

# The Tide Is Turning

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## Commodity Markets Are Ripe For A Revival

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- We expect commodity prices to exit the unexciting downtrend which had its roots in the ‘Global Financial Crisis’ and a **commodity deflation cycle to begin** in the next few months.
- Commodity prices including energy, metals and softs have been in a downtrend at least since 2011 with many trading at multiyear lows. In fact **the Core Commodity CRB Index is trading close to the levels seen at the beginning of this century.**
- We see three key drivers of this commodity deflation
  - a. US Dollar is beginning to rollover.** A weaker US Dollar is likely to ease global tightness and trigger a commodity rebound.
  - b. Global growth which has been sliding slowly is beginning to stabilize** and is likely to see a recovery in 2020.
  - c. Commodity markets, especially Base Metals appear cheap with low levels of inventory,** poor growth in new discoveries and low capacity addition. Moreover, given the current tightness in demand and supply scenario for most metals, **the deep contango indicates the markets pessimism is reaching an extreme.**
- Historically higher commodity prices have been accompanied by an uptick in global growth, especially for Emerging markets, many of which are commodity exporters. Metals, Energy and Industrials (MEI) sectors tend to benefit during such phases. The ‘Mining Clock’ is indicating that some of these sectors are fully prepared to capitalize on a commodity deflation trend.
- **Our focus for Indian markets is on NSE Metals Index which has moved very closely with trend in global commodity markets and appears ripe for another such move.**

# Commodities Prices At Five Decade Low Relative To Stocks

## Commodities Are At The Cheapest Relative To Stocks



\*Source: Bloomberg, Edelweiss Professional Investor Research

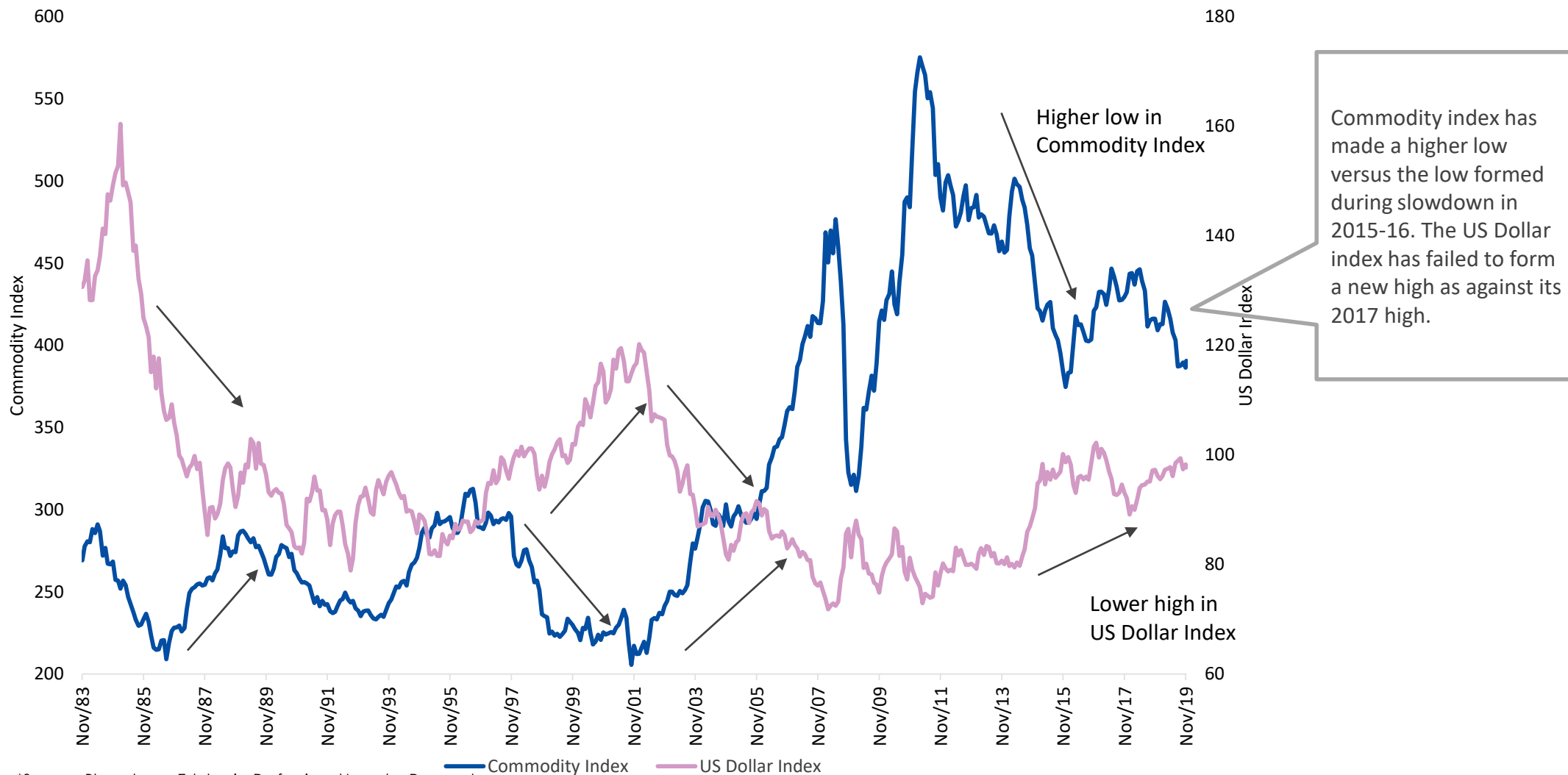
## A Softer Dollar Could Propel Commodities Higher

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- Commodity prices and US Dollar move in opposite direction
- US dollar tops seems to be in place
- Relatively higher EU growth could push USD lower
- US Fed's balance sheet expansion to restrict USD rise

# Commodities And Dollar Move Opposite To Each Other

## Commodities Are Priced in US Dollar, And Strengthen When Dollar Weakens



\*Source: Bloomberg, Edelweiss Professional Investor Research

# US Dollar Tops Reoccurring With Eerie Similarity

### Major Tops in US Dollar Index Are 16 Years Apart

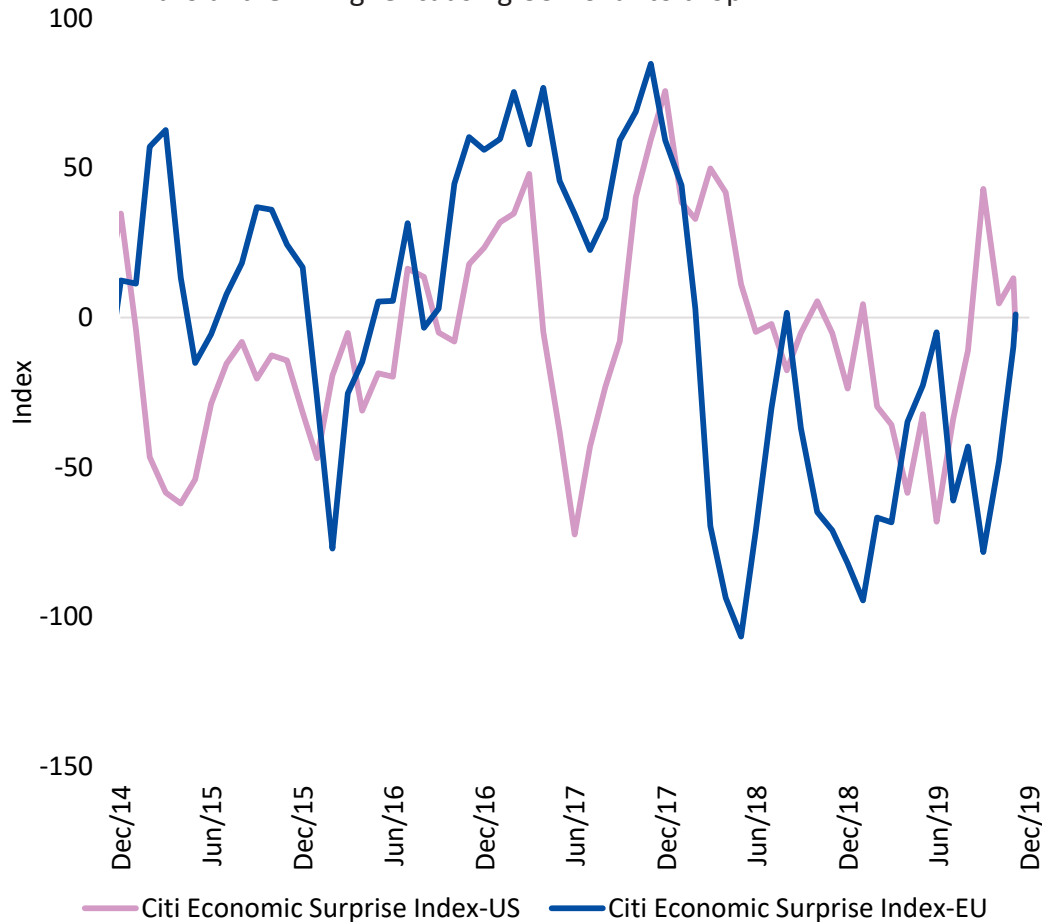


\*Source: Bloomberg, Edelweiss Professional Investor Research

# Europe Could Incrementally Grow Faster, Euro Can Stage A Comeback

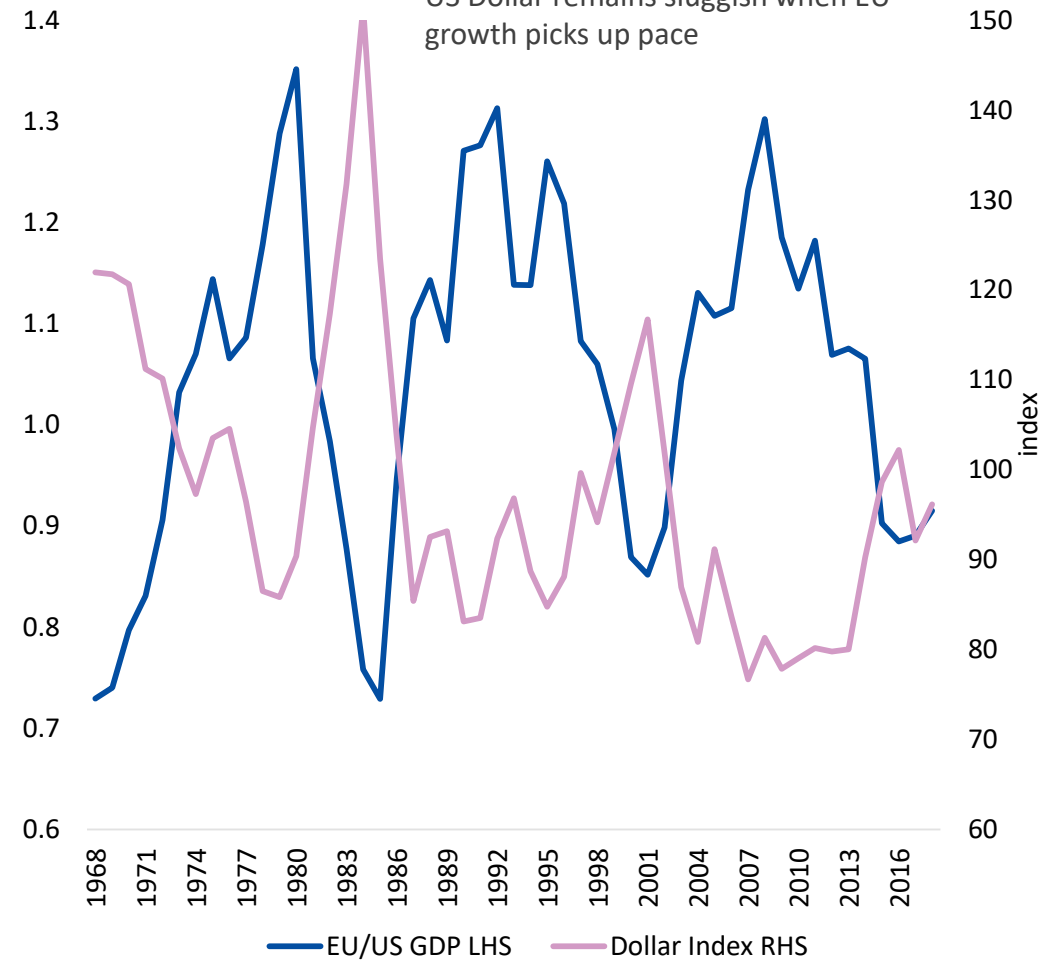
## Economic Data Has Surprised Positively In EU Than US

Recovery in EU growth and end of Brexit uncertainty could propel Euro and GBP higher causing US Dollar to drop



## Higher Relative EU Growth Is Dollar Negative

US Dollar remains sluggish when EU growth picks up pace



\*Source: Bloomberg, Edelweiss Professional Investor Research

# As German Yield Recover, Flows Into US Dollar Could Stall Its Uptrend

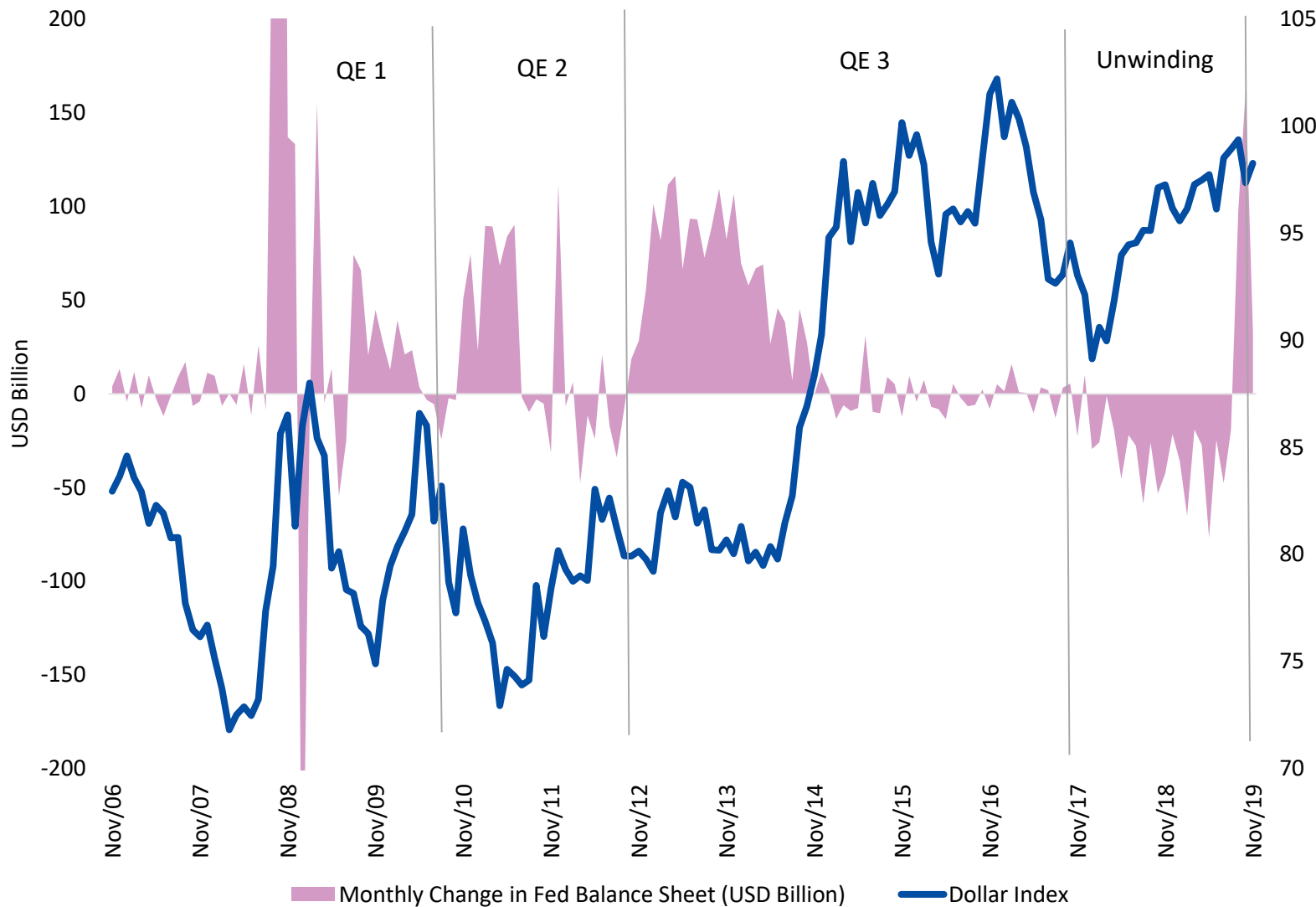
### With Falling Spread Between Germany And US Bonds, Dollar Stands To Lose



Hunt for yields has kept US Dollar too strong recently. This could change as other markets come back to normalcy.



# US Fed Balance Sheet Expansion Could Weigh on The US Dollar



US Fed's balance sheet reduction had been the basis of our call at the beginning of 2018 to turn cautious. However recently the Fed has started to expand its balance sheet again, that too at a record pace. This is Dollar negative

\*Source: Bloomberg, Edelweiss Professional Investor Research

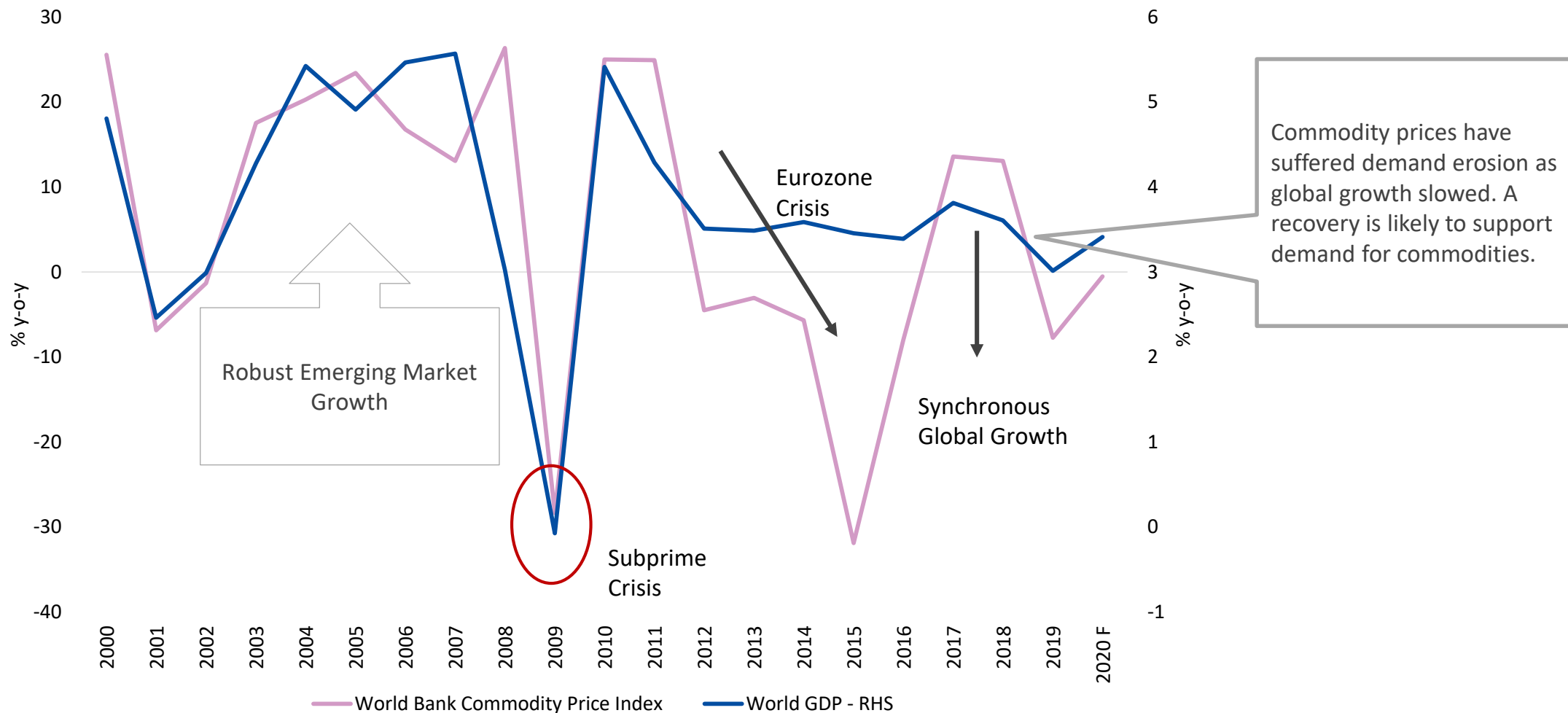
## Global Growth Recovery To Support Commodity Demand

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- Global growth likely to stabilize and revive
- Global liquidity is easing
- Supportive monetary and fiscal policies should aid recovery
- Global PMIs are suggesting stabilization and probable revival

# Global Growth Drives Commodity Prices

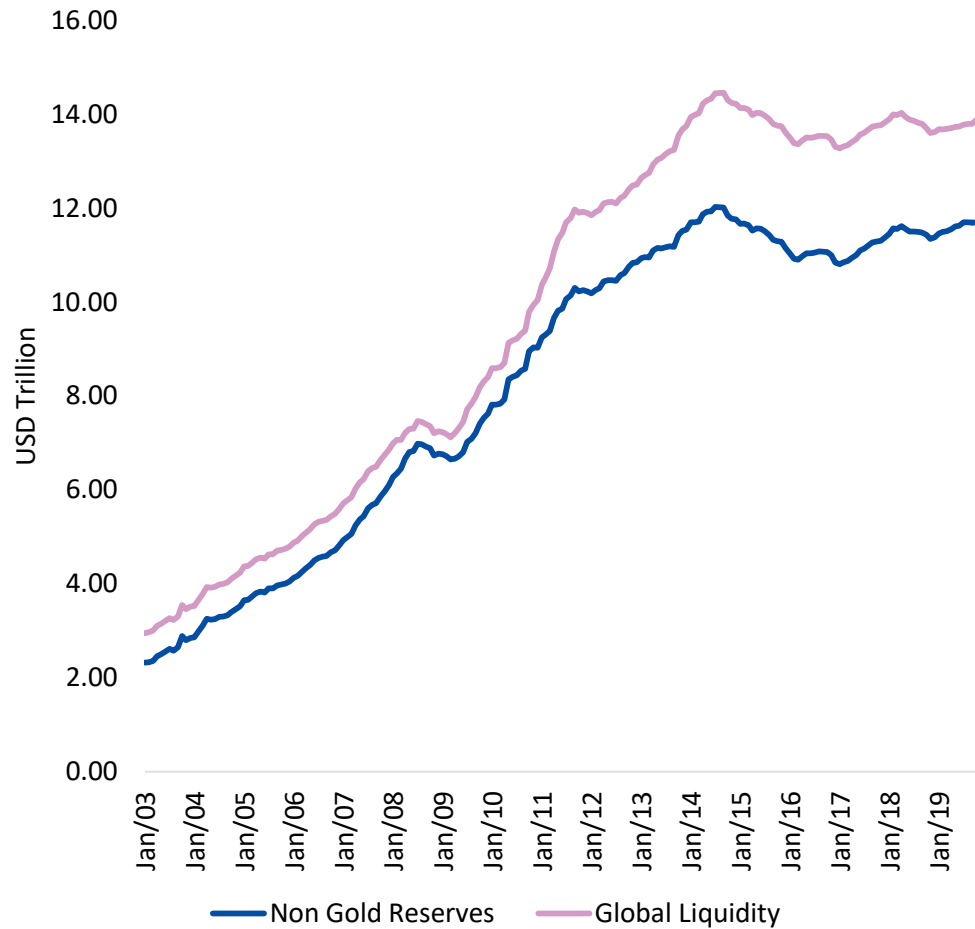
## Global Growth Is Flat lining After Two Turbulent Years, Revival Will Boost Commodity Prices



\*Source: Bloomberg, Edelweiss Professional Investor Research

# Global Liquidity Is Inching Up

### With Fed Easing and Dollar Falling, Global Liquidity Is Improving



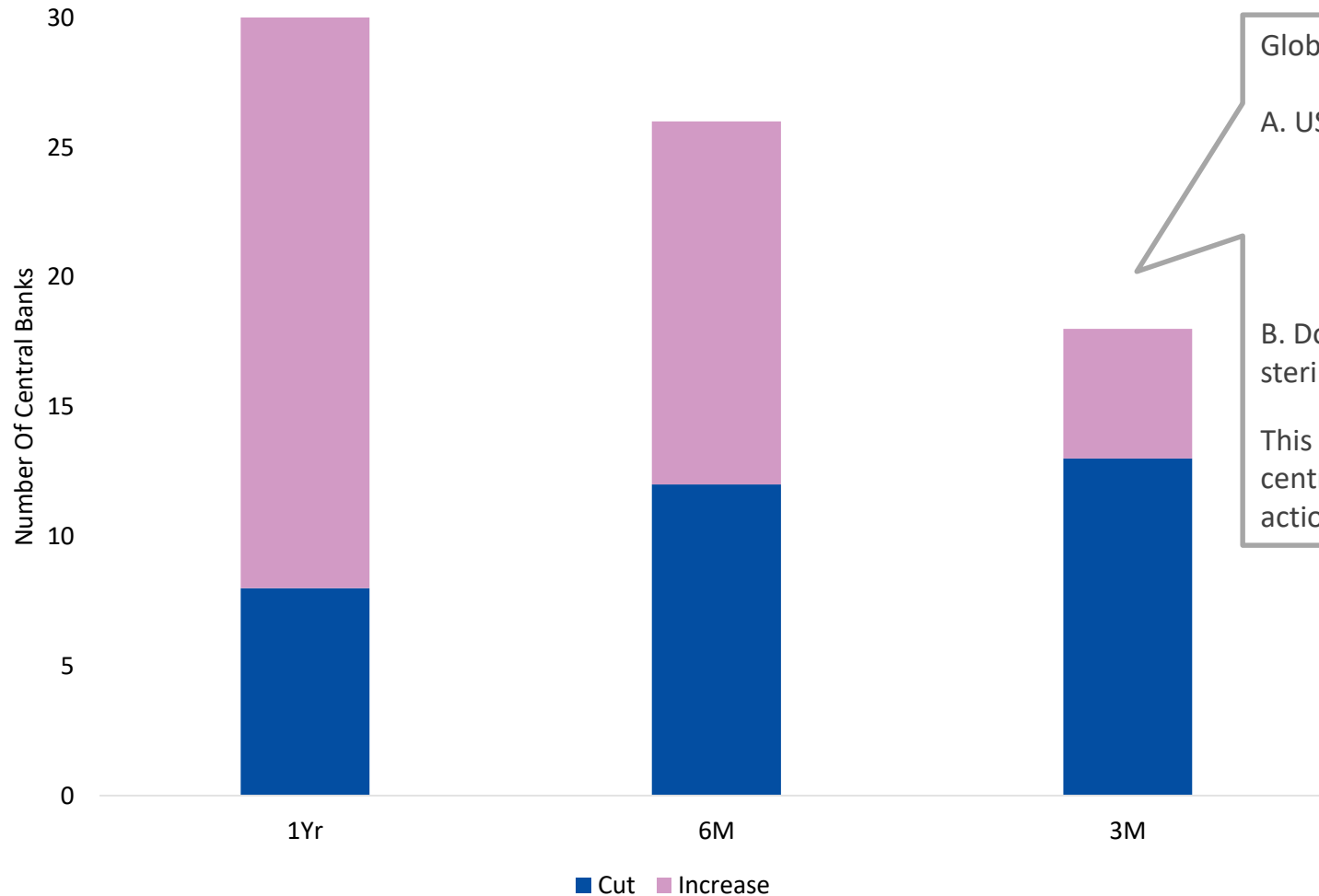
### With Significant Uptick In Recent Months



\*Source: Bloomberg, Edelweiss Professional Investor Research

# Central Banks Are Dovish, Monetary Policy Is Supportive

## More Central Banks Are Cutting Rates



Global and local easing cycle has 2 components

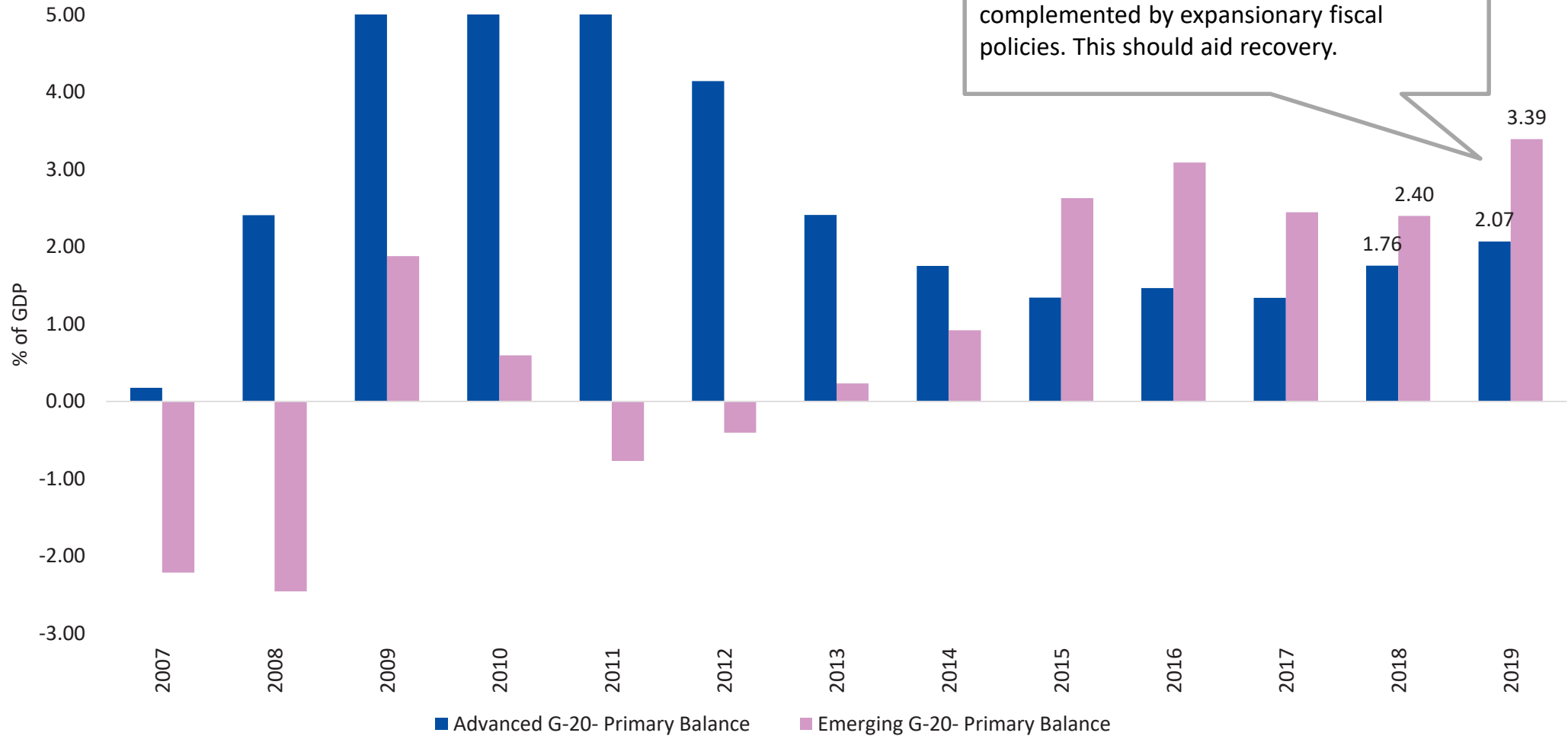
- A. US Dollar's dominance
  - i. That the US Fed reduces rates/Eases balance sheet
  - ii. US Dollar depreciates
- B. Domestic policy is easy and the central bank sterilizes lower FX inflows

This is the combination which revives growth. Most central banks are indicating the desired policy action

\*Source: Bloomberg, Edelweiss Professional Investor Research

# With Fiscal Policy Also Joining Hands

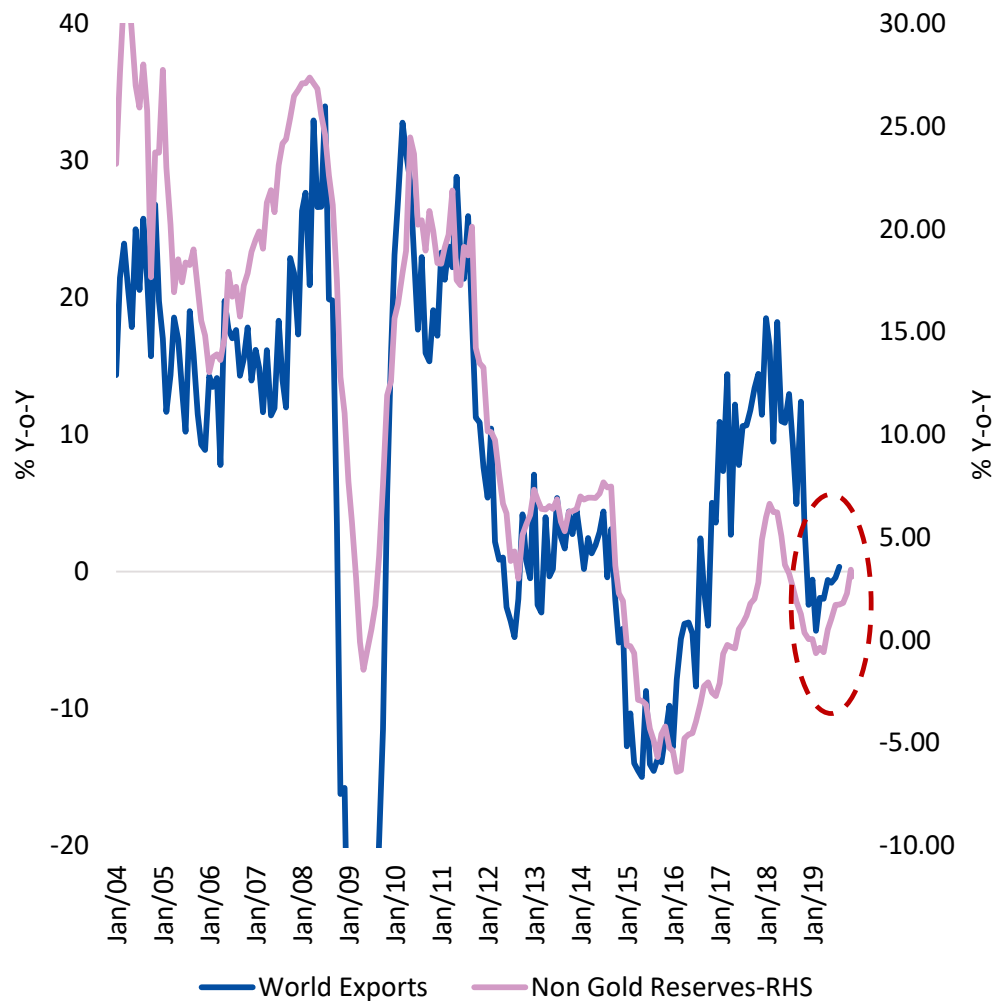
In most economies monetary policy is being complemented by expansionary fiscal policies. This should aid recovery.



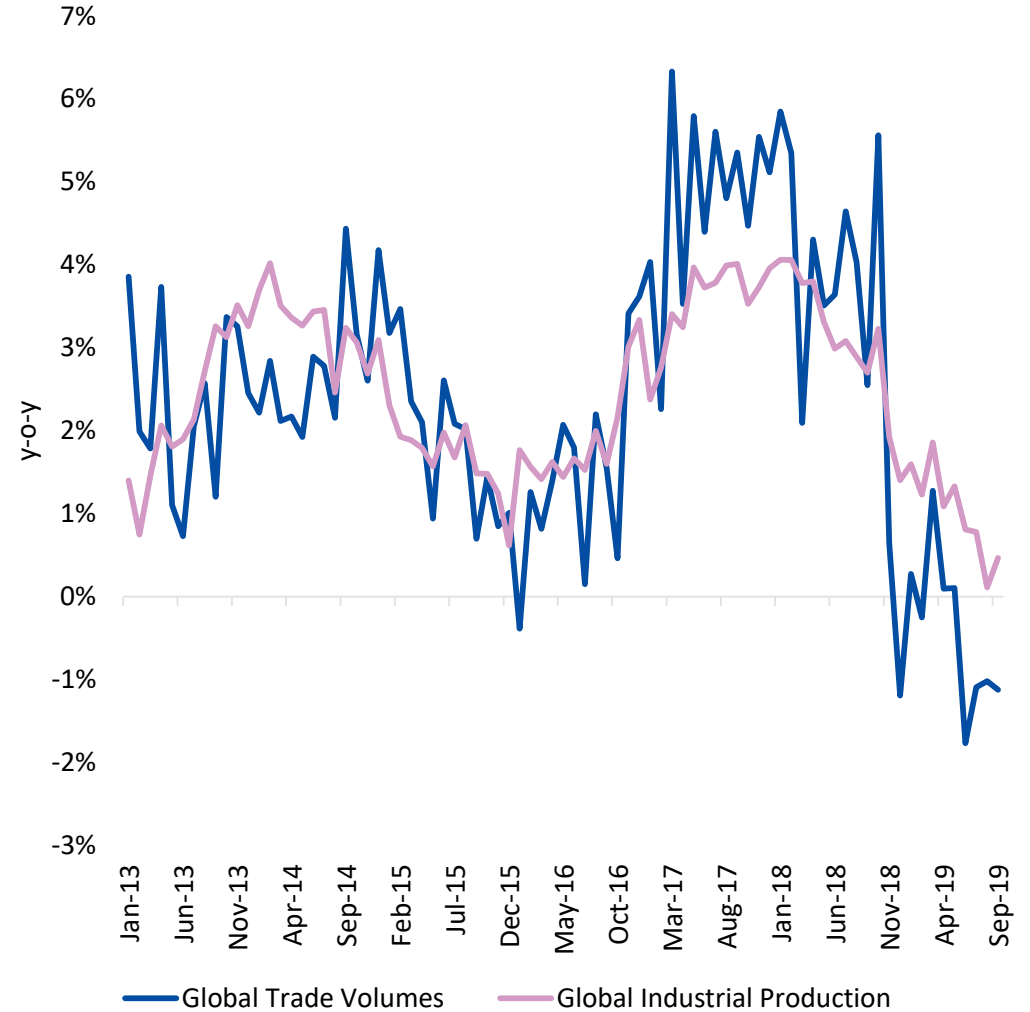
\*Source: IMF, Edelweiss Professional Investor Research

# Fiscal & Monetary Easing Would Propel Global Trade, Growth

### Global Liquidity is Positive for Exports Growth



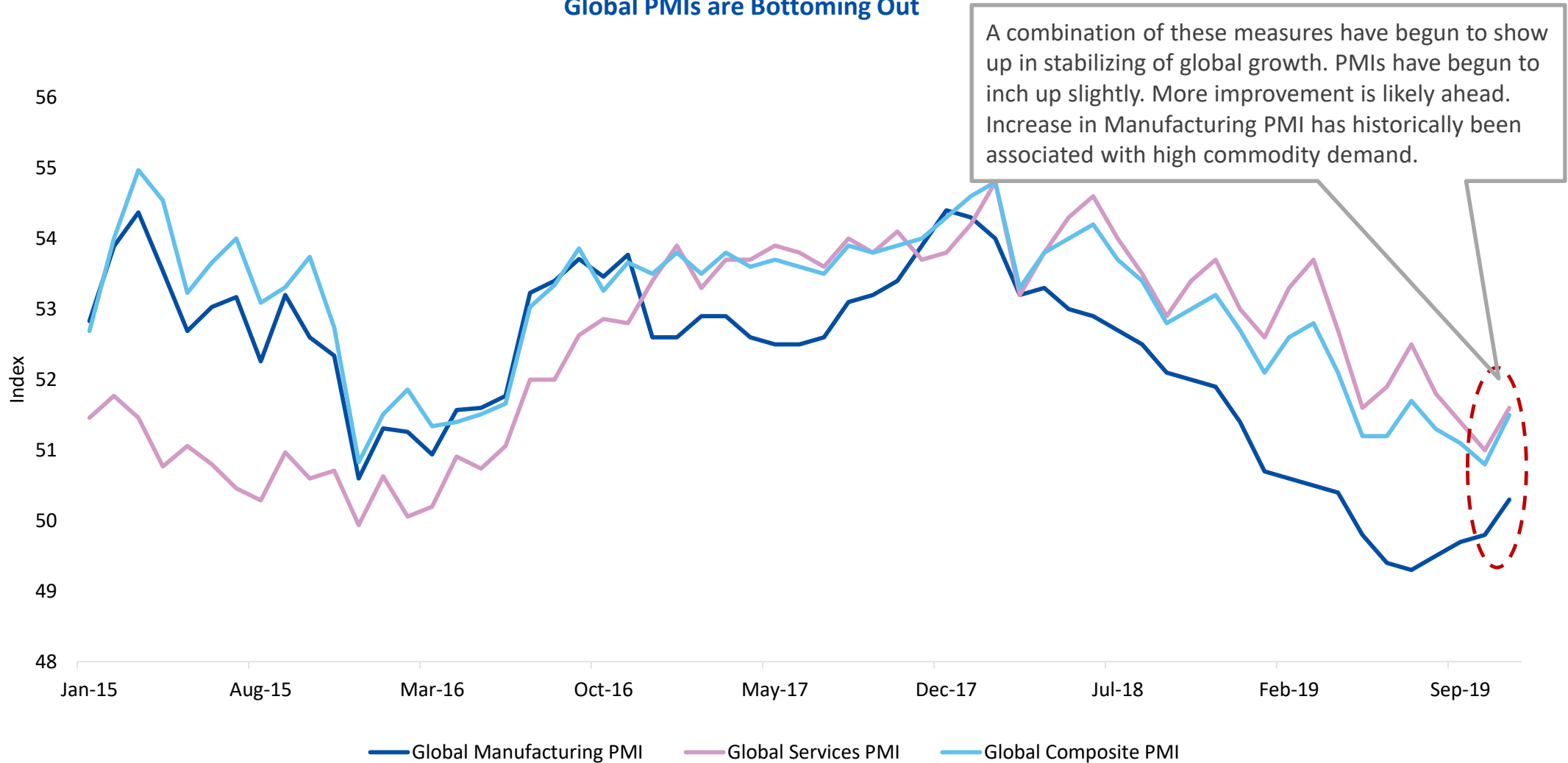
### With Further Push Expected From Volume Uptick



\*Source: Bloomberg, IMF, CPB Trade Monitor, Edelweiss Professional Investor Research

# Signs of Stability Is Beginning To Appear

## Global PMIs are Bottoming Out



\*Source: Bloomberg, Edelweiss Professional Investor Research

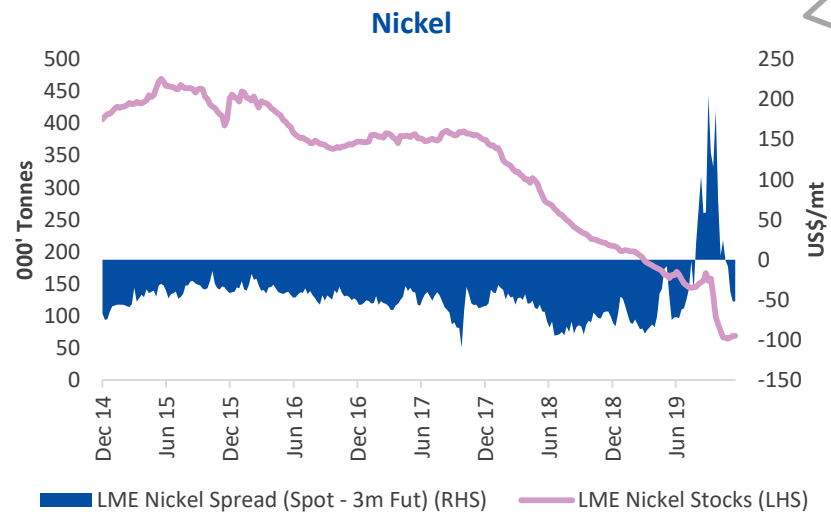
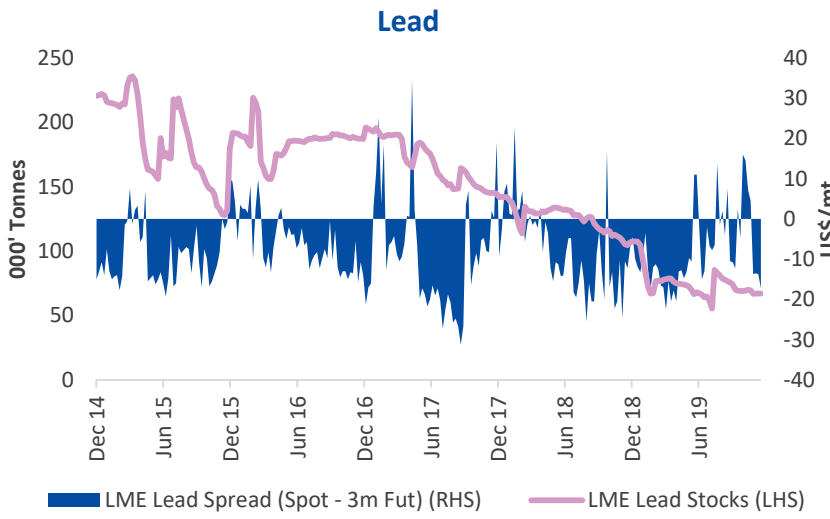
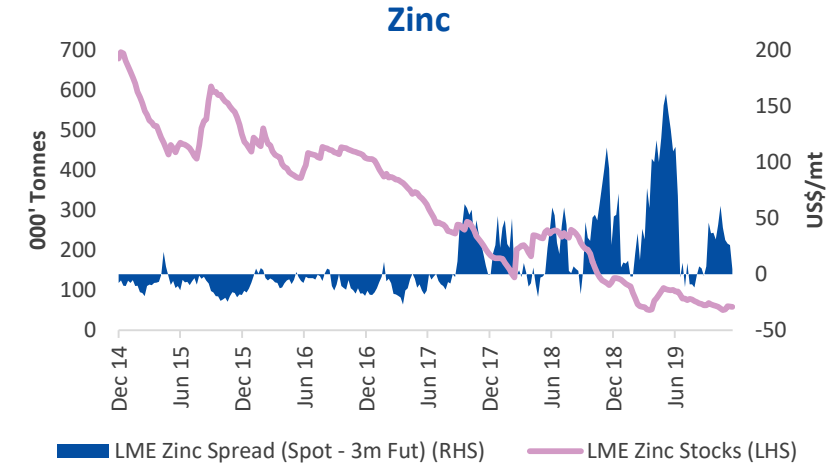
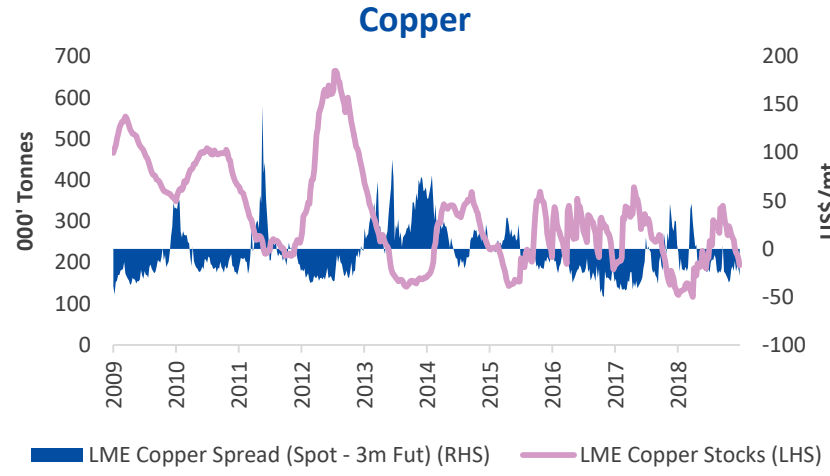


## Commodity Prices Are Depressed Reflecting Slowdown, But Are Ripe For Turnaround

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- Fundamentals are well positioned
- Capex Bottoming Out
- Mining clock indicates cyclical support
- Time cycle is aligned positively

# Physical Markets And Time Spreads Not In Sync, Indicating Extremity



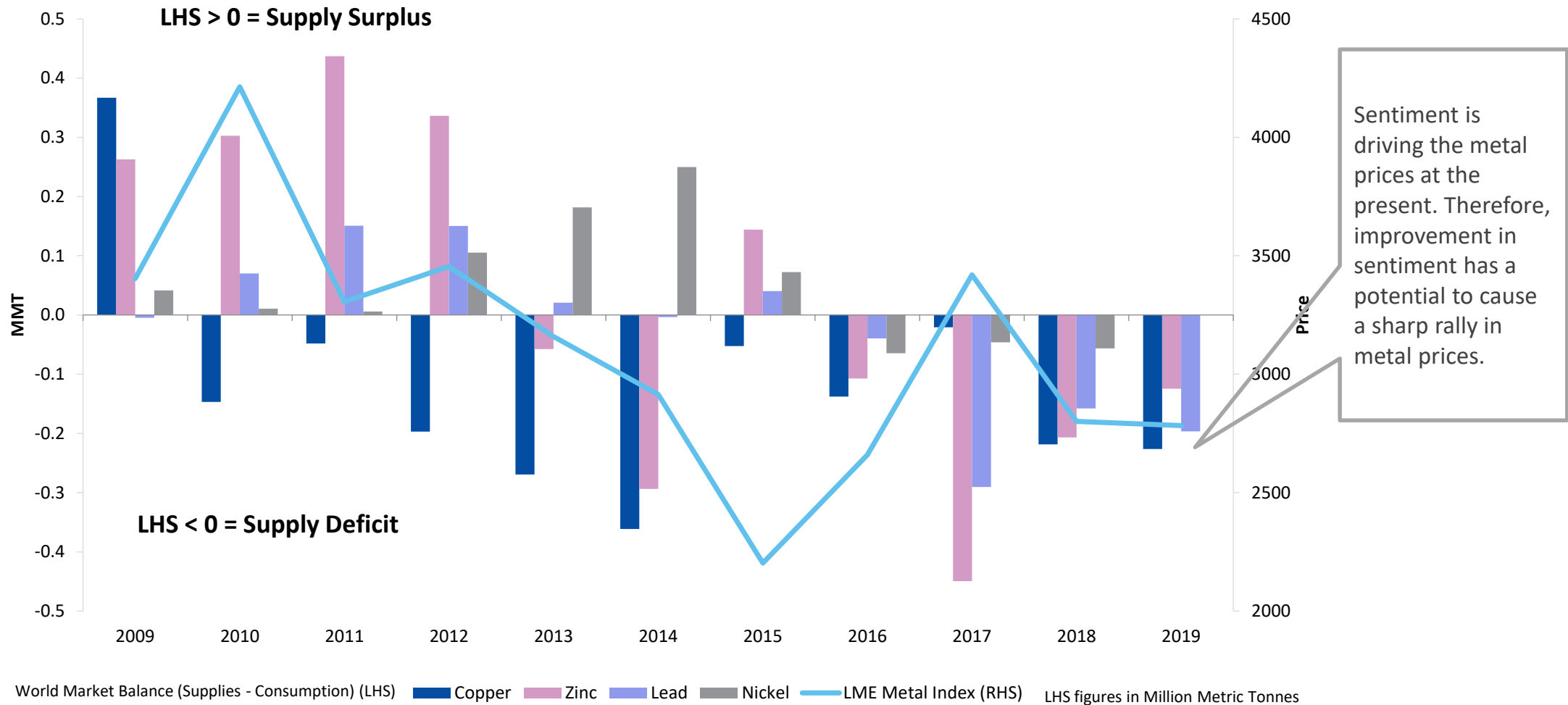
Given that base metal inventories are at multi-month lows and prices are at depressed levels, the market seems too pessimistic and ripe for a change in trend

\*RHS>0 = Backwardation  
 RHS<0 = Contango

\*Source: Bloomberg, Edelweiss Professional Investor Research

# Key Industrial Metals In Supply Deficit

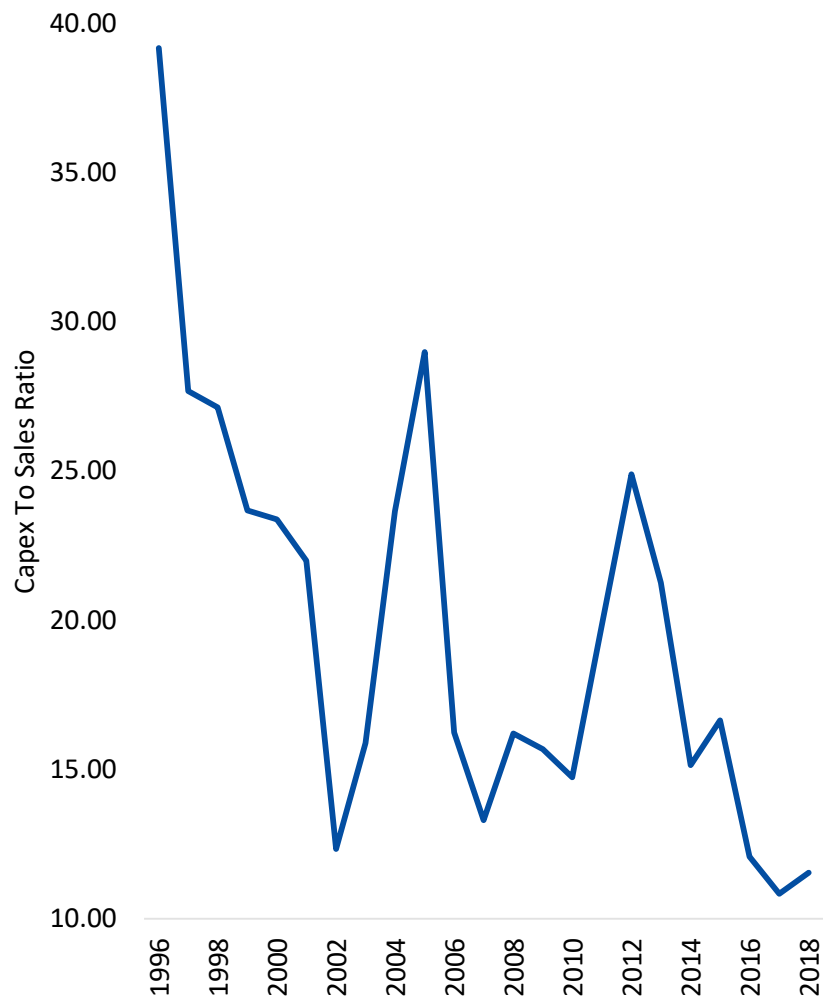
Key industrial metals have been in supply deficit over the past few years



\*Source: Bloomberg, Edelweiss Professional Investor Research

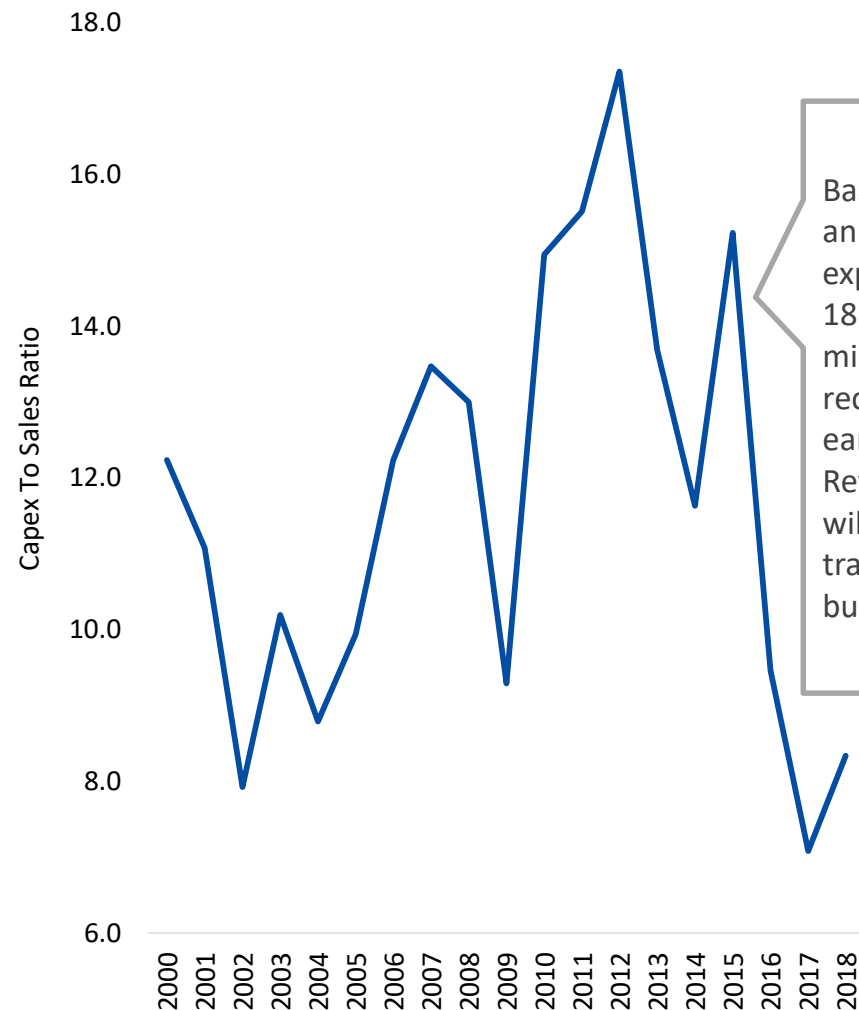
# Not Much Investment Has Gone Into New Capacity

### Global Capacity Addition Is Low..



\*Top 5 Mining Companies Globally

### ..With Similar Trend In India



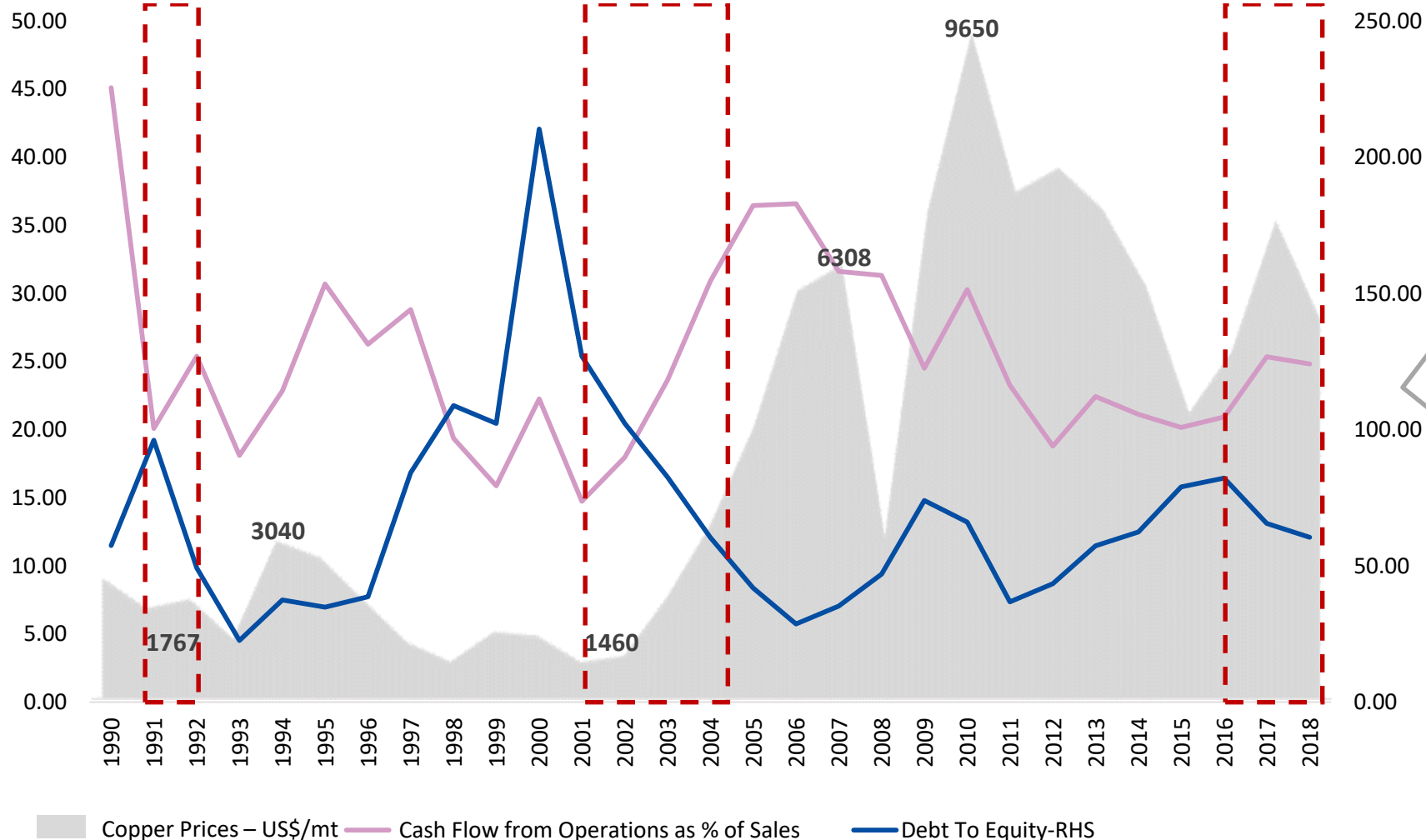
Based on the latest announcements, capex is expected to rise further, by 18.4% in 2019 as the mining sector continues to recover from the slump earlier in the decade. Revival of mining capex will mark the next trajectory of commodity bull run.

\*Top 5 Indian Mining Companies

\*Source: Bloomberg, Edelweiss Professional Investor Research

# 'Mining Clock' Indicates A Change In Market Cycle

## Mining Clock Indicates The Cyclical Point Based On Financials Of Corporates

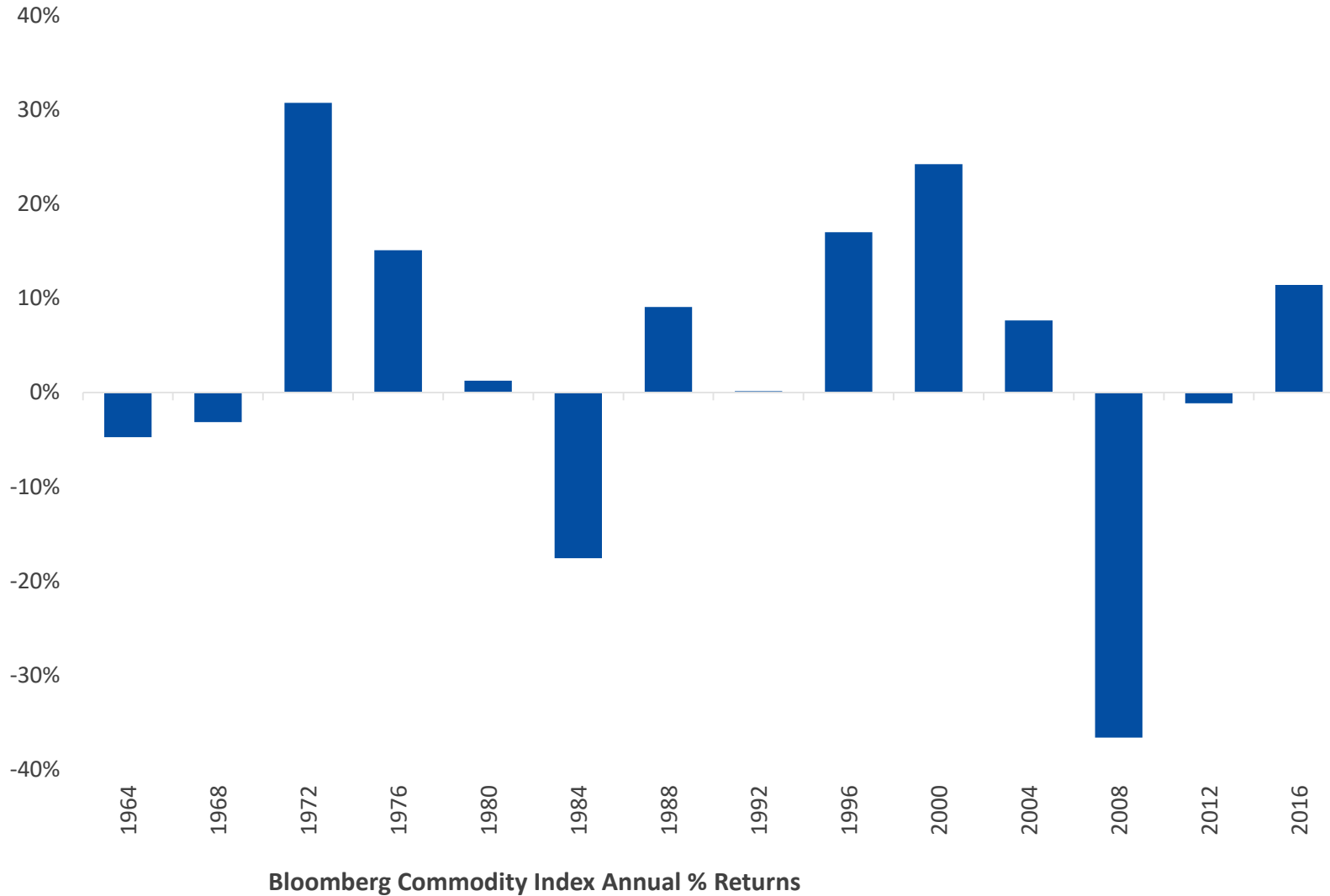


Mining Companies tend to move away from over leveraging and become cash flow positive in the cycle towards boom. This divergence is where we stand today, in the early one-third of the boom cycle, marking the right time to enter the industry.

\*Source: Bloomberg, Edelweiss Professional Investor Research

# Election Years Are Commodity Positive

### Commodity Index Gains In US Presidential Election Years



Data since 1960 reveals that commodities, in general, have given positive annual return on 9 out of 14 occasions, with an average return of 3.8% and **6.9%** ex of Global Financial Crisis)

\*Source: Bloomberg, Edelweiss Professional Investor Research

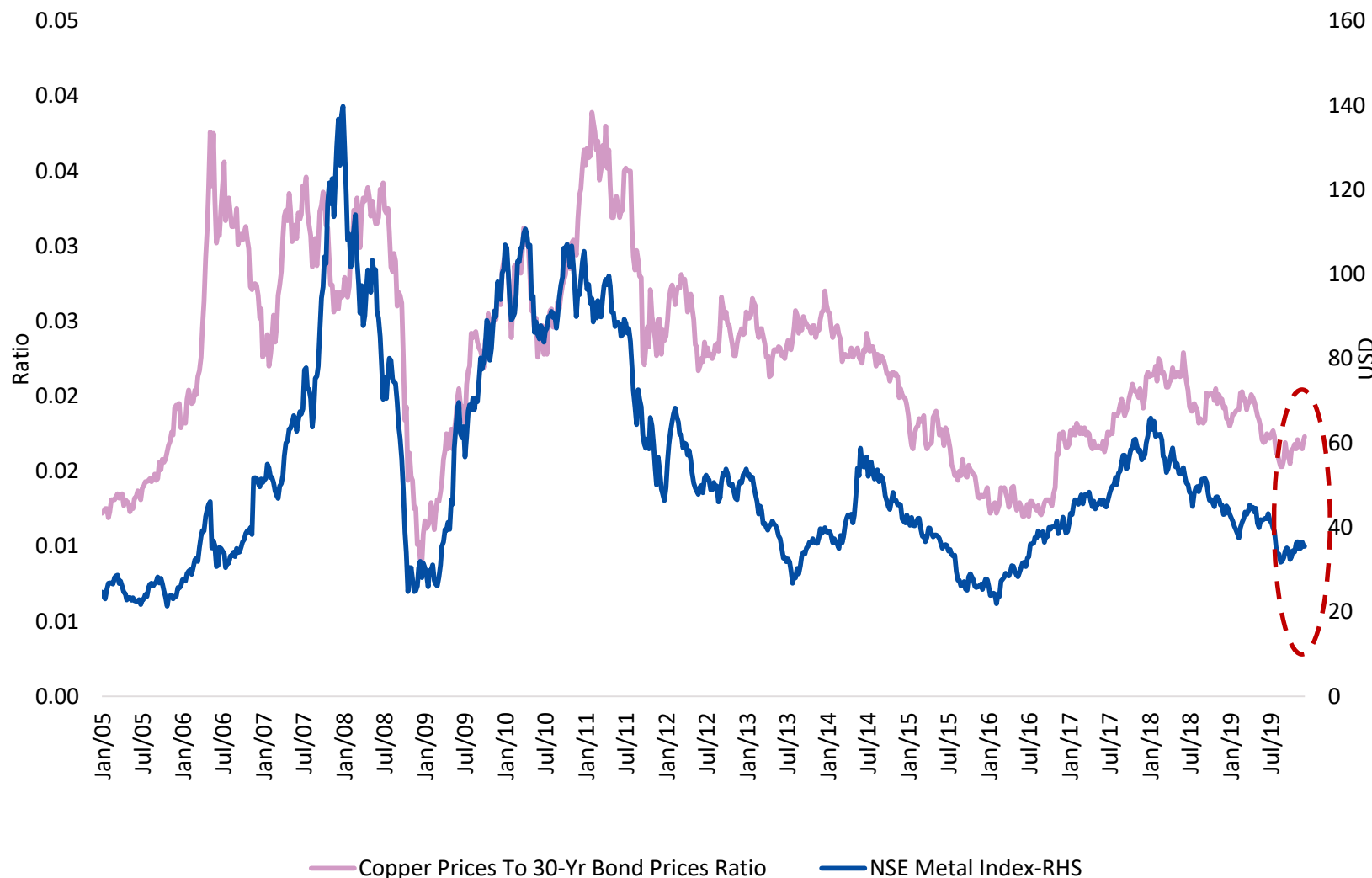
## Actionable: NSE Metal Index Will See Recovery

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- NSE metal index moves with copper to bond price ratio
- Commodity companies likely to see improved financials
- Emerging markets to outperform

# Index Gains Will Emerge From Rising Commodity Prices

### NSE Metal Index Moves Closely With Copper To Bond Prices Ratio



**NSE metal index traces close path the Copper to Bond Ratio. Our analysis suggests if copper to bond ratio goes up by 1% Y-o-Y, dollar denominated NSE Metals Index goes up 1.08%\***

*\*54% of variation in the index is explained by the ratio*

\*Source: Bloomberg, Edelweiss Professional Investor Research

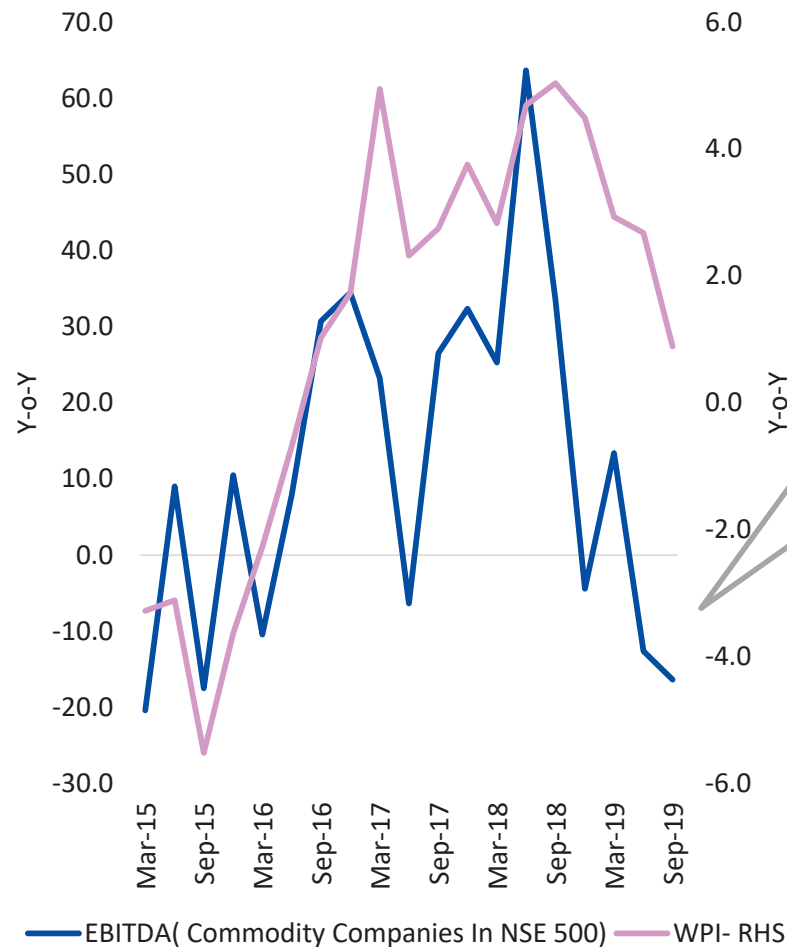


# India WPI Moves In Tandem With Commodity Prices

### WPI and Global Commodity Prices Tracks A Close Movement



### With Uptick In WPI Positive For Earnings Of Commodity Companies



Commodity reflation will provide boost to WPI which has a close impact on earnings of the commodity companies. This will mark the revival in corporate earnings.

\*Source: Bloomberg, Ace Equity, CMIE, Edelweiss Professional Investor Research

# Softer Dollar, Growth Revival, Stronger Commodities Equals EM Uptrend

## Emerging Markets Have Underperformed US Equities, This Could Change As USD Falls



\*Source: Bloomberg, Edelweiss Professional Investor Research

## In Conclusion

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- Commodity Reflation is round the corner as:
  - Dollar Will Weaken
  - Global Growth Will Revive
  - Commodities Will See A Cyclical Uptick
- This will provide the buoyancy to the emerging equity markets especially the metals, energy and industrial (MEI) sectors
- NSE Metal Index (LMP 2485) stands to gain over the next few quarters and years

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