ANDBANK RESEARCH

Global Economics & Markets

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Commodities – "4 reasons to shed weight in your portfolio".
The end of the super-cycle. Outlook and Recommended strategy

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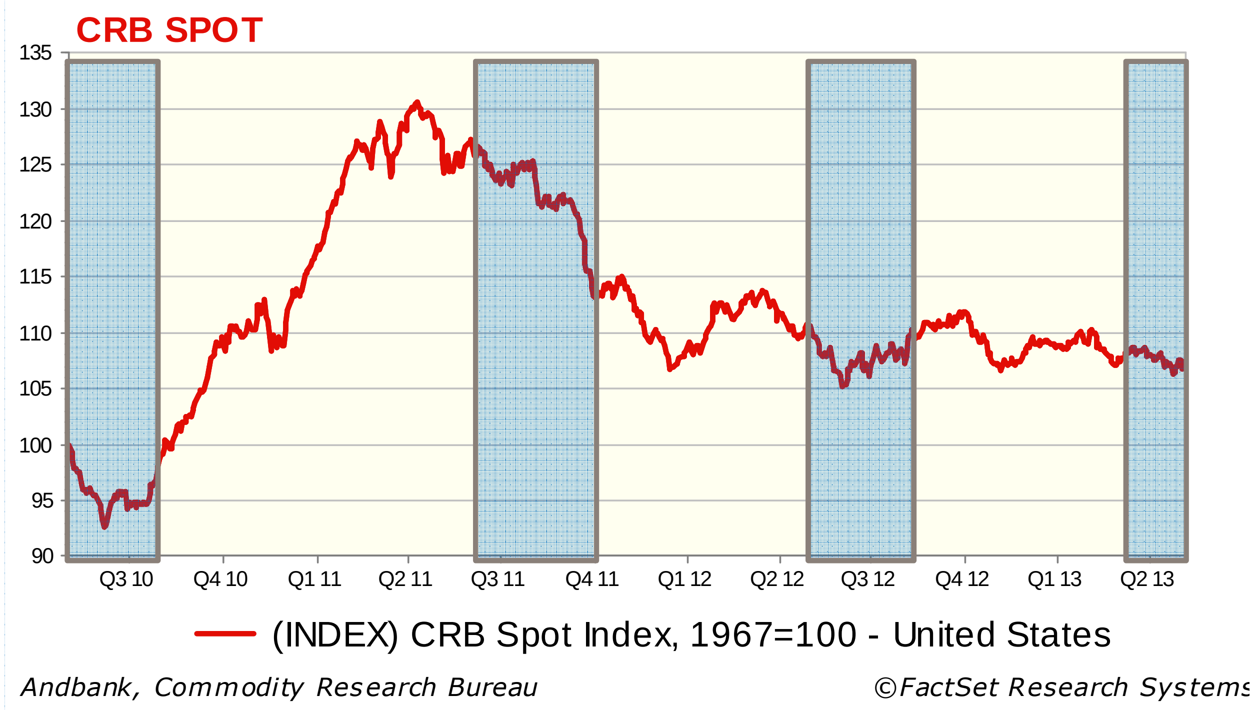
At no time in the last 200 years have commodity prices risen as fast and as high as in the last decade without a sharp decline.

While we rule out the continuity of the super cycle, we think that complexity is now much higher than any time in the past, what could cause the price of industry-related commodities to remain on a lethargic mode for a long time.

1st. During the last three years we have seen weakness in commodities during summer "soft-patches"



The run for the exits in mid-April (the largest decrease in net long positions since 2008), coincided with the release of weaker than expected Chinese data. Is this suggesting us anything else?

2nd. The primary driver of the commodities super-cycle (the construction-led heavy industrial boom) has now slowed and we suspect that this slowdown is clearly structural (not just cyclical)

- For a long time, market consensus was that Chinese growth seen in the last decade could be maintained, and with it, the industrial boom. It was on the back of this that the super cycle in commodities took place.

- However, we have argued on many occasions that, despite our positive outlook for Asia (and China in particular), the latest must "sacrifice" growth if it wants to ensure the necessary credibility of its currency and bond market. Therefore, China must not embark in Pharaonic programs of economic stimulus.

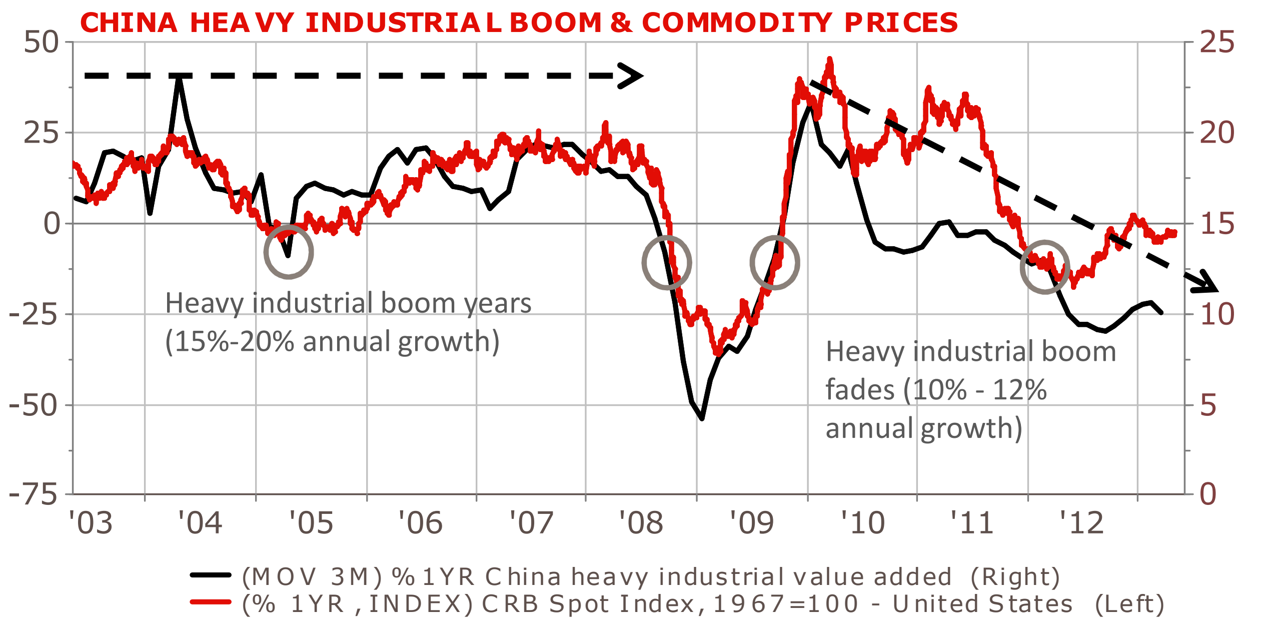
- As a result of this, we suspect the structural growth for the next decade will be lower than that seen during the past decade.

- In other words. The heavy industrial boom (and growth) has slowed in a manner that is structural and not just cyclical.

- Said this, we believe that a structural growth of 7,5% is much better than a cyclical although stronger double-digit growth.

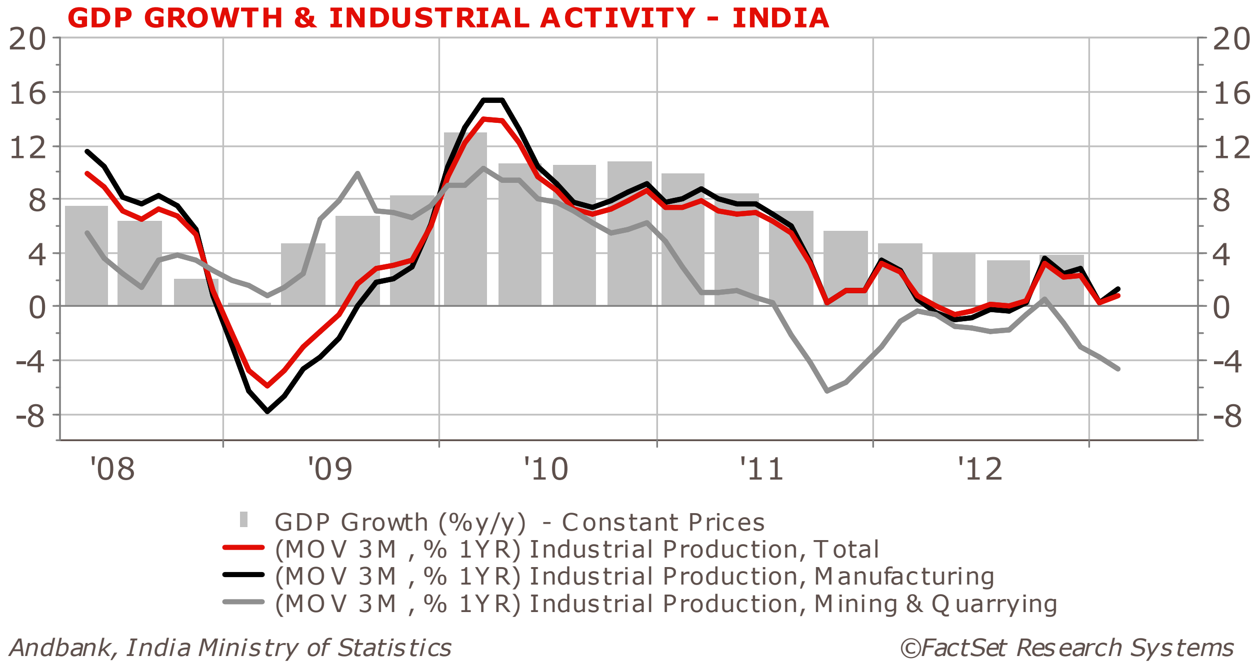
What are the implications that this structural slowdown may have on industrial commodity prices?

1. **This new "normal" will not necessarily imply big additional falls in industrial commodity prices …**
2. **… but it means that the prospects for a new structural bull market for the next few years are dim.**
3. **Chinese heavy industrial output growth looks likely to stabilize at around a level which has been associated with a zero y/y growth in commodity prices.**



Andbank, CRB, Chinese Nat Bureau of Statistics *©FactSet Research Systems*

3rd. Those who think that India will pick up China's baton as a leader in commodity consumption … seem increasingly likely to be disappointed

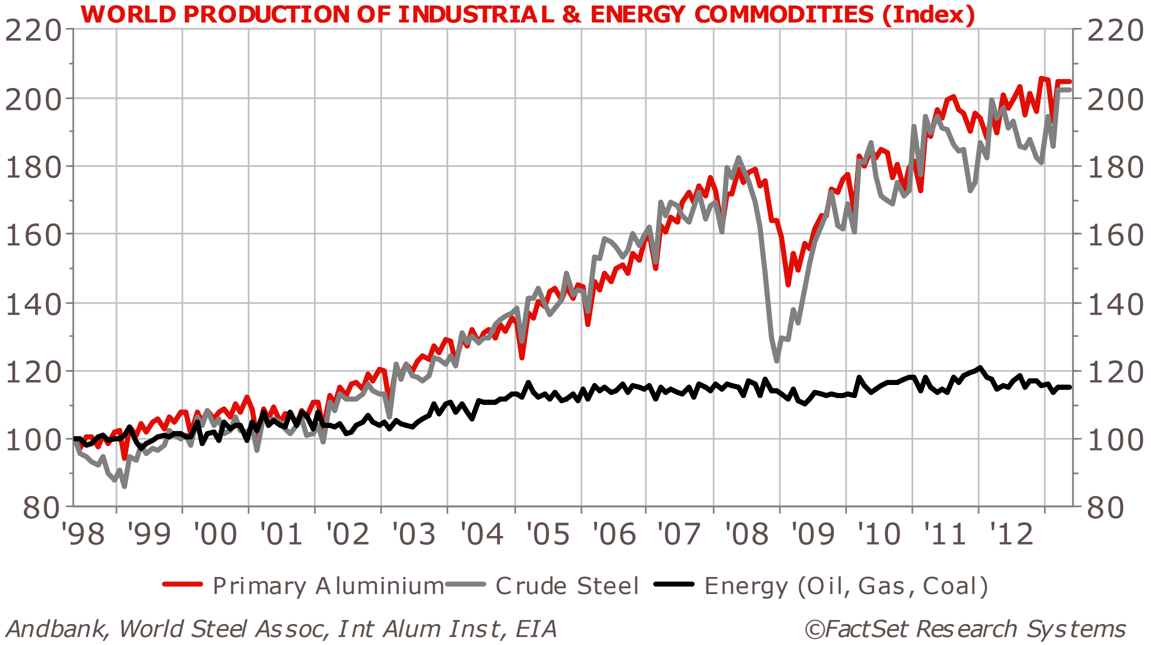


India is definitely losing steam, presence, influence and growth!

4th . Metal producers and miners have been clearly caught off guard

The pace at which some producers have expanded capacity of production for certain industrial products has led the world into a clear excess of capacity.

As those players adapt themselves to the outlook of a more "reasonable" structural growth in Asia, many projects will be cancelled, what will eventually will help to tighten the markets, although WILL NOT PREVENT THE OVERSUPPLY IN METALS & MINERALS during a long period of time (years), and this should keep prices subdued



Conclusions

1. The primary driver of the commodities super-cycle has now slowed and we suspect that this slowdown is clearly structural

2. China must “sacrifice” growth, what means that must not embark in Pharaonic programs of economic stimulus if it wants to ensure the necessary credibility of its currency and bond market. This calls into question the hitherto bright horizon for commodities

3. India is definitely losing steam, which evidences the lack of an obvious replacement of the biggest source of incremental demand for commodities.

4. Abundant capacity in industrial related commodities makes an oversupply in metals & minerals inevitable for a long period of time.

5. This new “normal” will not necessarily imply big additional falls in industrial commodity prices but it means that the prospects for a new structural bull market for the next few years are dim.

6. Therefore, we consider in our central scenario for industry related commodities, prices could remain within a range.

Instruments and ideas that suit best the environment described

Tailor made products

1. **Strangle (Recommended).**
   - Underlying asset: Basket of Aluminum & Zinc (spot price in the London Metal Exchange)
   - Combination of short & long options.
   - Maturity (2 years)
   - Coupon: 8,10% (4,05% per year), to be received at maturity.
   - Range: +/- 15% in price (whenever the price of the underlying basket remains within the range, there is no loss of capital. The coupon is always paid).
   - If the underlying asset declines or goes over 15% of the spot price set at the inception of the product, the client would loss from that level.
   - Example: At maturity the basket have increased (or decreased) 16% in value. The client receives coupon of 8,10% and loses 1% in capital. Total return is of 7,10% (3,55% per year).

For further information about the levels or customization of the idea, please contact with our trading desk in Andorra or Panamá

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