JUN 2020

the INVESTORS voice

Magazine of the Australian Investors Association - *Investors helping Investors*

SOLVING THE SHARE MARKET ENIGMA

AUSTRALIAN INVESTORS ASSOCIATION

T | 1300 555 061
www.investors.asn.au

QUALITY OUTPERFORMS
CRITICAL METALS
UNKNOWABLE FUTURE
ROBOTS & A.I.
EMERGING MARKETS

fees, memberships and advertising on Alibaba's e-commerce platforms. Core commerce also includes revenue generated from the sale of goods (i.e. first-party sales), primarily through Alibaba's New Retail initiative, Hema, as well as revenue generated from the provision of logistics services (through Cainiao) and local services (through Ele.me and Koubei).

The next most important division is cloud computing, which earned 7% of Alibaba's revenue by providing cloud solutions. The unprofitable 'digital media and entertainment' segment attracted 6% revenue from membership fees and advertising. This revenue was mainly derived from Alibaba's online video platform, Youku, and online browser, UCWeb, as well as through diverse content platforms that provide film, online ticketing, music, news, literature and gaming.

The other division is the loss-making 'innovation initiatives and others' segment, which earned 1% of revenue. Within this division are found the company's operating system, navigation technology, AI-powered voice assistants and smart speakers, and enterprise-communication software, where revenue is typically generated through software or annual fees.

With so many dominant positions across so many industries likely to ensure that these four segments generate strong growth over time, the party marking Alibaba's next birthday of note could be the most bizarre yet.

Michael Collins, Investment Specialist, Magellan Asset Management

Sources include company filings and website, Bloomberg and Hoover's, a Dun & Bradstreet Company.

---

[1] See Reuters. 'Tearful Ma bids Alibaba farewell with rock star show.' 9 September 2019. reuters.com/article/us-alibaba-jackma-idUSKCN1VU0VY

CHINA, CHINA, CHINA - AND FOR GOOD REASON

JOHN FORWOOD

As a fund manager focusing exclusively on junior resource companies, we are naturally fixated on the heightened tensions emerging between West and East. Members of the AIA would likewise be observing closely, cognisant of the daily dialogue in that conversation. At present that may be focused on service industries like tourism and education but has moved on to soft commodities barley and beef. Hard commodities seem to occupy a special place and thus far remain largely immune from political intrigue, and some are bouncing back hard and fast from early COVID19 impacts.

China drives commodities

We always hear a lot about China in the media regarding commodities and that is because they are an important driver of global demand - in fact China is the biggest game in resource town.

China is the major part of global demand for hard commodities. The world's largest importer of oil, and the world's largest consumer of many metals including iron ore and copper, China consumes approximately half of the world's metals and mining resources - more than double the proportion it consumed when we had the SARS outbreak in 2002.

China accounts for 53% of the world total steel production, which requires iron ore, manganese, coking coal plus/minus vanadium, molybdenum and other specialty metals. It simply is in every conversation about hard commodities.

Rebound

China rebounded strongly in April and that is a real theme of what we are seeing. It may be pent up demand releasing itself after lockdowns in China in February and March, but it is clearly there. For example, industrial production rose 3.9% year-on-year in April after collapsing 13.5% in the January-February period. An interesting piece of data potentially reflecting Chinese infrastructure stimulus is that China excavator sales rose 60% in April yoy while auto sales rose 4.4% yoy.

The Bank of China has pledged a yet "more powerful" monetary policy response to the virus. As a result, total financing came in at CNY3,090bn in April which translates into a 12.0% yoy growth - the strongest in nearly two years.

Anecdotally, traffic in Beijing is reported to be even busier now than it was the same time last year. That again may be partly as a result of pent up travel demand, and perhaps more people are driving than catching public transport to avoid the possibility of catching Covid.

Transport and Fuel

Looking to transport and energy, crude oil inventories in China have shrunk in recent weeks after rising to record levels in Q1. And in April China became Australia's biggest market for LNG, receiving 40 cargoes, above last April's total of 36.

So, while there is a threat of trade disputes between our two countries, this does not yet appear to have affected energy and hard commodities.

In terms of automotive sales, in April vehicle sales in China rose 4.4% yoy although passenger car sales fell 2.6%. While EV battery demand in the first quarter tumbled along with EV sales, China's announcement that the government would extend EV purchase tax exemptions for two more years until the end of 2022 should mitigate a fall-off in EV sales in China.

Also, the impact of the recent oil price collapse on EV sales in China may be muted, because China's gasoline pricing mechanism does not allow price adjustment in gasoline if the crude oil price drops below US$40/bbl. So, the Chinese consumer is not going to benefit to the same extent in terms of ICEs using fuel.

Iron Ore

Turning to bulk commodities, iron ore has really surprised on the upside with China's iron ore imports increasing sharply in April - up 19% yoy.

The price of 62% iron ore rose 8% to US$86/t in a month due to a decline in port inventory in China. Shipments from Brazil have fallen and Chinese domestic production has been sluggish. We think the demand for iron ore is due to Chinese stimulus. China is reliant on Australian iron ore imports, with Australia accounting for 63% of total imports.

Copper a barometer

With regards to demand for base metals, copper is a barometer of the global economy and we have seen China refined copper production rising 6.5% yoy in April.

In addition, local governments in China have begun offering incentives to companies purchasing base metals, in a move to avoid inventory pile ups. Meanwhile, supplies of copper concentrates from South American mines have been impacted by Covid, and TC/RC charges levied by smelters have been slashed as a result.

While in the longer term several leading forecasters are now predicting a copper surplus in 2020 (CRU, Sonami, Fitch), this is not in evidence at the moment with copper stockpiles falling in China throughout April.

Zinc and Nickel

In terms of zinc, galvanized sheet output grew 14% yoy in March and is expected to have remained strong in April, supported by the rise in construction/infrastructure activity. Meanwhile, mine supply of zinc concentrates from Peru in particular has dried up during Covid shutdowns. However, in May given that Peruvian mines have begun reopening, that could flow to reduce tightness in the market.

Nickel is another interesting barometer of industrial production. It is an essential component of stainless steel. Chinese stainless-steel output rose 9% yoy in April, increasing 180,000 tonnes to 2.22mt (SMM News). So positive news here also. Supply of nickel pig iron ores, from leading lateritic ore producer the Philippines, has been affected by Covid shut-downs but these mines are also now reopening.

Gold always important

Over the last few months, the Lowell Resources Fund has moved to over 50% of the portfolio invested in gold, and we have had some great successes in the gold sector such as ASX listed Predictive Discovery and De Grey Mining. Gold is always important to the junior resources sector, but especially today with ultra-low real interest rates.

What we are seeing with regards to demand for gold is fascinating. The gold price is in record territory particular in non-US currencies but also in USD. Seeing it at a price of US$1,700/oz is a 30% increase on where it was 12 months ago below U$1,300/oz, with credible commentators forecasting that it is going to strengthen further.

What is fascinating to us is that most of that buying has come from ETFs while the physical market, which is primarily China and India, has all but collapsed. Jewellery demand has fallen by an annualized rate of -41% compared to the average from 2009-2019, which is astounding.

Gold is almost in a battle between East and West: a struggle between very weak physical demand from the East, in China and India, versus strong investor inflows from the West – dominantly through ETF's.

By Scotia Bank's estimation, the loss in physical demand, is 5x larger than the increases in investment demand. This indicates that the traded price has disconnected from the underlying physical market.

This happens occasionally and could simply mean that the physical holders are also selling. Anecdotally, in Hong Kong and India there are some significant Covid driven cash-flow gaps of some big gold traders that need to be filled - salaries paid etc - while businesses are in shut down.

Its unknown territory

What we are seeing globally places us in unknown territory in modern times. Everyone, particularly those investing in and exposed to the junior resources space, is watching China like a hawk. It is the first country to begin coming out of virus lockdowns and investors everywhere are looking for signs as to how that is being managed and watching for any potential flare ups.

While we have seen some low prices for a number of base metals, we are seeing strong demand out of China in general where April has resulted in a really solid rebound. We will watch that closely to see how that continues.

The cure for low metal prices

In terms of metal prices, the ultimate cure for low prices is low prices themselves. Falls in the price of base metals are already flowing through to delays or cancellations in the development of new mines.

In the mid-term, as the world pulls out of the recession, we are going to see demand for metals pick up further and the supply chains will see tightness.

As a result, members of the AIA can expect stronger prices when forecast economic recovery takes hold, and in some or even many commodities and metals you can expect shortfalls and significantly higher prices.

The cyclical nature of the sector is a major reason that investing in the junior resources sector of the market requires close monitoring and a medium to long term investment horizon.

John Forwood, CIO of
Lowell Resources Funds Management

Lowell Resources Funds Management is the investment manager of the ASX-listed investment trust Lowell Resources Fund (ASX: LRT). Our website contains regular videos on content such as this and you can subscribe for regular articles and video updates www.lrfm.com.au

> **“China consumes approximately half of the world's metals and mining resources”**