5-year historic average. From this low base, positioning has recovered and is now less than 1 standard deviation below its 5-year historic average.

However, there is still a significant amount of recovery left for copper positioning to normalise. The momentum is now more positive and we believe improving sentiment will continue to drive copper prices higher.

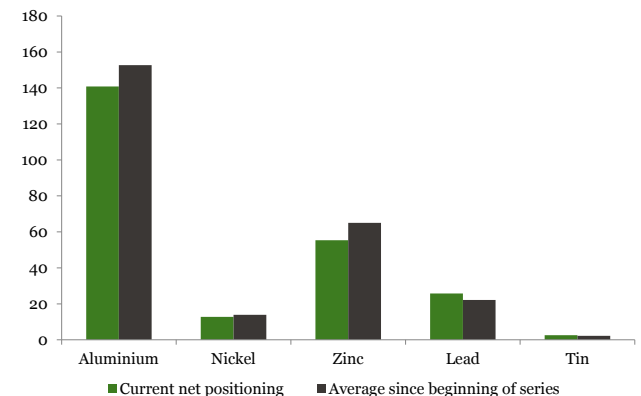
COMEX Copper Net Speculative Positioning Recovering



Source: Bloomberg, ETF Securities. Net positioning measured in 1000s of contracts as of 01/03/2016

Positioning data for other metals don't have as much history (LME non-commercial positioning data series start in 2014) and so it is difficult to judge just how high speculative positioning needs to be to signal a break out of bear market conditions. But it is clear that speculative positioning has increased for other metals. Aluminium, nickel and zinc positioning are approaching series' averages, while lead and tin are above.

LME Metal Futures Market Positioning



Source: Bloomberg, ETF Securities. Net positioning measured in 1000s of contracts as of 01/03/2016

We believe that as long as the global economic recovery continues apace (even factoring in the lower target level of Chinese economic activity), industrial metals demand will absorb expected supply and the recent market recognition of the firmer fundamentals will drive further positive momentum for the asset class.

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