LME Base Metals Outlook

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General Overview and Summary:

When we last penned our thoughts on the longer-term metals outlook at this time last year, prices were on a tear as investors were plowing money into both stocks and commodities, reasonably certain that the global recovery was gaining traction. However, the roughly year-long rally in metals -- as well as a host of other complexes -- came to an abrupt end in the second quarter of this year in the wake of the Euro crisis. Here, a relatively manageable problem having to do mainly with Greece debt spiraled out of control, leading to widespread doubts about the stability of the region's banks, and even the debt of other sovereign governments. After weeks of dawdling, the European Central Bank finally cobbled together a respectable €750 billion "stabilization fund", which the markets viewed as effective enough to stabilize the situation. Some time after that, "stress tests" were conducted on the various banks, and although the high number of passing grades raised doubts about the stringency of the tests, investors were nevertheless relieved that at least some transparency was breaking into Europe's opaque banking system.

Fast-forward to the present, and the Euro crisis now seems to be a distant memory, best typified by the fact that the crisis makes only occasional headlines. What's more, the Euro has recovered most of its earlier losses, and is now comfortably above the $1.30 mark against the dollar. The markets, for their part, have since moved on to other more pressing issues --ones that we suspect will be not be "solved" as easily. In this regard, the key issue investors will grapple with in 2011 involves the US recovery itself, and just how strong it is going to be moving forward. There are two schools of thought in this regard. One view suggests that the slowing growth pattern we have been seeing over the last few months is a precursor to another slowdown. Proponents of this school suggest that the impact of global stimulus programs has by now started to fade, and that a weak private sector will be unable to pick up the slack. The other line of thinking suggests that the slow-growth period we currently seem to be in, at least in the US, is just a normal pause in the recovery cycle, and that the fiscal and monetary backdrop remains accommodative enough to prevent the economy from slipping back into recession.

It has been interesting to watch the psychology in the commodity markets alternate between these two competing points of view. For much of June and July, investors were taking the various macro reports of an impending slowdown in stride, figuring that the abrupt decline in commodity prices that took place over April and May had, to some extent, discounted the deceleration. Moreover, investors were sensing that the global growth cycle was merely pausing after the heady advances seen earlier in the year. As a result, June and July were quite strong in the commodity markets, with prices lifting sharply off relatively oversold levels. Things change drastically in August when the macro statistics were missing their estimates by much larger margins, reviving fears that the US economy was possibly slipping back into recession. In fact, the Reuters--Jeffries CRB commodity index sold off by some 10% from it is earlier monthly peak in August, and was off some 4% on the month.

What happens to base metal prices for the balance of the year and, more importantly, going into 2011, depends largely on how one views prospects for the US recovery. For our part, we are cautiously optimistic about the growth picture going into next year, and list a number of themes on the next two pages that we believe will keep global growth on track. Should this prove to be the case, we could see metal prices trading somewhat higher next year, although some will do better than others. We discuss individual metal prospects later in this report, but first outline our reasoning as to where we see things going, starting with our main thesis, one calling for continued growth in 2011.

1) We do not expect to see a double-dip recession set in over the US economy in 2011, or in other regions for that matter. Instead, the global recovery should remain on track, although it will certainly remain sub-par, at least in the West. Recently, there were a few key macro releases that helped dispel fears of an imminent retreat back into recessionary conditions. The first item came out in late August, showing an unexpected increase in the Chinese purchasing managers' index, with the rise in the new order component reading being particularly reassuring. The report out of China was followed by a similar surprise coming out of the US, where the ISM manufacturing index rose from 55.5 in July to 56.3, a rather unexpected increase considering that six out of eight regional Fed manufacturing readings-- out earlier in the month-- all fell. That same week, we had reports out of Europe showing exports surging by the greatest amount on record during the second quarter, while European corporate spending rebounded from a two-year slump, ending eight quarters of contraction. In addition, European manufacturing gauges, although slowing lately from the very strong pace seen in the second quarter, remain in expansion mode. None of these variables suggest that we are in the midst of tipping back into a global slowdown, and with growth likely to be strong enough, particularly in Asia, we should see an underlying level of support for metals set in over the course of 2011.

2) Here in the US, we think that much of the recent slowdown is attributable to business uncertainty over existing and future US government policies having to do with health care costs, taxes, and financial regulations. This may explain why companies are sitting on more than $2 trillion of cash and not using the money to hire more workers. However, with most of these reforms either enacted or likely to be voted on fairly soon, (as will be the case with the tax cuts), we suspect this fog will lift in the months ahead. Another reason companies may be forced to step up the hiring pace may be because increases in productivity are now ending. In fact, recent readings show productivity actually trending lower, meaning that companies have to tap the labor pool in order to keep up with increasing demand. Once companies start to hire, which we expect to be by early next year, we could see market psychology improve noticeably-- more jobs will lead to more consumer spending, which, in turn, would lead to yet more hiring --and more buoyant markets.

3) No analysis of the metals market is complete without some thoughts as to what will happen in China. For much of the last several months, we have been hearing that the Chinese economy could be the next one to "pop" given the speculative excesses that have been building up in real estate and in the various dodgey loans that have been doled out. Although this scenario may yet transpire, it is unlikely in our view, and in fact, recent data out of China suggest that the economy is gaining strength, not losing it. As examples, the government just reported that August industrial production was up 13.9% from a year earlier, and was also up from July levels. Other reports show banks extending about $80.5 billion in new loans in August, up from July, while money supply also increased -- up by 19.2% from a year earlier. Urban fixed-asset investment, a good indicator of capital spending, was higher as well. We should also remember that unlike here in the West, the Chinese government is in the enviable position of having both the political ability *and* the financial muscle to correct any imbalances should they see the economy slowing down. From the metals point of view, all this means that Chinese metal demand will likely remain fairly strong for the balance of this year and into 2011.

4) Another variable that should keep metal prices supported in 2011 has to do with our belief that the Chinese will continue to steer some of their cash (some $2 trillion and counting) into commodity investments as a diversification away from the dollar. We saw China do this in late 2008 and early 2009 in what has to be considered one of the best-timed long-side trades in decades. We should also remember that propping up metal prices will be good for China's domestic metal producers as well, since the quality of their bank and inventory loans will be enhanced by higher commodity prices.

5) While metals demand remains on track for 2011 (although varying in strength from region to region) one must not forget about the supply side of the equation either. Here, despite relatively high historical prices, we are not seeing producers turn on much capacity in any of the metals, with aluminum and to some extent zinc, perhaps being the exceptions. Further upstream, things get even tighter from the concentrate point of view, evidenced by plunging treatment charges and a scarcity of material. We doubt there will be much improvement going into next year either, keeping mine production relatively restrained across a number of metal complexes.

6) As our readers will note from the accompanying charts in this report, stock levels in most metal categories have been declining this year, and given the capacity constraints on the supply side, we do not think they will be replenished much next year either. Therefore, the tight inventory situation we are expecting will provide an additional element of support for prices, certainly for those metals where stockpiles are tight.

7) Despite the “flight-to-safety” bouts occasionally exhibited towards the dollar over the past two years, there is no doubt that investors have lost some confidence in the greenback given the relish with which the US government has expanded its balance sheet. Moreover, as the recovery takes root in 2011, the weakness in the dollar should manifest itself more clearly, as investors abandon its safety and venture into riskier asset classes like commodities. Already, one of the beneficiaries of this easy money is gold, which has recently soared to record highs, taking silver along with it. We have to suspect that some other base metals may get swept along in sympathy over the course of 2011 as potential “anti-dollar” plays. Certainly, the growing number of ETFs and ETPs will make such purchases somewhat easier for investors, although we have our doubts that just by starting an ETP, supply/demand imbalances in a particular metal will necessarily be corrected.

8) Investment flows into the commodity space have been increasing for much of this year, although there has been some leveling off in the last two months. We expect this moderate inflow to continue going into 2011, thus providing an underlying bid for most metals.

Price Outlook: We have tabulated below our 2011 price forecasts for the various metals, and as we can see, trading ranges on most are expected to be higher than what has been apparent so far this year. As discussed in the individual summaries that follow, we are most bullish on copper and tin given the tight stock picture and looming deficits for both this year and next. Aluminum and zinc will be in surplus next year, and therefore should be relative laggards. Although lead will also be in surplus in 2011, its overall stock levels as a percentage of consumption is still quite low, and will not approach the ratios seen in either aluminum or zinc. As a result, we could see it surprise to the upside. We are somewhat wary about nickel prospects for next year, given the likelihood of a ramp-up at Vale’s Canadian operations and the expected entry of Goro metal into the nickel system. Whatever happens, volatility promises to remain high, and therefore, keeping a pulse on the day-to-day action will remain critical.

MF GLOBAL 2011 PRICE FORECASTS

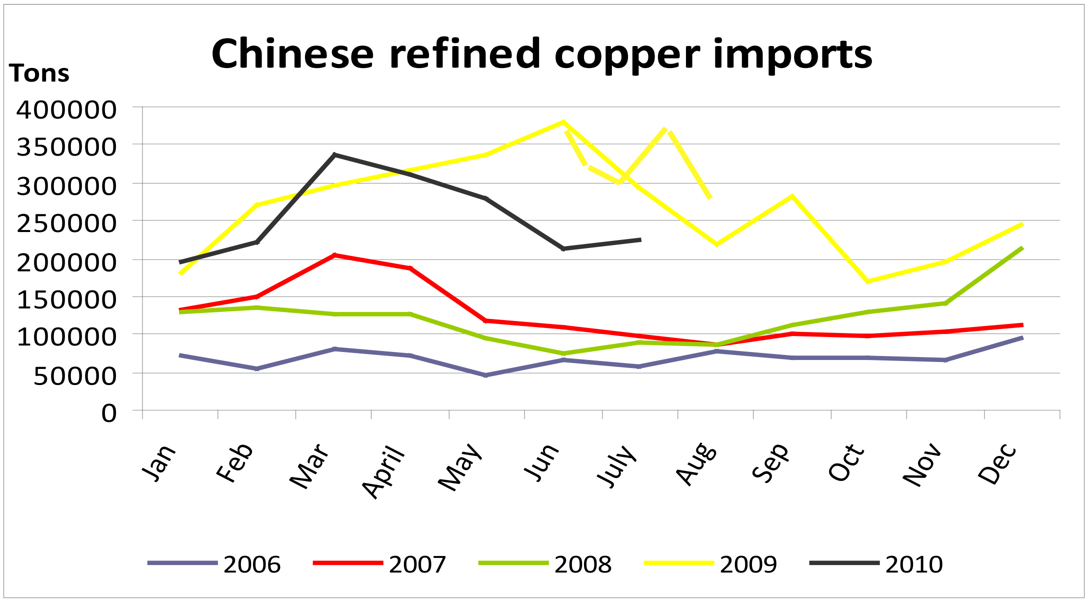
Metal		2011 High	2011 Low	Average
Copper	(page 4)	$9,000	$6,200	$7,300
Aluminum	(page 7)	$2,750	$1,850	$2,250
Zinc	(page 10)	$2,700	$1,800	$2,250
Nickel	(page 12)	$30,000	$18,000	$24,500
Lead	(page 14)	$3,000	$1,750	$2,350
Tin	(page 16)	$30,000	$19,000	$22,500

Copper: Ever since putting in a low of $6200 back in June of this year, copper prices have reversed course and are now hovering in the mid-$7000 region, not far away from their 2010 high of $8043. We attribute this resilience to the fact that copper's supply/demand balance has been tilting towards a deficit for much of this year, best evidenced by the fact that inventories continue to get worked off. Copper stocks in Shanghai, for example, are off by some 100,000 tons since March, while inventories on the LME are down some 150,000 tons since peaking at 555,000 tons in February. (See our chart below). Global exchange stocks-- comprising those on the LME, COMEX, and the Shanghai Futures Exchange-- are now just under 600,000 tons, equivalent to just 11 days of global usage.

Of course, no analysis of the copper market is complete without looking into China's copper import profile, and the most recent monthly data we have in this regard shows refined copper imports off by some 14% vs. last year. However, July and August import levels finally broke a string of four consecutive monthly declines. Moreover, the lower import trend is not as alarming as it first looks either in that last year's numbers were exaggerated by Chinese stockpiling programs. In addition, scrap imports are actually 10% *higher* year-to-date than they were at this time last year, offsetting the slight dip in imports. Finally, our leading Chinese fabricator accounts report that their demand is steady, telling us that much of the imports -- unlike last year -- are actually being used up, and are not heading into hidden government stocks or private stashes.

The general macro picture in China also supports the scenario of stronger Chinese copper demand for the balance of the year and into 2011. Although the pace of growth slowed earlier in 2010, the most recent set of macro numbers were quite strong, as we discussed in our introduction. In addition, the government's drive to push its urbanization program further into the interior of the country will go a long way in insuring that copper demand remains on track for the time being.

With respect to the global supply/demand picture, the latest ICSG report released in late September shows the world refined copper market to be in deficit by about 280,000 tons from January to June 2010 period vs. a



deficit of 125,000 tons for the same period last year. This is largely attributable to the fact that copper production fell sharply in the first half of this year, with collective output from key producers such as Rio Tinto, Freeport McMoRan, Xstrata, and BHP Billiton, down some 12% from 2009 levels. Operational difficulties, declining ore grades, and slower production ramp-ups are behind the declines, as are deferrals and project delays emanating from the 2008 economic crisis. Given the entrenched nature of these problems, we would not be surprised to see anemic growth rates for mine production next year as well, which we expect to be up only by a scant .6% year-over-year.

On the demand side, we expect consumption in 2011 to be up by 1.6%, and unlikely to repeat 2010's strong increase (up 5.2%). Despite this, prices should still be able to push higher, as production will be hard-pressed to keep up with even this sluggish rate of growth, particularly from the concentrate side. As a result, copper's inventory cushion will remain rather tight going into 2011, thus providing a constructive backdrop for further gains.

Price Outlook: Our table below outlines the supply/demand numbers for both this year and next. We expect to see a market in deficit by about 370,000 tons this year and likely by a similar amount next year. These back-to-back deficits will pull the ending stock ratios to critically low levels, particularly next year, and perhaps set up copper prices for a break above the 2008 high sometime by mid-2011. For the balance of this year, we likely have seen our lows for the year, and expect 2010 to finish trading between $6850 to $8000. Next year, the trading range should shift higher, with prices trading between $6200- $9000, assuming the generally moderate growth scenario we have outlined in our introduction stays in place.

Copper Supply/Demand Annual Balances

	2006	2007	2008	2009	Year to Date to May 2010	2010F	2011F
World Refined Usage	17,058	18,239	18,056	18,198	8,018	19,150	19,450
Yr-Over-Yr Ch	NA	6.9%	-1.0%	0.8%	3.4%	5.2%	1.6%
Mine Production	14,991	15,474	15,526	15,754	6,385	15,850	15,950
Yr-Over-Yr Ch	NA	3.22%	0.34%	1.47%	0.00%	0.61%	0.63%
Refined Production*	17,291	17,934	18,221	18,377	7,828	18,780	19,100
Yr-Over-Yr Ch	NA	3.72%	1.60%	0.86%	2.20%	2.19%	1.7%
Refined Balance	233	-305	165	179	-190	-370	-350
Total Refined Stocks	1131	1027	1161	1428	1450	1050	700
Weeks Use	3.45	2.93	3.34	4.08	9.40	2.85	1.87

*** Primary&Seconday**
Source: ICSG

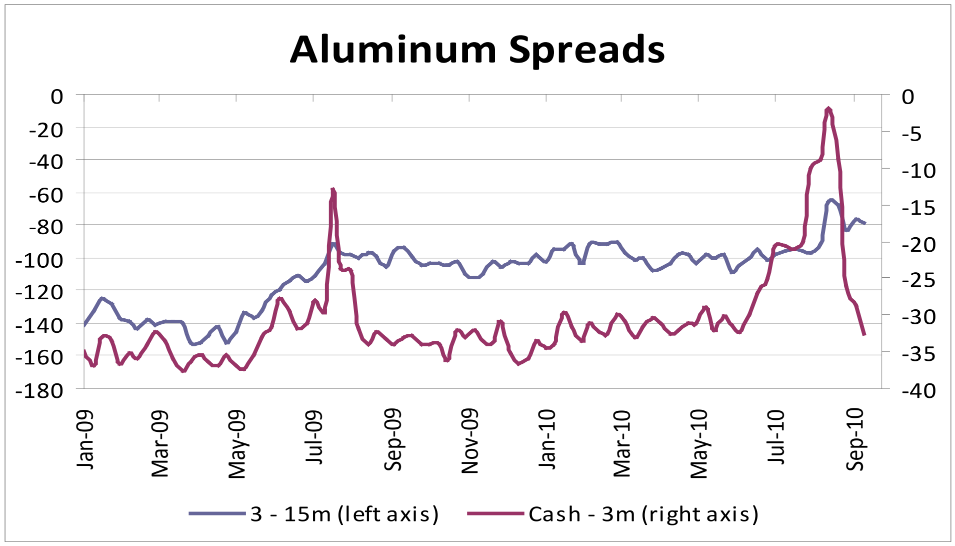
Aluminum: Aluminum has been the most unusual acting metal of the six covered in this report. Ever since collapsing to an intraday low of $1285 in late February of 2009, the market has staged an impressive turn, now trading around $2160/MT. All this has been occurring despite the fact that a whopping 4.5 million tons of metal is stored on the LME, while another 1.5 million tons is estimated to be held off-exchange.

The disconnect between relatively high aluminum prices and the inordinately high amount of LME stocks, (equivalent to about 12% of global consumption), is widely attributable to the fact that much inventory is tied up in financing deals, said to be said some 70% of the exchange's total. We suspect that some of these deals have come under pressure over the summer months after the cash-to-three's spread shriveled from about $30 contango to about flat at one point in late August, with backwardations evident within the spread. The far forwards also tightened, with the three's-to-fifteen spread coming in from -150 to -80 at the time of this writing. (See our charts on the next page).

The fact that aluminum spreads have come in should not come as a total surprise. As more institutions put metal on warrant while simultaneously selling the forwards, the more pressure there will be on the spreads to tighten. Put another way, players cannot all be the same way around, (i.e., long physical metal, short LME), and expect to continuously borrow the spreads at consistently lucrative contangos. This summer's persistence backwardation is evidence of that, as some players obviously felt confident enough squeezing certain periods. Moreover, spreads could get unhinged on their own accord at some later date, either on account of rising rates, a hike in storage fees, or aggressive producer selling in the forwards. In fact, even before the current backwardation set in, we have been seeing the quantity of metal placed on LME start to decline, perhaps telling us that financing plays -- at least for new metal -- are not as lucrative as they once were.

Just as we went to press, there was a report that UK-based ETF Securities had established an account with the LME's electronic transfer system for stock warrants, leading to talk that a physically backed aluminum ETP was to be introduced fairly shortly. There also had been prior speculation that variously placed Glencore, Deutsche

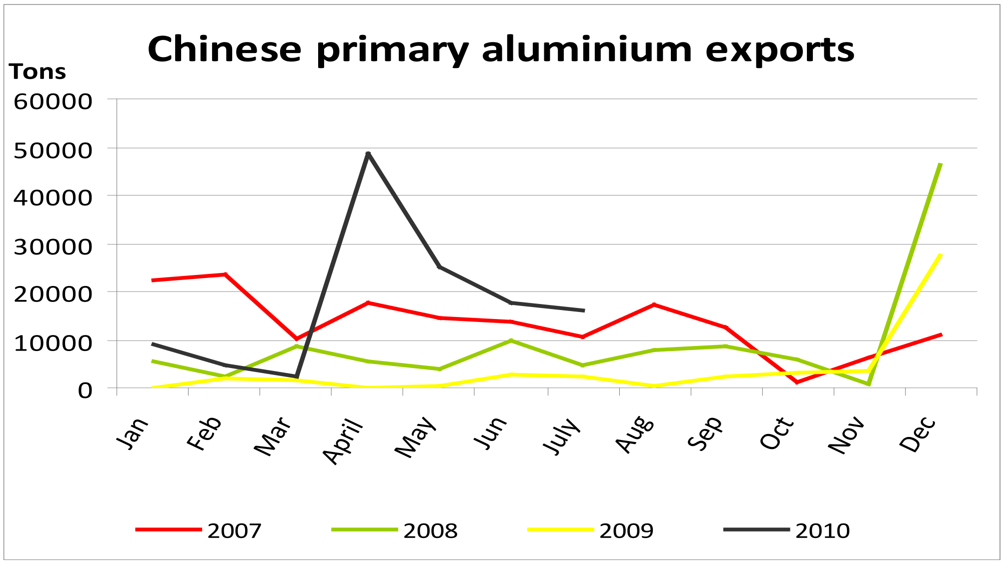
Bank, and Rusal as potential players who could form an ETP and possibly siphon off some 1 million tons of metal to support it.



Although the market has responded positively to such speculation, we are not sure this will ultimately be the panacea that the bulls portray it to be. Shifting metal around does not reduce its supply, this despite the fact that much of it has to be held aside to support an ETP. Moreover, it remains to be seen how much interest such a product could generate outside of the institutional players who likely will use it. Certainly, from an investment point of view, buying an aluminum ETP unit would entail the same risks of being exposed to an aluminum futures contract, with the key difference being that margins will not be levied. However, investors will still be subject to the vagaries of price movements, interest rates, storage charges, and the costs of rolling positions in contango markets. Of this list, the contango cost could end up being the most onerous, as investors found out when they piled into an oil ETP some years back. Furthermore, none of these ETPs have been tested in a scenario where investors are looking to get out. In sum, other than providing a convenient way for buying aluminum for those who are so inclined, while arguably providing some "cover" for institutional investors who may wish to disguise their LME purchases, an aluminum ETP will do little to address aluminum's potentially costly holding structure, or for that matter, the more important issue of aluminum production that is still outpacing demand.

Looking at supply/demand data, figures released by the International Aluminium Institute in late August shows that January-July 2010 refined production (excluding China) was running about 15% higher than the same time last year, while Chinese production was up a whopping 50% over the same time period. Granted, the comparisons are against a depressed 2009 base, but even more recent month-over-month numbers are showing only a slight moderation in production. Total primary August aluminium production in China, for example, stood at 1.388 million tons, admittedly down from the previous month, but well ahead of last year, and hardly off much from May's monthly record of 1.418 million tons. Perhaps one reason why Chinese production may be holding up (or more accurately, not decreasing as fast as it should) is because Chinese smelters are converting primary ingot into product, which still benefits from tax rebates of 13-15%. In fact, as our charts on page 9 shows, exports of aluminum products have rise sharply this year, almost doubling to 1.03 million tons in the first six months of this year vs last year, roughly the amount of primary ingot production that has estimated to have been sidelined since March.

If the Chinese authorities are serious about clamping down on production, they would remove product export incentives and boost power prices yet again, thus forcing smelters to cut back production even more than they already have. However, as long as product export incentives stay in place, smelters will likely look to overseas markets as a repository for primary units that cannot be sold domestically. This alternative is not problem-free either, as we saw recently when the US Commerce Department found that the Chinese government illegally subsidized $550 million in aluminum extrusions. Canada and Australia made similar claims earlier in the year, while the Europeans raised punitive tariffs on Chinese-made aluminum car wheels just as we went to press. Of course, while cutting aluminum production could be the most logical step forward for the Chinese, at the end of the day, the practical implications of any such cutbacks translates into lost jobs. This may be too high a price for the Chinese government to pay, which is why we suspect that many of these "suspended" operations are likely just biding their time until market conditions improve.



On the demand side of things, we suspect that 2010 aluminum demand will be up by some 8.9% over 2009 levels, but because production will still outpace it, the year should end up with another surplus, which we estimate to be around 800,000 tons. Next year looks only slightly better; supply will be up by a more modest 1.5%, while demand will increase by 2.1%, generating a surplus of some 600,000 tons.

Price Outlook: We believe that narrowing spreads and longer-lasting backwardations could be recurring themes going into 2011, and likely force *more* aluminum onto the market, thus keeping the upside somewhat in check. In addition, any forays to the $2300-$2600 level will be met by producer selling, and so prices will be hard-pressed to push beyond these levels, although we cannot necessarily rule out a brief stab to $2750 based on technicals alone. On the downside, the 1800-$1900 level should hold, as that seems to be a level where producers feel the most pain, with cutbacks usually following pretty quickly once prices get to these levels. As always, the focus will be on China, particularly on how much metal it is producing, and how much is indeed still being made and sold under different guises.

Refined Aluminum Supply/Demand Annual Balance

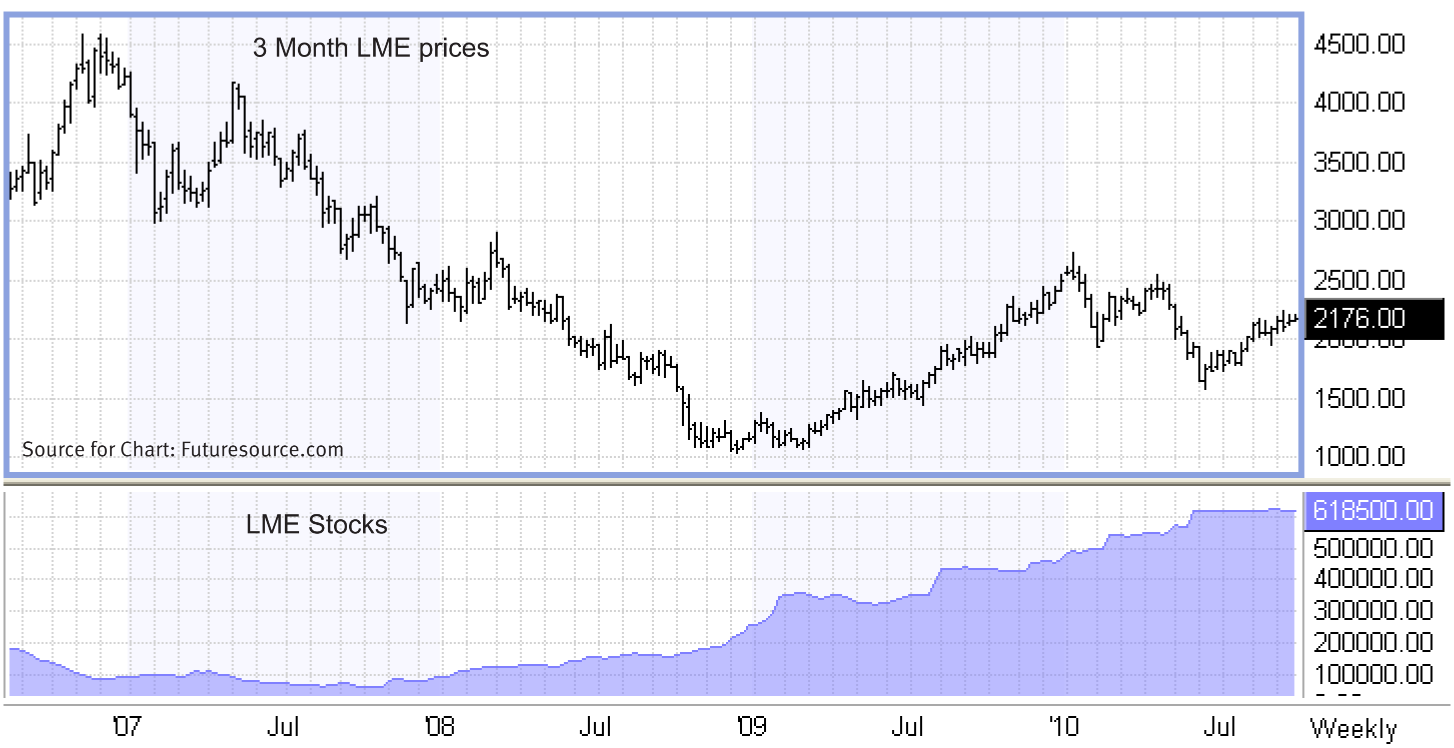
	2006	2007	2008	2009	Year-to-date to June 2010	2010F	2011F
Consumption	33,953	37,585	37,042	35,276	19,772	38,400	39,200
Yr-Over-Yr Ch	NA	10.7%	-1.4%	-4.8%	21.0%	8.9%	2.1%
Refined Production	33,975	38,137	39,686	36,410	20,284	39,200	39,800
Yr-Over-Yr Ch	NA	12.25%	4.06%	-8.25%	17.60%	7.66%	1.5%
Reported Balance	22	552	2,644	1,134	512	800	600
Total Stocks	2764	2961	4708	6485	6479	7285	7885
Of Which Held By..							
Producer/Consumers	2019	1917	2154	1562	1560	NA	NA
Exchange	744	1043	2553	4922	4919	NA	NA
Weeks Use	4.23	4.10	6.61	9.56	NA	9.87	10.46

SOURCE: WBM / F: MF GLOBAL FORECASTS

Zinc: Zinc has been among the poorer performing metals in the LME, down by some 30% since the beginning of the year, as unlike many of the other metals, its supply/demand backdrop remains quite bearish. This is best evidenced by the fact that LME stocks have continued to climb, up by almost 200,000 tons so far this year to currently stand around 623,000 tons. Similarly, Shanghai stocks have risen by some 70,000 tons from trough-to-peak over the course of 2010, and although they have retrenched sharply since peaking in early June, they now stand at 230,000 tons, practically unchanged on the year. Part of the stock build up on the LME could be attributable to financing deals, where there have been decent buildups of metal, particularly in New Orleans.

Ironically, zinc producers were among the first to institute large-scale cutbacks, even before the brunt of the crisis hit the markets in late 2008 and 2009. Since then, however, they have displayed much less restraint, with a number of operators stepping up production. Nyrstar, for example, reported a 16% sequential increase in Q1 2010 production thanks to the reactivation of its Balen smelter in Belgium, while Glencore, has reopened Iscaycruz, its largest zinc mine in Peru. In the meantime, Teck Resources said that second quarter zinc output was running 2.1% higher than a year ago, while sales from Red Dog are expected at 170,000 tons in Q3, up from the unusually depressed 70,500 tons recorded in the second quarter. More importantly, the company has secured a permit to extend mining into a new ore deposit called Aqqaluk, which should help alleviate the chronic shortage of concentrates now evident throughout the system once it comes on stream later this year.

On the supply/demand side, the International Lead and Zinc Study Group sees global production of refined zinc exceeding consumption by 176,000 tons in the first half of 2010 due to the impressive expansion in global mine output we alluded to earlier--up some 13.4% to 6.047 million tons in the January-June period. Refined zinc production is up an even stronger 17.3% over the same period versus last year. Although consumption has kept pace--up 19.9% in the January-June 2010 period vs. last year-- it has not been able to significantly make much of a dent in stockpiles, with ending stocks projected to be somewhere around 1.3 million tons by the end of 2010, equivalent to about 10.6% of world refined production. Next year hardly looking any better, with another 250,000 ton surplus expected, as refined production and consumption are projected to rise by 1.6% and 2.5%, respectively.



As with many other metals, the big question is what happens in China. On the production side, with Chinese marginal cost of production somewhere around $1600/MT, (this according to CRU), there will be little incentive for Chinese smelters to aggressively cut back on output despite announcements to the contrary. Zhuzhou, for example, said it was suspending as much as 8.8% of its capacity a few months ago, and smaller smelters also said they were cutting back, but yet, China's August refined production was up by almost 7% from July levels and is up by 24% year-to-date. We could see this production trajectory finally head lower over the balance of the year and into 2011 given the squeeze on margins. In this regard, CRU estimates that one out of six Chinese listed zinc companies have seen their operating costs increase by more than 50% this year on account of rising concentrate, power, and labor costs. However, with production still running at a healthy clip over last year (up 24% through August as mentioned earlier), while output of mined zinc is up more than the 50% over the same period, the cuts in output-- if they have indeed started-- have yet to show up in the numbers. Along with almost 180,000 tons of refined zinc and 1.7 million tons of scrap/concentrates imported into the country (year-to-date through July), we suspect that China has more zinc than it needs, evidenced by the fact that the country is now exporting a modest amount of refined metal --some 34,000 tons year-to-date through July.

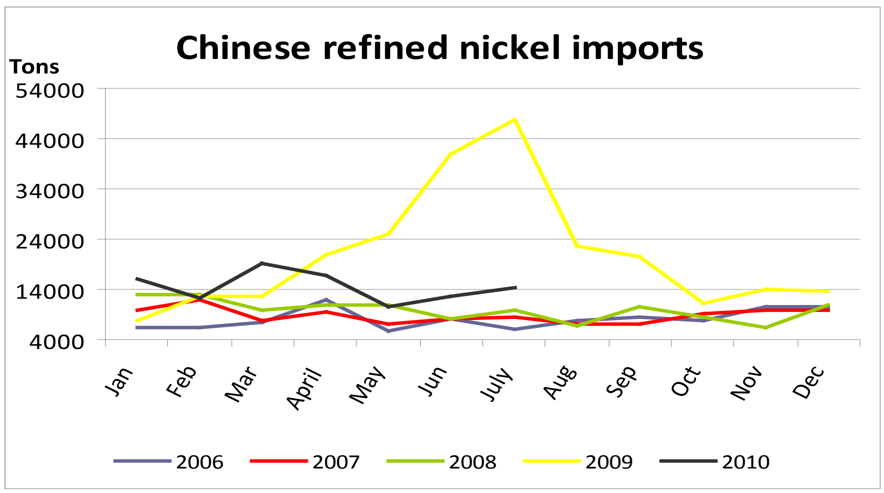
Price Outlook: The Chinese zinc profile suggests that production is still excessive, and needs to be rolled back. Until that happens, we do not expect prices to move dramatically higher. For the balance of this year, we expect prices to range between $1800-$2350. The trading range could shift next year if there is a meaningful decline in Chinese production, but we suspect that this may not happen to the degree that is necessary. At this point, we see prices trading between $1800-$2700 in 2011, with the highs well below the peaks seen in 2006-2007. Moreover, the back-to-back surpluses that will be with us both this year and next will likely mean that zinc will remain a relative laggard in the LME complex.

Refined Zinc Supply/Demand Annual Balance

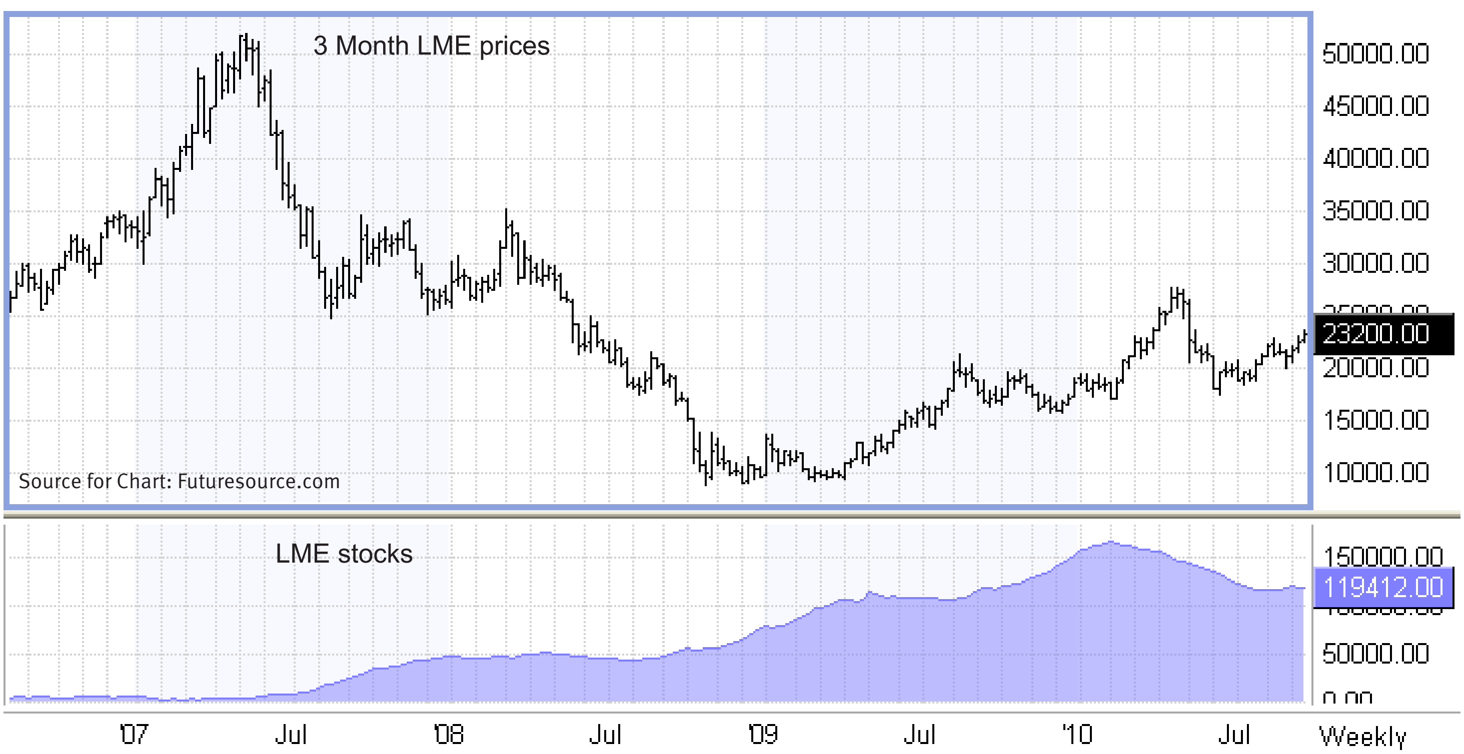
	2006	2007	2008	2009	Year-to-date to June 2010	2010F	2011F
Consumption	10,936	11,320	11,558	11,262	6,065	11,800	12,100
Yr-Over-Yr Ch		3.5%	2.1%	-2.6%	19.9%	4.8%	2.5%
Mine Production	10,447	11,119	11,654	11,345	6,047	11,900	12,100
Yr-Over-Yr Ch		6.43%	4.81%	-2.65%	13.40%	4.89%	1.7%
Refined Production	10,686	11,419	11,726	11,472	6,241	12,150	12,350
Yr-Over-Yr Ch		6.86%	2.69%	-2.17%	17.30%	5.91%	1.65%
Apparent Balance		99	168	210	NA	350	250
Total Stocks	489	549	738	1007	1258	1,300	1,500
Of Which Held By..							
Producers	254	271	280	231	227	NA	NA
Merchants	15.6	16.5	16.6	15.3	15.2	NA	NA
Consumers	128	118	125	99	98.3	NA	NA
Exchange	90	143	316	661	862	NA	NA
Weeks Use	15.30	8.50	7.50	7.50	7.50	5.73	6.45

Source: WBM/ILZSG
F: MF Global Forecasts

Nickel: Nickel prices had a spectacular run until the beginning of May, and for a while, the complex was among the year's best-performing commodity. However, prices are off by about 20% since then, as doubts emerged about whether the sharp ramp up in stainless production has gotten ahead of itself. To illustrate the point, world stainless steel production rose 43% in the first half of this year to some 15.6 million tons, and will likely end 2010 with an increase of around 20%-25%, one of the biggest annual rises in decades. This heady pace will unlikely repeat itself next year, and in fact, stainless demand already is already flagging, expected to be down 11% this quarter vs. the last. Despite this retrenchment, there is excess stainless metal being shopped around. Asian stainless producers, for example, sold Chinese-origin CR 304-series material at below US$3,000/ton CIF Europe in early August, undercutting European offers, which were relatively uncompetitive at US$3,700/ton. Not surprisingly, with Asian producers well stocked, there has been a corresponding outflow of nickel units from China. Antaike estimates that nickel exports out of bonded warehouses could reach 60,000 tons this year. Chinese trade data supports this view, with refined nickel exports now at 34,500 tons through July, about four times higher than they were during the same time last year. Refined nickel imports on the other hand, stood at 102,000 tons through July, down 40% from a year ago. (See our chart alongside).



Nickel is also coming under assault from cheaper pig iron, just as it did in 2006-2007. Antaike expects China's nickel production from NPI to rise to about 150,000 tons this year, higher than 100,000 tons estimate the group made earlier in the year. Through the first half of 2010, China produced 82,000 tons of PI, so the 150,000-ton estimate looks



feasible. However, a rise in raw material costs (particularly power) as well as ongoing pressure by the government to phase smaller operations, will likely lead to a production retrenchment in NPI as we close out 2010.

Looking ahead, there is more nickel supply coming onto the market. In July, Vale announced that it had reached a tentative agreement with its striking Sudbury and Port Colborne workers, leaving only the company's Voisey's Bay operation still on strike. Assuming the latter eventually settles as well, the upside production potential could be significant. Production in Q2 of 2009, for example, the last quarter of full output prior to the strikes, was just under 15,000 tons at Sudbury and 16,000 tons at Voisey's Bay, meaning that production could conceivably get to about 120,000 tons on an annualized basis. Vale is now producing well below this figure, with production around 3,400 MT/quarter for Sudbury and 4,800 tons per quarter for Voisey's Bay, equivalent to annualized production of roughly 32,000. However, if and when all the strikes are completely settled, Vale will have to think carefully about how much and how quickly it intends to ramp up production, as it single-handedly could turn the market lower if it is not too careful.

After several stumbles, including production issues with high-pressure acid-leach (HPAL) technology used to treat laterite nickel ore, Vale's Goro operation in New Caledonia could also get up and running later this year or early in 2011. Once fully started up, the new operation could add almost 60,000 tons of metal to the market. There are a host of other smaller startups coming on stream, with new output expected from Talvivaara in Finland, Jinchuan Group Munali mine in Zambia, and Western Areas NL's Forrestania project in Australia. Despite this, the sharp uptick seen in stainless demand from earlier in the year will likely force the market into a slight deficit for 2010 of some 12,000 tons. Next year looks more bearish, as with the expected fresh production and restarts, the nickel market could be saddled with a surplus, which we estimate to be around 10,000 tons.

Price Outlook: For the balance of this year, we see nickel prices trading between $20,000-$27,000, and although the trading range could shift slightly higher next year, it is unlikely prices will get anywhere near to where they got to in 2006/2007. Specifically, funds and technical buying could conceivably take nickel prices up to about $30,000 next year, but given all the fresh production that is expected to come our way, a downside retreat to $18,000 cannot be ruled out.

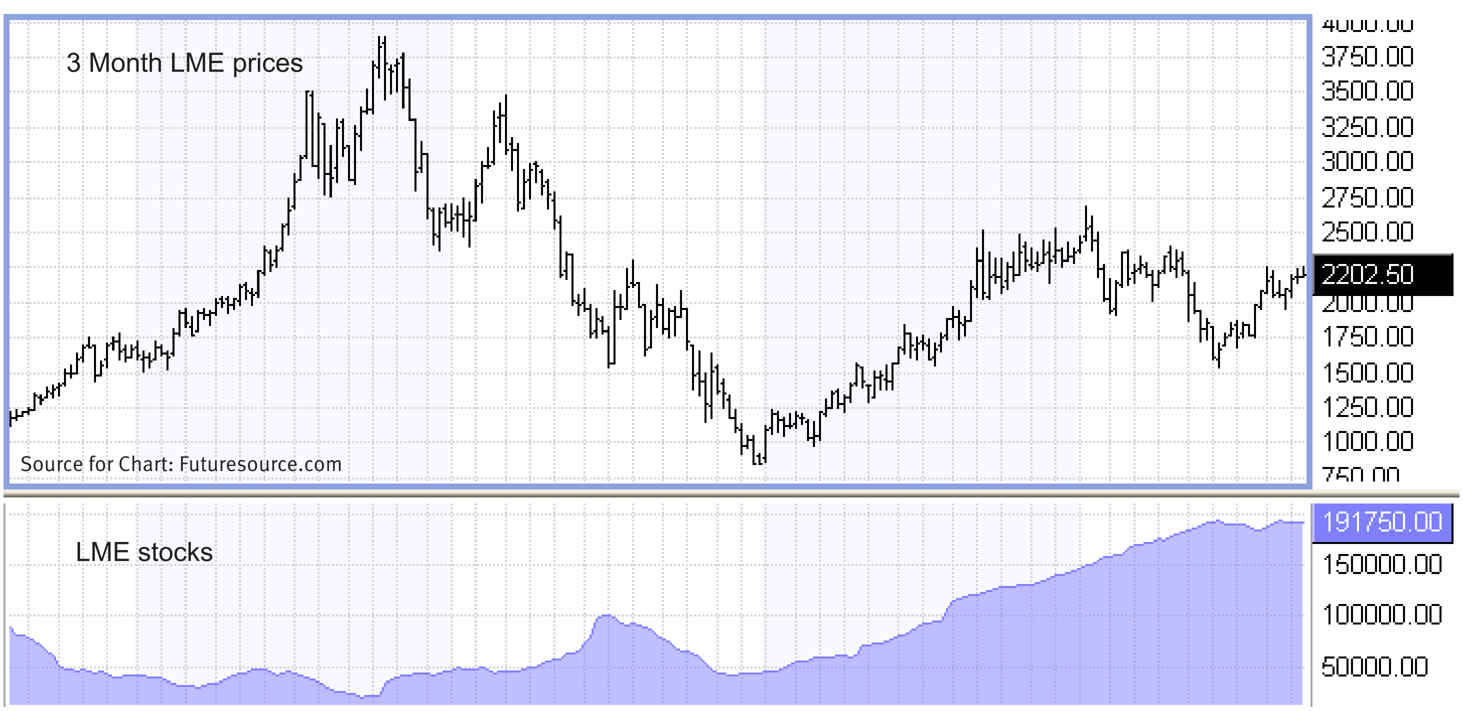
	2006	2007	2008	2009	Year to Date to June 2010	2010F	2011F
Consumption	1,365	1,355	1,294	1,305	725	1,412	1,455
Yr-Over-Yr Ch		-0.7%	-4.5%	0.9%	15.0%	8.2%	3.0%
Mine Production	1,445	1,567	1,491	1,348	661	1,320	1,420
Yr-Over-Yr Ch	NA	8.44%	-4.85%	-9.59%	-3.00%	-2.08%	7.58%
Refined Production	1,336	1,446	1,353	1,326	706	1,400	1,465
Yr-Over-Yr Ch	NA	8.23%	-6.43%	-2.00%	8.00%	5.6%	4.6%
Apparent Balance	-29	91	59	21	-19	-12	10
Total Stocks	87	125	155	164	130	155	165
Of Which Held By..							
Merchants/Consumers	80	77	77	6	6	NA	NA
Exchange	6.6	48	78	158	124*	NA	NA
Weeks Use	3.31	4.80	6.23	6.53	NA	5.71	5.90

*** Through July**
Source: WBM / F: MF Global Forecasts

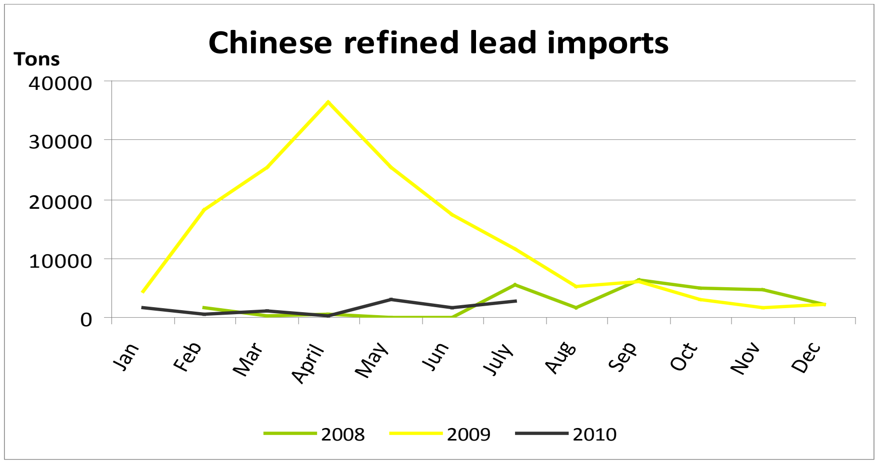
Lead: Lead has struggled this year, down some 22% year-to-date, but things were much worse earlier in the year, when prices were off by some 44% at one point. Similar to zinc, lead has been dogged by excess production, preventing stocks from declining. LME lead stocks are now at 192,000 tons, up some 31% since the start of the year, and at their highest level since 2002. Although there has been a decline since April, the existing overhang is still large enough to impede any substantial rallies from taking place. Furthermore, in a sign of how depressed the market has been for example, there hardly has been an uptick in seasonal demand for lead despite this summer being the hottest on record in many parts of the globe. Here in the US for example, July replacement battery shipments rose only by 4.44% for the first seven months of this year compared to last year, while July shipments actually fell compared to June. Another drag on the market comes from the fact that Chinese refined lead imports have been very soft, running at about 90% less than year-ago levels. (See our chart on the next page). Moreover, the substantially larger concentrate and scrap import category is running at about 20% off last year's pace. One explanation behind this softening may have to do with the fact that Chinese automobile demand has slowed sharply in recent months due to the end of tax rebates and intense competition. While Chinese imports are off, we are not seeing any resurgence in lead exports either, perhaps because the government announced the cancellation of VAT rebates on a host of semi-finished products in mid-July.

On the supply side, the latest report from the International Lead and Zinc Study Group shows global lead mine production rising to 1.98 million tons in the first six months of 2010; this is up 12.1% from the same period last year, and has been driven higher by increased production from Australia, China, and Mexico. Output is well ahead of consumption, which was up only a meager 1.7% in the January to June period.

Despite the overall surplus, stocks as a percentage of consumption still remains fairly low, substantially less than aluminum or zinc, and on par with copper. In addition, growing environmental concerns about lead production will likely make it increasingly difficult for companies to extract and treat concentrate, resulting in closures of more marginal operations, particularly in China. This eventually should have a constructive impact on the supply/demand balance, as lead becomes increasingly more problematic to produce.



With regard to supply/demand estimates, we expect to see an 80,000-ton surplus in 2010, followed by a smaller 50,000 ton surplus next year. Despite these increases, we note from our table below that the ending stock ratio for both this year and next will be around three weeks, which as mentioned earlier, is fairly low. However, the sharp falloff in Chinese import demand seems to have offset concerns about inventories, perhaps explaining why we have seen such a restrained tone in lead prices for much of this year. Should the Chinese get back into the market in 2011, prices could surprise to the upside given the low-level of ending stocks.



For the balance of this year, we see prices fluctuating between $2000 -$2400, but next year, we see a somewhat higher trading range of between $1750-$3000.

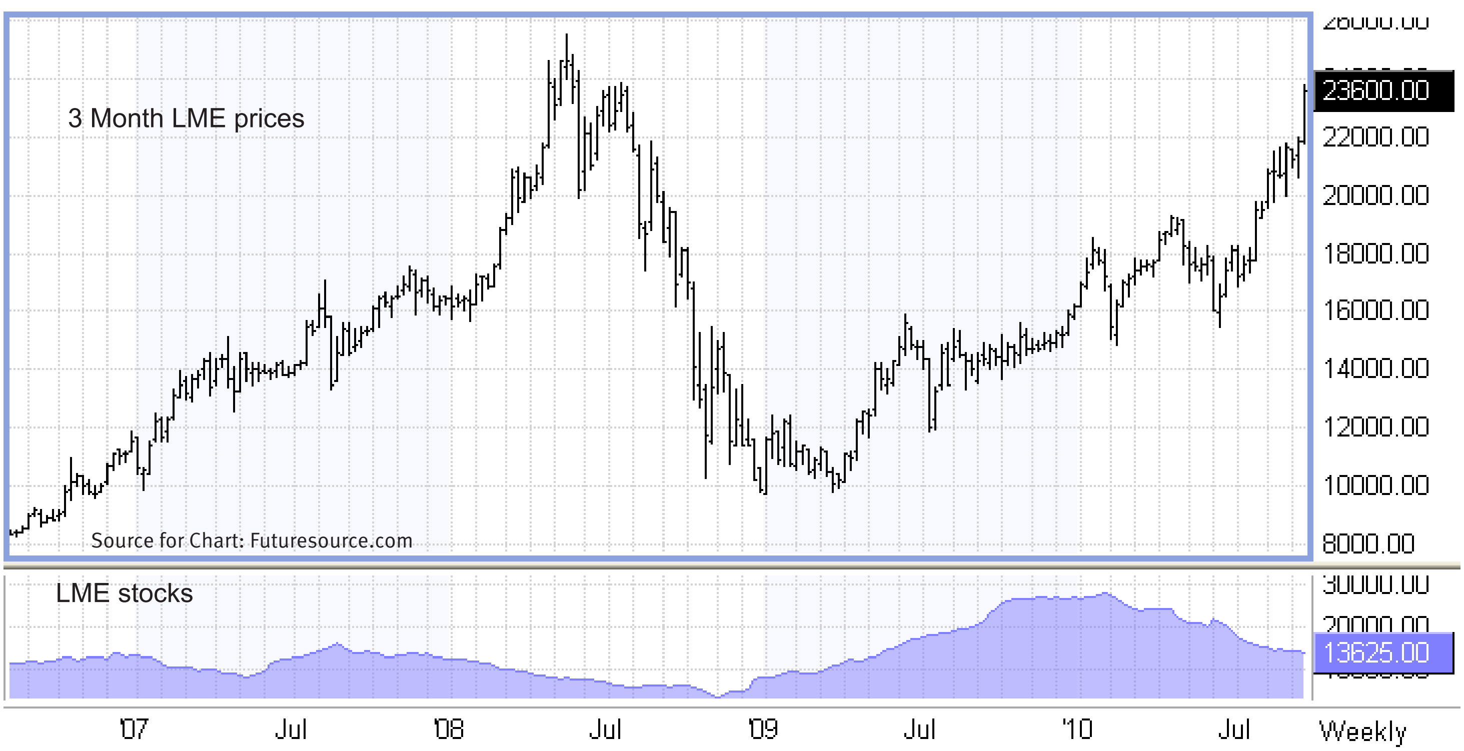
Refined Lead Supply/Demand Balances

	2006	2007	2008	2009	Year-to-date to June 2010	2010F	2011F
Consumption	8,063	8,177	8,648	8,625	4,235	8,520	8,650
Yr-Over-Yr Ch	NA	1.4%	5.8%	-0.3%	1.7%	-1.2%	1.5%
Refined Production	7,935	8,121	8,653	8,722	4,285	8,600	8,700
Yr-Over-Yr Ch	NA	2.34%	6.55%	0.80%	0.70%	-1.40%	1.16%
Reported Balance	NA	-56	5	97	50	80	50
Total Stocks	280	257	293	388	432	468	518
Of Which Held By..							
Producers	108	97	114	107	123	NA	NA
Merchants	0.9	0.8	1.3	0.8	0.8	NA	NA
Consumers	130.4	114.5	132.4	137.1	124.2	NA	NA
Exchange	41.1	45.4	45.2	144.1	184	NA	NA
Weeks Use	1.81	1.63	1.76	2.34	5.25	2.86	3.11

Source: WBM/ILZSG /F: MF Global Forecasts

Tin - Usually ignored by packagers of commodity indices and frequently overlooked by most of the funds, tin seems to have had the last laugh in the metals space, particularly after posting a stellar run so far this year. Three-month LME prices are now hovering around $23,000 a ton -- a three-year high. We think the fact that there are only a handful of major producers has a lot to do with tin's overall resilience in that supply shortages are not easily remediable. To illustrate the point, we note that of the roughly 325,000 tons of tin produced globally, 270,000 tons, (or some 83%), is produced in only four countries: China (134,000 tons), Indonesia (60,000 tons), Peru (36,000 tons), and Malaysia (35,000 tons). Of this group, China exported practically all its output during the 1980s and early 1990s, but now largely consumes whatever it produces, and in fact, had to top up its needs further this year by importing an additional 10,000 tons of metal over the first six months. Malaysia has depleted much of its tin concentrate base some time ago, and depends on imported feedstock from the rest of Southeast Asia to toll metal. This largely leaves Peru and Indonesia (and to a lesser extent Bolivia) as the sole "vertically integrated" producers in that they have their own concentrates and refined metal, most of which they export.

Concentrating so much export capacity within a handful of countries has led to numerous supply problems over the years. This year's supply bottleneck has come from Indonesia, where exports of refined tin dropped 14.5% in the first half of the year compared to the same period in 2009, and may be off close to 20% for the year as a whole. The first-half drop was attributable to heavy rains that hampered production and a broader trend of more easily-mined reserves having largely been depleted. More importantly, there has been an effective crackdown on illegal mining by the government, with the authorities acting on complaints from larger smelters that independents are siphoning off concentrates, while not paying taxes or adhering to the environmental regulations. As a result, many small and medium-sized smelters have reduced output or shut down entirely. (The latest closure was at the PT Donna Kembara Jaya smelter, which shut last month, removing about 5% cent of Indonesia's output from the market). PT Timah itself produced 19,500 tons of refined tin in January-June period this year, up a scant .63% from the same period last year. For the year as a whole, output will be in the range of 45,000-50,000 tons, down from a previous May forecast of 50,000 tons. An increase in offshore mining helped keep the decline somewhat in check, as output from this venue rose 28% to just over 9,000 tons vs. the same period last year.



Peru has been hard-pressed to make up for Indonesia's shortfall, as its production has been fairly steady, holding at roughly 40,000 tons per year for much of the last few years. Other than that, there are hardly any sources of new supply; only two greenfield mines are on the short-term horizon, one in Argentina and the other in Kazakhstan, but neither one approaches the production profile of the other existing major producers.

Unlike the constrained supply base, tin demand is scattered across a diverse consumer base and geographies, and this makes the market even more sensitive to large prices swings. The World Bureau of Metal Statistics estimates that total tin demand jumped 20% in the first four months of this year compared with the same period of 2009, while the International Tin Research Institute (ITRI) is even more upbeat, saying that global solder shipments in the first quarter of 2010 will be 50% cent higher than the artificially depressed first quarter of 2009. For 2010 as a whole, which provides a more balanced picture, ITRI expects demand to be up by some 13%, while production is forecast to remain basically flat.

Given this backdrop, it will come as no surprise that tin will be in deficit this year, estimated to be in the order of some 15,000 tons. In fact, we are already seeing signs of a tighter supply/demand balance in the LME stock picture (See our chart). Inventories at LME warehouses are down 45% this year to 15,000 tons, the lowest level since June 2009 and equal to about 16 days of global consumption.

Price Outlook: Looking further out, MF Global sees tin prices heading to the $24,000-$25,000 range by year-end, assuming there are no unexpected export surges coming out from either Peru or Indonesia. On the downside, we think tin will be hard pressed to break below $20,000. Tin's trading range could shift higher in 2011, where we project another 8,000-ton supply/demand deficit materializing, particularly if supply continues to be as unresponsive as it has been this year. Consequently, we see a $19,000-$30,000 trading range for next year, and if anything, the bias should favor prices breaking out above this range.

Global Tin Supply/Demand Balance (in 000 MT)

	2008	2009	2010F	2011**
('000 tons)				
Production	325.7	323.2	325.5	332
DLA Sales	3.9	0	0	
Consumption	341.6	300.4	340	345
Market Balance	-12.1	22.9	-14.5	-13
Reported stocks	32.5	46.2	34	21
Stock Ratio (weeks/con)	4.9	8	5.2	3.1

F - ITRI forecast
**** MF Global forecast**