

10 September 2010

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MF Global Sector Note

Underlying Commodity Research

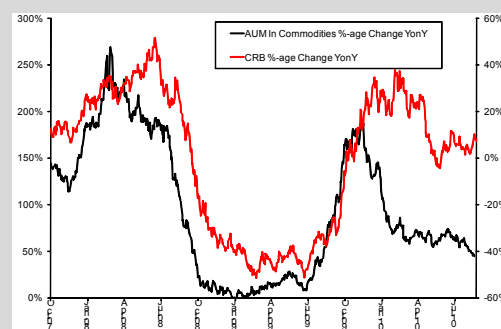
# FUND FLOWS TAKE-AWAY

BASIC INDUSTRIES

## Mining

- » **Commodity prices have good momentum.** But both our commodity traders as well as our analysts believe that uncertainty surrounding seasonality and certain fundamentals could provide pitfalls. **Eventually**, both **we** analysts and the commodity traders see good upside once the seasonally more challenging September and October are out of the way. The question is whether we will see another adjustment in the meantime?
- » **What the commodity traders think.** The commodity traders like the price momentum and think that eventually the money will come flowing back into the sector. That said, the volumes remain low, while CTAs are the main driver of the latest upward move. **Low volumes remain a concern, especially as the fundamentals are seen as no more than neutral so far;**
- » **What the analysts think.** We are much more cautious at least in the **short-term**. Fundamentals, such as the ISM and Chinese money supply remain unconvincing. Seasonality is most accentuated in September and October. **That said, if we do get through the next two months without any accidents or resistance levels are broken, then we too would become much more positive;** and
- » **It will be interesting to see whether new highs can be broken?** Seasonality might soon prove to be in the sector's favour, but normally September is a very challenging month. It is for this reason that we still have a more Neutral position on the sector with two **BUYs** (**AngloAmerican**, TP 3,300p and **BHP Billiton**, TP 2,300p) and two **SELLs** (**Vedanta**, TP U/R (from 2,200p) and **Antofagasta**, TP 800p).

FUND FLOWS VS THE CRB INDEX



Source: MF Global UK Limited

For the analyst certification and other important regulatory disclosures, please refer to the Regulatory Disclosures Section, located at the end of this report.

# Fund Flows vs. The Miners – Price Momentum Looks Good, BUT Fundamentals & Fund Flows Remain Unconvincing

Our commodity traders like the momentum, but uncertainty remains around sovereign debt, seasonality and low volumes. The analysts remain more cautious for now given challenging fundamentals, but would become more positive if we can get through this seasonally weaker period!

CHART NO. 1 | CHINESE MONEY SUPPLY VS. THE SECTOR – FUNDAMENTALS REMAIN CHALLENGING

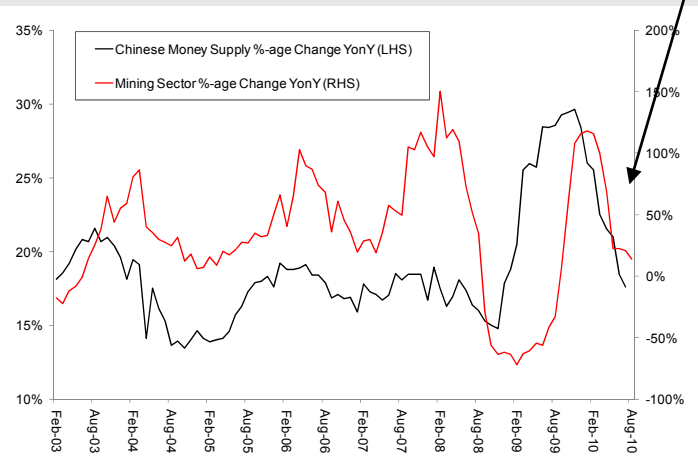
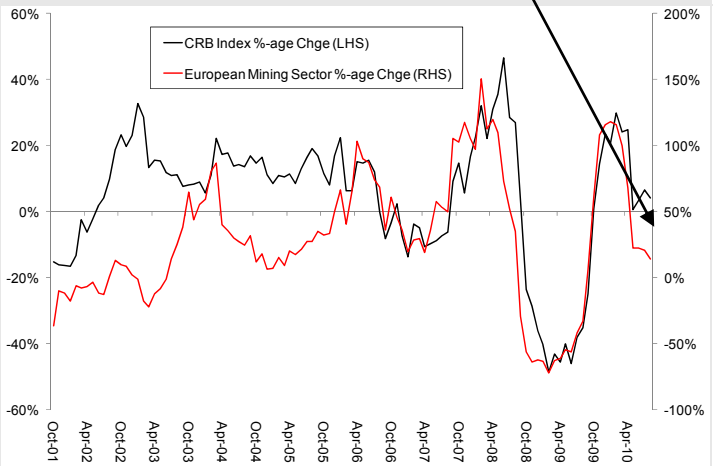


CHART NO. 2 | THE CRB INDEX VS THE MINERS



Source: MF Global UK Limited, CFTC & BLB

TABLE NO. 1 | PICK YOUR COMMODITY EXPOSURE ACCORDING TO FUND FLOWS – BREAKING OUT OR FALLING BACK AGAIN?

Approx % Sales	Ticker	Recommendation	Target Price	Current Price	Aluminium	Copper/Niob	Nickel	Zinc	Iron Ore	Manganese	Ferrocrome	Coal	Petroleum	Uranium	Gold	Platinum/Pd	Diamonds	Industrial Minerals	Other	Spot traded exposure
Anglo American	AAL LN	BUY	£33.00	£25.37	0%	12%	3%	2%	23%	0%	0%	25%	0%	0%	0%	19%	6%	9%	0%	60%
Antofagasta	ANTO LN	SELL	£8.00	£11.20	0%	92%	0%	0%	0%	0%	0%	0%	0%	0%	1%	0%	0%	0%	8%	92%
Aquarius Platinum	AQP LN	NEUTRAL	£4.30	£3.13	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	100%	0%	0%	0%	100%
Boliden	BOL SS	N/R	NA	95.50 kr	0%	30%	2%	60%	0%	0%	0%	0%	0%	0%	2%	0%	0%	0%	6%	94%
BHP Billiton	BLT LN	BUY	£23.00	£19.26	6%	18%	5%	2%	20%	4%	2%	21%	18%	1%	0%	0%	2%	1%	0%	69%
Eramet	ERA FP	NEUTRAL	€270	€214	0%	0%	25%	0%	0%	48%	0%	0%	0%	0%	0%	0%	0%	0%	27%	25%
Lonmin	LMI LN	NEUTRAL	£17.00	£16.50	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	100%	0%	0%	0%	100%
Norsk Hydro	NHY NO	N/R	NA	kr 33.07	92%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	8%	92%
Rio Tinto	RIO LN	NEUTRAL	£34.00	£35.40	35%	14%	0%	0%	28%	0%	0%	15%	0%	1%	1%	0%	1%	5%	0%	72%
Vale	VALE US	N/R	NA	\$27.75	8%	5%	21%	0%	51%	1%	1%	2%	0%	0%	1%	0%	1%	0%	8%	63%
Vedanta	VED LN	SELL	U/R	£20.38	9%	55%	0%	22%	11%	0%	0%	0%	0%	0%	0%	0%	0%	0%	4%	92%
Xstrata	XTA LN	NEUTRAL	£9.50	£11.39	0%	34%	8%	12%	0%	0%	5%	40%	0%	0%	0%	1%	0%	0%	1%	75%

Source: MF Global UK Limited estimates & Company data

## FUND FLOWS – Creeping Up But Lacking Conviction

### What The Traders Say

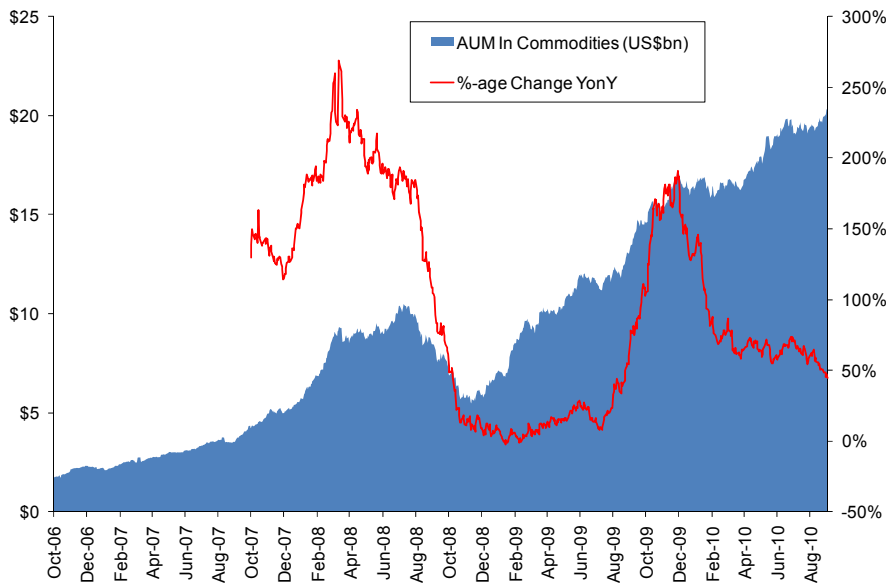
- » **The commodity traders like the price momentum, but remain concerned about the low volumes and some of the fundamentals.** Long positions have been rolled, while new positions are being added all the time. Volumes are quite a bit weaker than would normally be the case, while fundamentals are seen to be neutral. Our trade focused commodity traders hear mostly concerns about the US, not China. Concerns about sovereign debt in Europe contrast with some very positive commentary for physical demand for copper. The metal is seen as a leader with a deficit expected to be reported sooner rather than later. **The view is that eventually more funds will flow into the commodity space, but that the next two months could be quite testing;** and
- » **CTAs continue to remain the main drivers of this market.** The macro and hedge funds generally represent no more than 40% of activity and are little involved at the moment, at least at the LME. The main caution here seems to hang around the US\$, the sluggish equity market and the fact that seasonality is not in favour of commodities for now. The key levels for copper are seen at around US\$7,500/t and US\$8,000/t in terms of support and resistance.

### What The Analysts Say

- » **Fundamentally, the analysts are much more concerned, albeit if the next two months pass without any major upheavals or resistance levels are taken out then we too believe new highs could be possible.** Chinese money supply, the ISM and sovereign debt remain our main concerns. In addition fund flows although recovered remain still quite a bit below the April highs at least in industrial metals and energy. Volumes do remain low and any bad news could accentuate commodity price moves;
- » **Seasonality too is a big question mark.** Historically, September and October are very difficult months for commodities. With the ISM remaining overbought and the Chinese money supply not seeing its adjustment stop we are concerned that this year won't be different; and
- » **Funds flow into gold remain supportive, albeit fund flows into platinum have lost significant momentum.** We would expect gold to move to new highs, albeit a double top would be good news for higher risk assets such as equities.

## Fund Flows – Positions Are Being Added Again

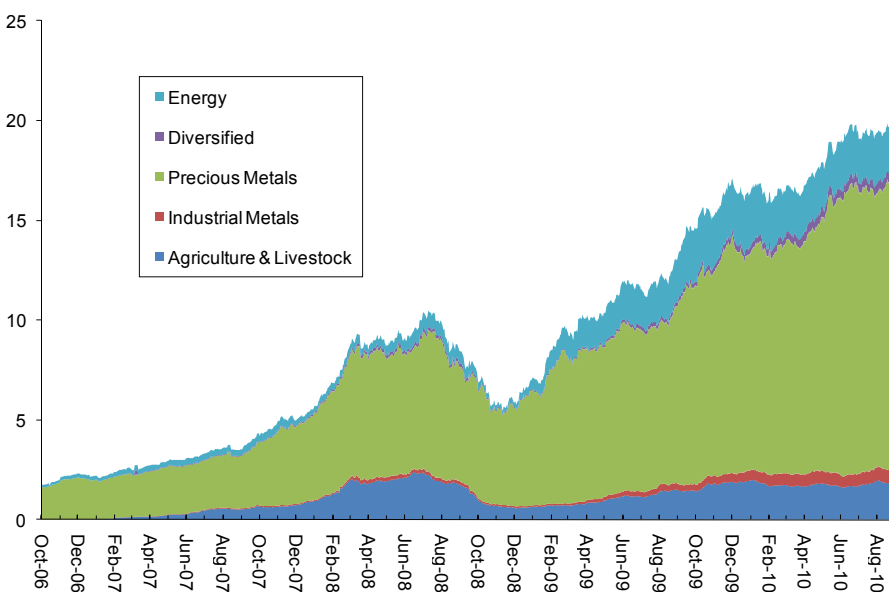
CHART NO. 3 | FUND FLOWS – AUM IN COMMODITIES SAMPLE (US\$BN)



FUND FLOWS INTO COMMODITIES NOW BREAKING NEW HIGHS BUT momentum is still decelerating

Source: MF Global UK Limited, ETF Securities & Other Providers

CHART NO. 4 | FUND FLOWS BY COMMODITY (US\$BN)



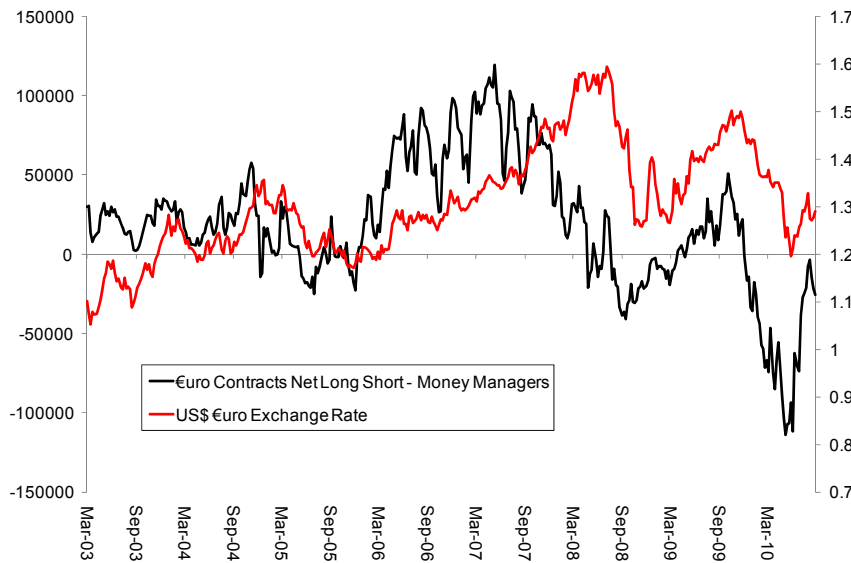
FUND FLOWS REMAIN SOLID FOR GOLD, BUT MORE CHALLENGING IN INDUSTRIAL METALS, ENERGY AND NOW EVEN PLATINUM

The latest move up in fund flows into copper come mainly on the back of gold.

Source: Source: MF Global UK Limited, ETF Securities & Other Providers

## The Euro – The Shorts Are Back, But For How Long?

CHART NO. 5 | THE US\$/€ EXCHANGE RATE DRIVES COMMODITY PRICES

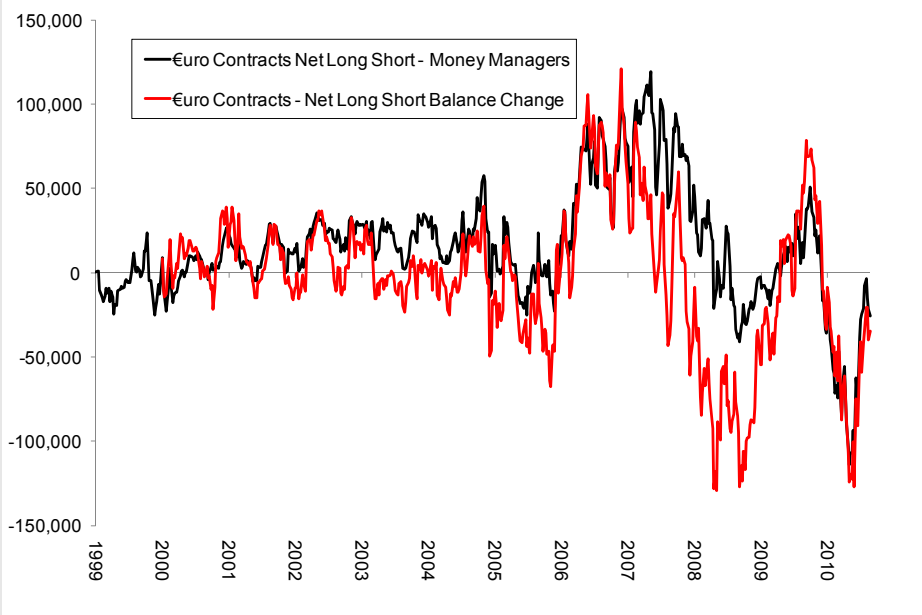


### THE EURO HAS STARTED TO WEAKEN AGAIN

Lingering doubts about sovereign debt in Europe remain a key concern

Source: MF Global UK Limited & Other Providers

CHART NO. 6 | FUND FLOWS INTO EURO CONTRACTS AND MOMENTUM



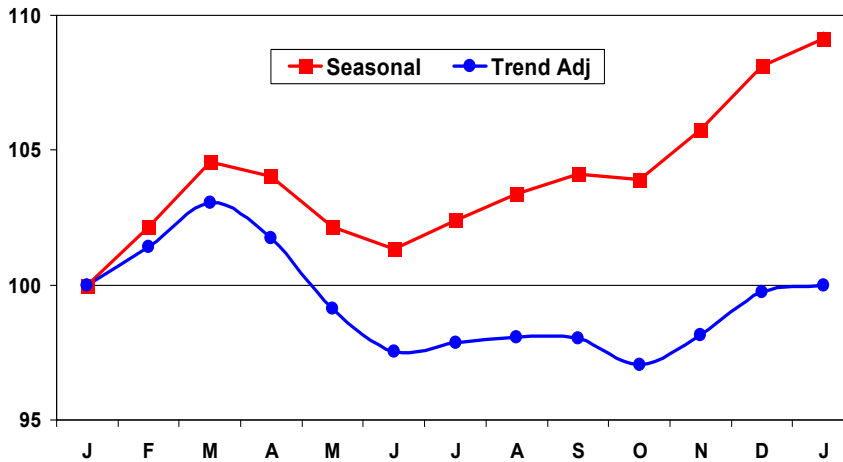
### THE EURO SEEMS TO BE RUNNING OUT OF MOMENTUM

The Euro is clearly no longer as oversold as only a few months ago. Will we see a double dip?

Source: MF Global UK Limited & Other Providers

## What About Seasonality? Some Risky Months Ahead

CHART NO. 7 | COPPER SEASONALITY STARTING TO KICK IN AGAIN

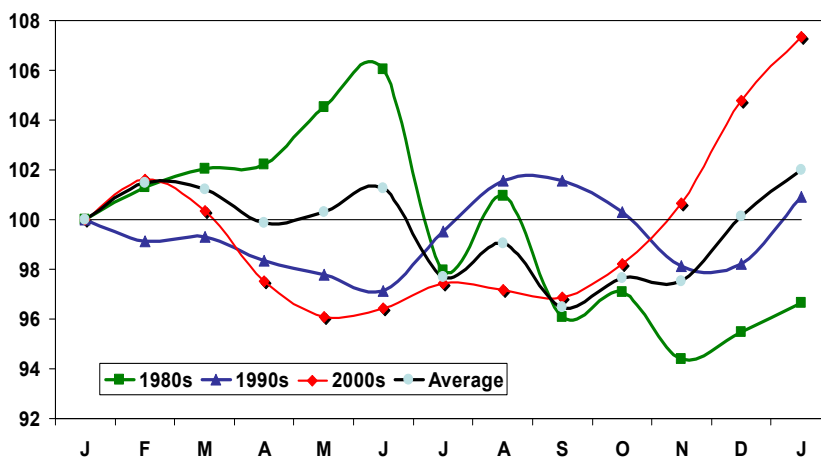


Source: MF Global UK Limited, Metals Desk

### HISTORICALLY SEPTEMBER AND OCTOBER ARE CHALLENGING MONTHS

History is never a guide for the future, but seasonality does matter in this sector

CHART NO. 8 | ALUMINIUM ALSO IMPACTED BY SEASONALITY



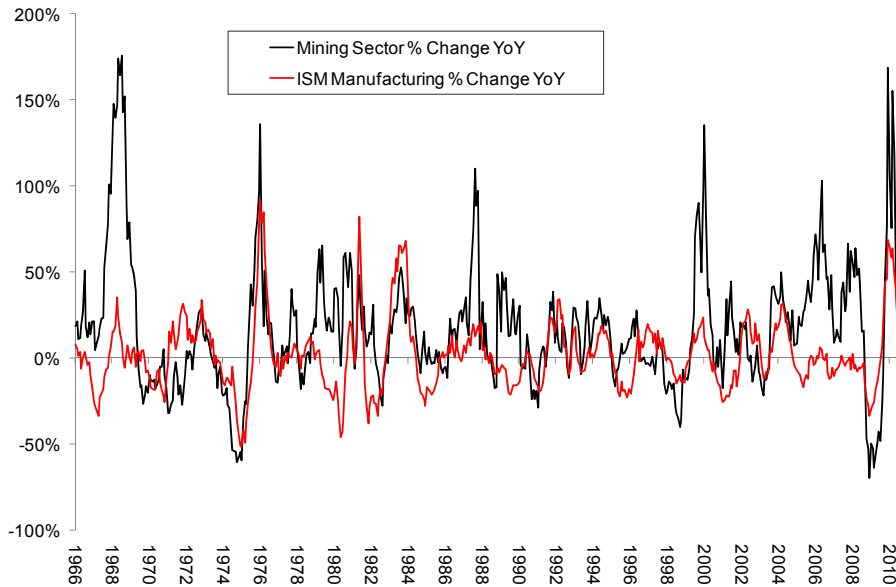
Source: MF Global UK Limited, Metals Desk

### WEAKNESS IN ALUMINIUM CAN LAST EVEN INTO NOVEMBER

Aluminium remains the fundamentally weaker metal

## What About Ecomic Fundamentals?

CHART NO. 9 | THE ISM VS. THE MINING SECTOR

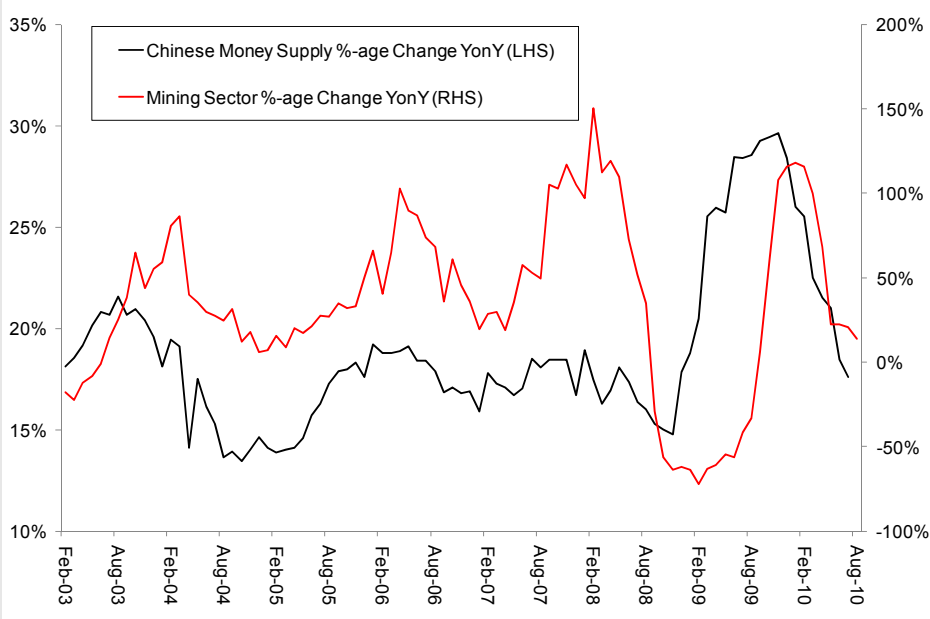


**THE MOMENTUM OF THE ISM REMAINS EXTREMELY UNFAVOURABLE**

The Mining Sector remains too overbought, in our view!

Source: MF Global UK Limited & BLB

CHART NO. 10 | CHINESE MONEY SUPPLY VS. THE MINING SECTOR



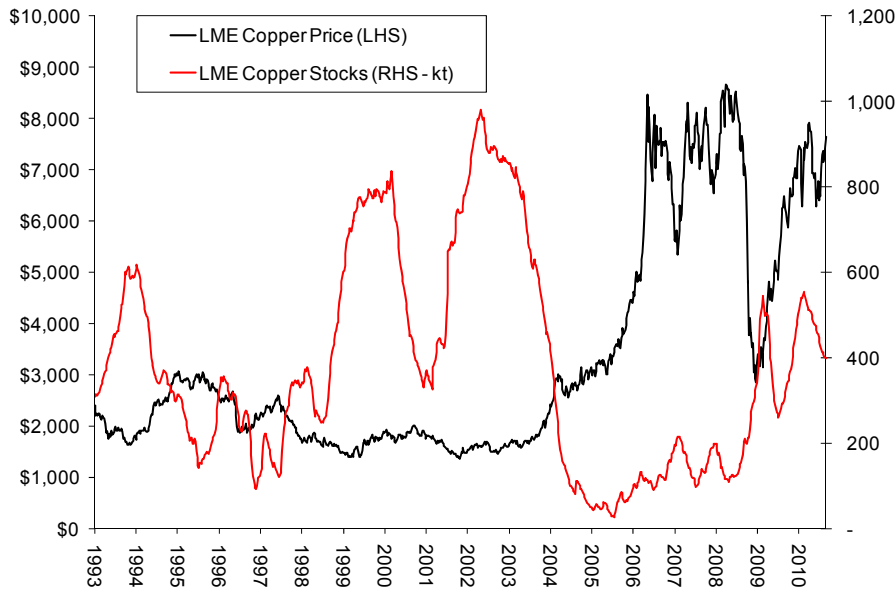
**CHINESE MONEY SUPPLY HAS NOT STOPPED CONTRACTING**

The Mining Sector is not reflecting this yet!

Source: MF Global UK Limited & BLB

## What About Commodity Fundamentals?

CHART NO. 11 | THE COPPER PRICE VS. WAREHOUSE STOCKS

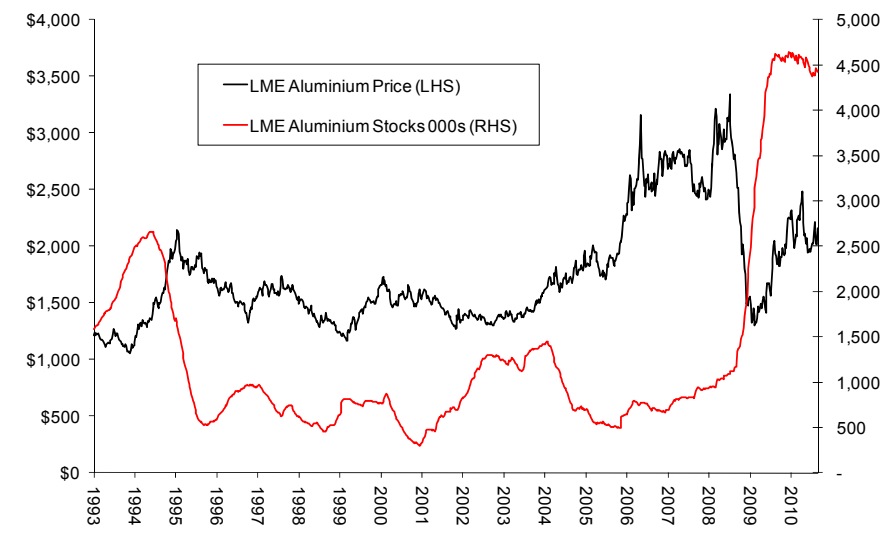


Source: MF Global UK Limited

### COPPER IS EXPECTED TO MOVE INTO DEFICIT THIS QUARTER

That said, the warehouse stocks don't look that convincing. The uptrend seen since the credit crunch is not broken

CHART NO. 12 | THE ALUMINIUM PRICE VS. WAREHOUSE STOCKS



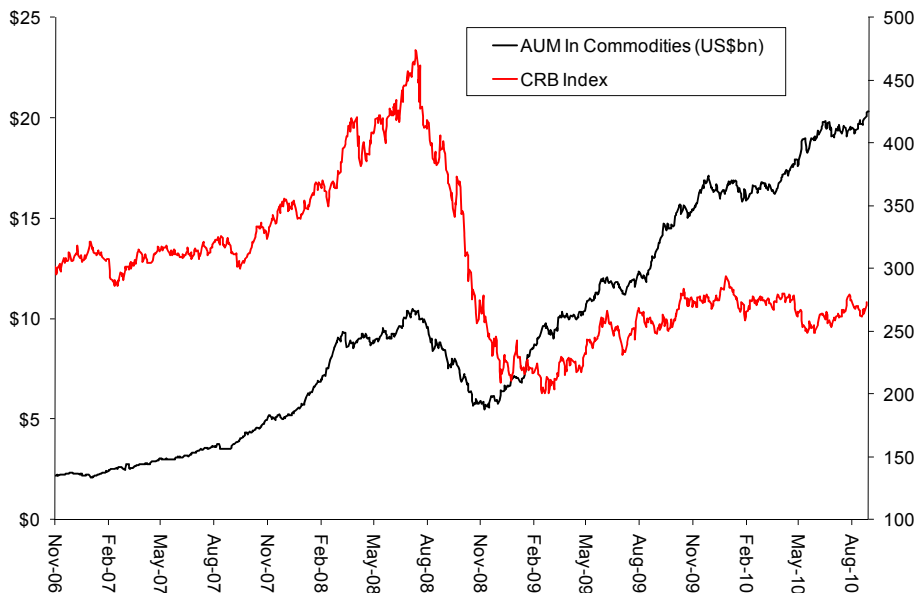
Source: MF Global UK Limited

### ALUMINIUM REMAINS A VERY DIFFICULT MARKET

Warehouse stocks remain significantly overextended!

## The CRB Index – Absolute Fund Flows Now Also Rolling Over

CHART NO. 13 | AUM IN COMMODITIES (US\$BN) VS THE CRB INDEX

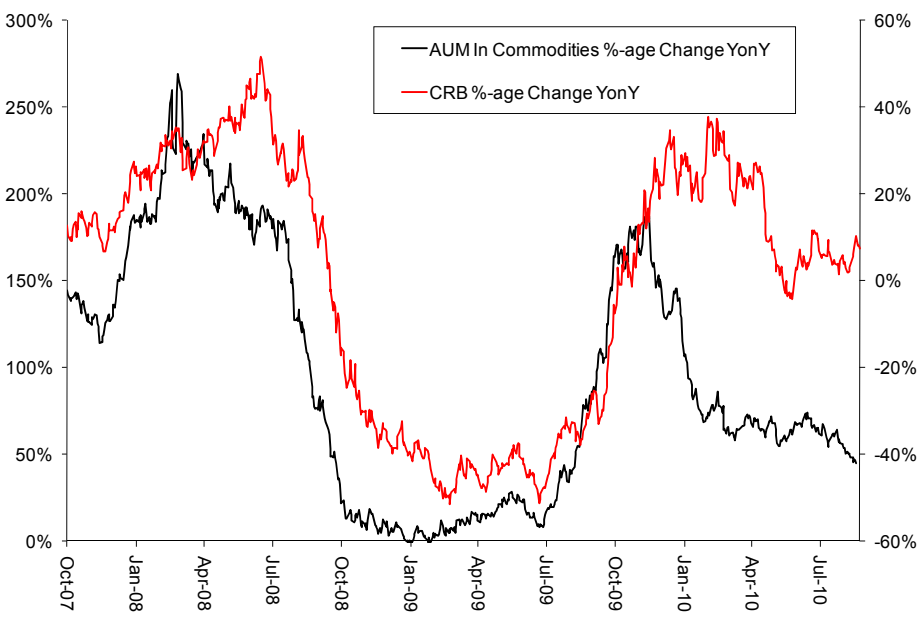


FUND FLOWS ARE MOVING UP IN ABSOLUTE TERMS BUT THE TREND IN THE CRB INDEX IS STILL DOWN

The question is whether the CRB index finally breaks out of its slight downward trend?

Source: MF Global UK Limited, ETF Securities & Other Providers

CHART NO. 14 | FUND FLOWS INTO COMMODITIES VS THE CRB INDEX MOMENTUM



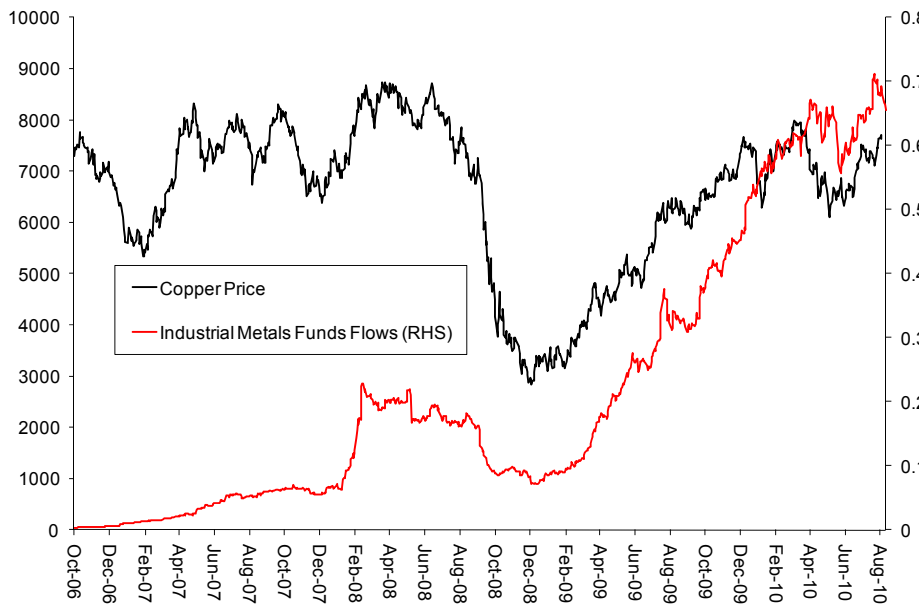
MOMENTUM IN FUND FLOWS REMAINS NOT VERY SUPPORTIVE

Momentum for the CRB index does not look all that convincing either!

Source: MF Global UK Limited, ETF Securities & Other Providers

## Base Metals – Will Prices Break Out?

CHART NO. 15 | AUM IN INDUSTRIAL METALS (US\$BN) VS THE COPPER PRICE

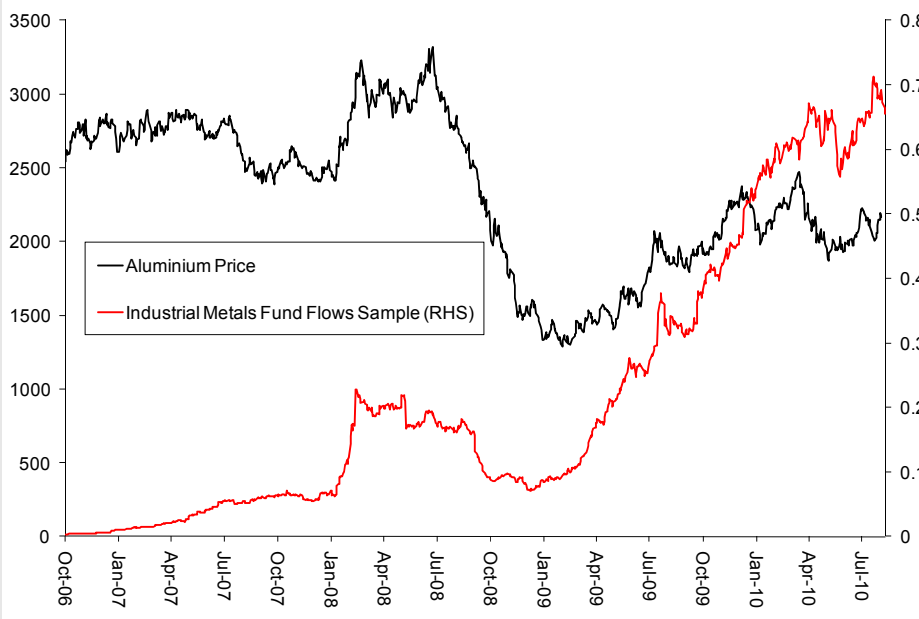


### FUND FLOWS INTO INDUSTRIAL METALS DON'T LOOK ALL THAT CONVINCING

Although long positions have been rolled over and new positions have been added, the latest statistics don't look all that convincing

Source: MF Global UK Limited, ETF Securities & Other Providers

CHART NO. 16 | AUM IN INDUSTRIAL METALS (US\$BN) VS THE ALUMINIUM PRICE



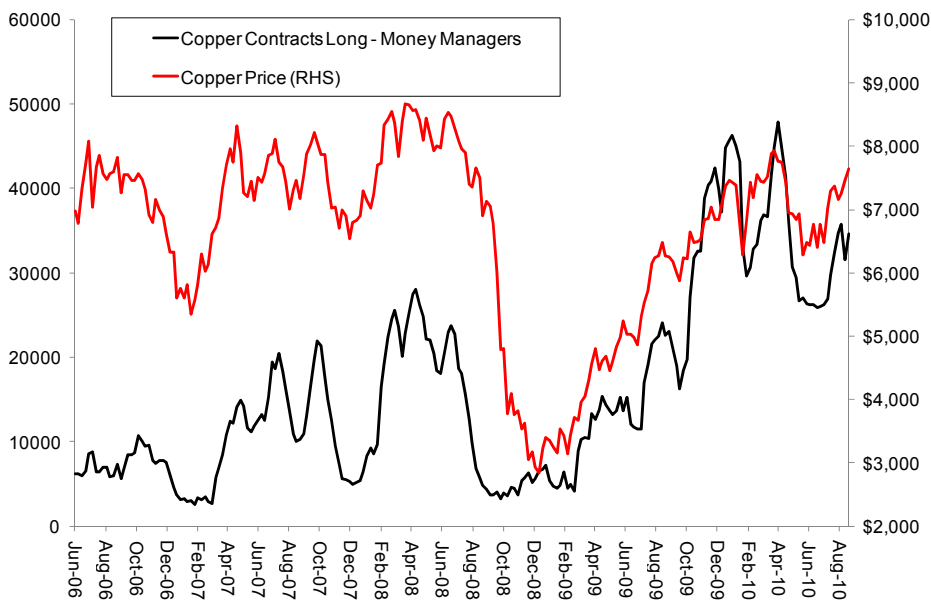
### THE ALUMINIUM PRICE SEEMS TO HAVE LOST MOMENTUM

The trend does not look good, in our view.

Source: MF Global UK Limited, ETF Securities & Other Providers

## Base Metals – Funds Flows Are NOT Back To The April Highs

CHART NO. 17 | FUND FLOWS INTO COPPER VS. THE COPPER PRICE (US\$/T)

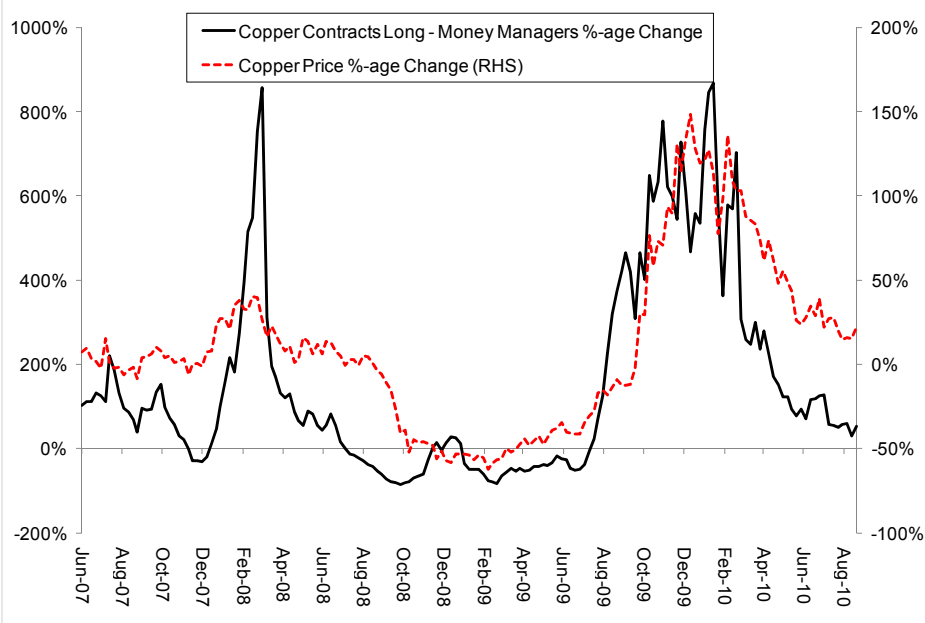


Source: MF Global UK Limited, & CFTC

FUND FLOWS INTO COPPER – THE TREND STILL HAS NOT RECONNECTED WITH THE PRE APRIL LEVEL

We believe the copper price remains at risk.

CHART NO. 18 | FUND FLOWS VS PRICE MOMENTUM FOR COPPER



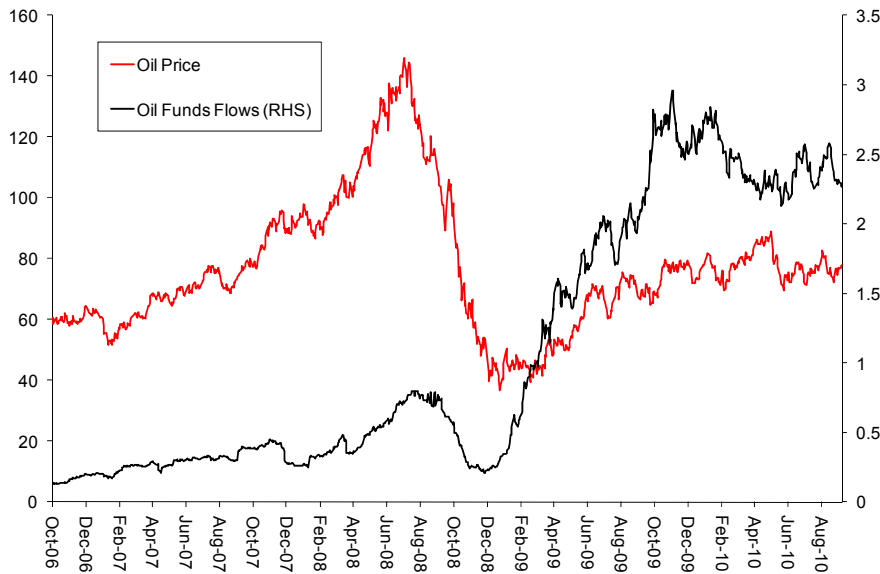
Source: MF Global UK Limited, & CFTC

FUND FLOW MOMENTUM INTO COPPER SEEMS TO BE STABILISING THOUGH

But momentum of the copper price remains at risk, in our view.

## Energy – The Trend In Fund Flows Appears Weak

CHART NO. 19 | FUND FLOWS INTO OIL VS. THE OIL PRICE (US\$/B & US\$BN)

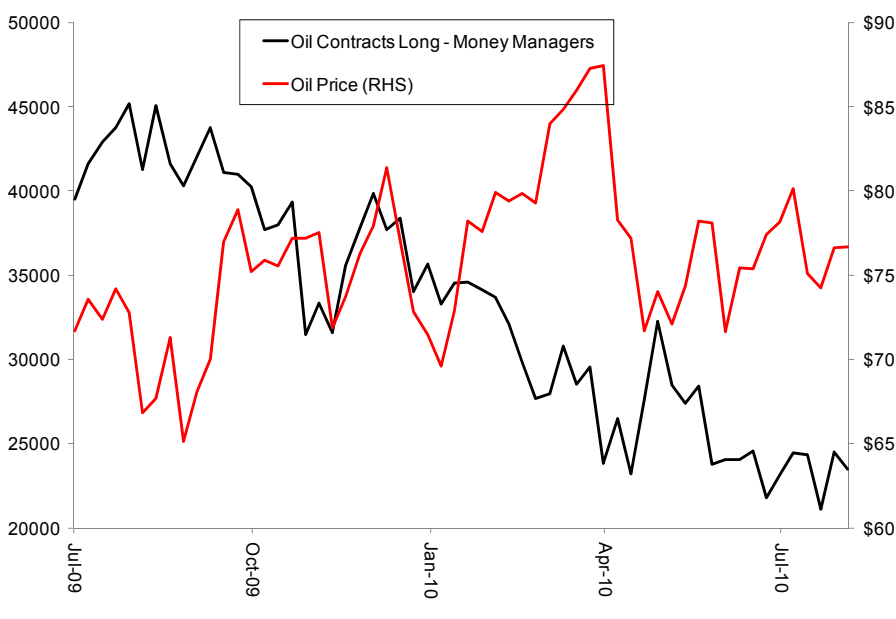


FUND FLOWS INTO OIL HAVE FALLEN BACK MARKEDLY

The price trend remains unconvincing

Source: MF Global UK Limited, ETF Securities & Other Providers

CHART NO. 20 | FUND FLOWS VS OIL PRICE (US\$/B)



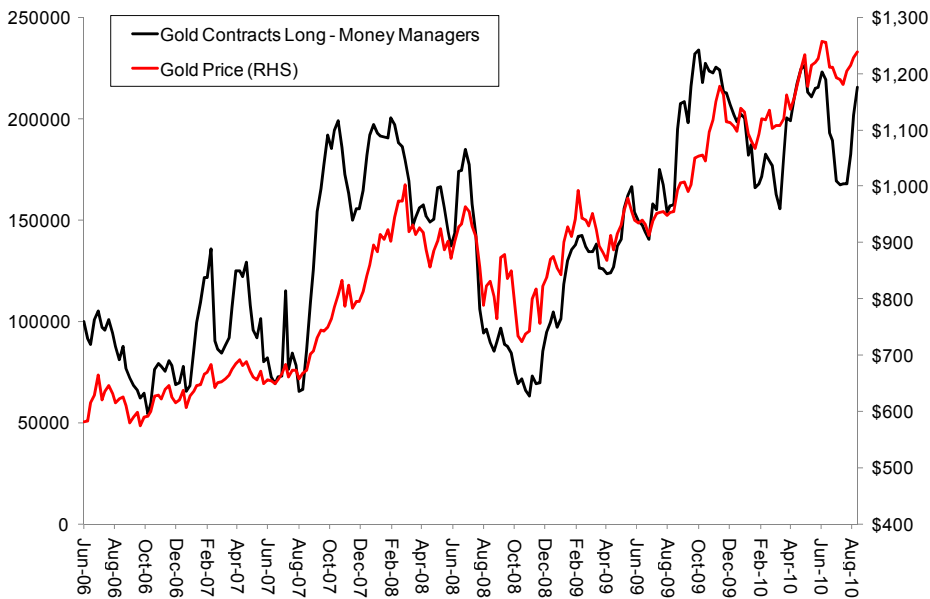
THE FUND FLOW TREND INTO ENERGY IS NOT CONVINCING

The oil price seems out of step with fund flows

Source: MF Global UK Limited, & CFTC

## Precious Metals – Fund Flows Into Gold Remain On An Upward Trend

CHART NO. 21 | FUND FLOWS INTO GOLD VS. THE GOLD PRICE (US\$/OZ)

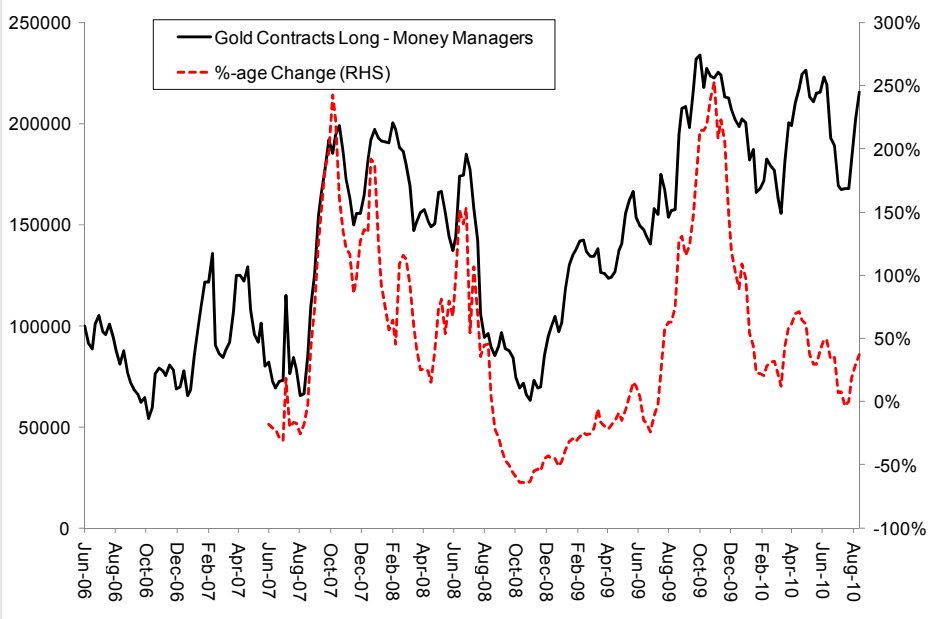


### FUND FLOWS INTO GOLD – FUND FLOWS HAVE REBOUNDED

And more upside seems possible in both fund flows as well as the gold price.

Source: MF Global UK Limited, & CFTC

CHART NO. 22 | FUND FLOWS VS PRICE MOMENTUM FOR GOLD



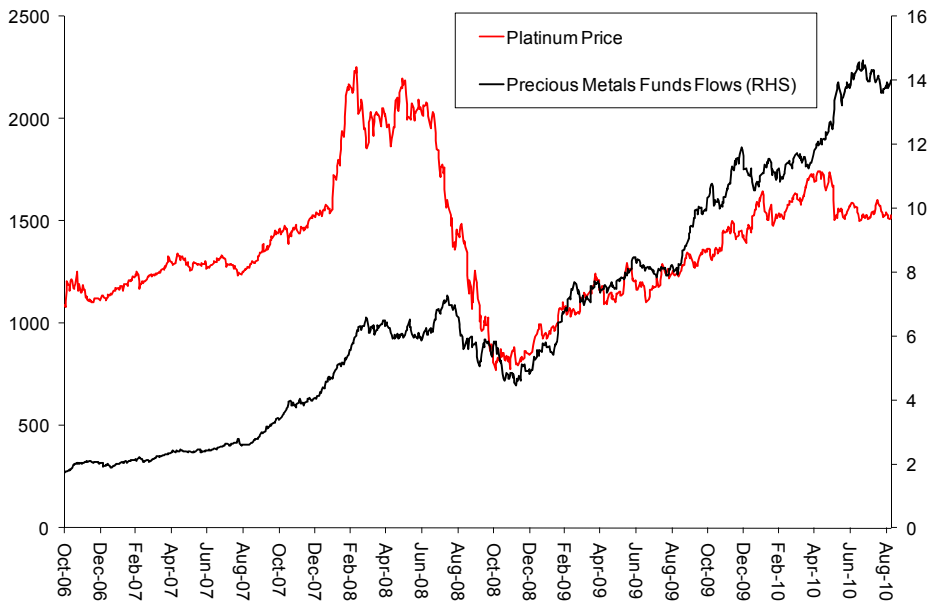
### FUND FLOW MOMENTUM INTO GOLD REMAINS REASONABLY SOLID

Gold remains a safe haven asset.

Source: MF Global UK Limited, & CFTC

## Precious Metals – Platinum Slightly More @ Risk Now

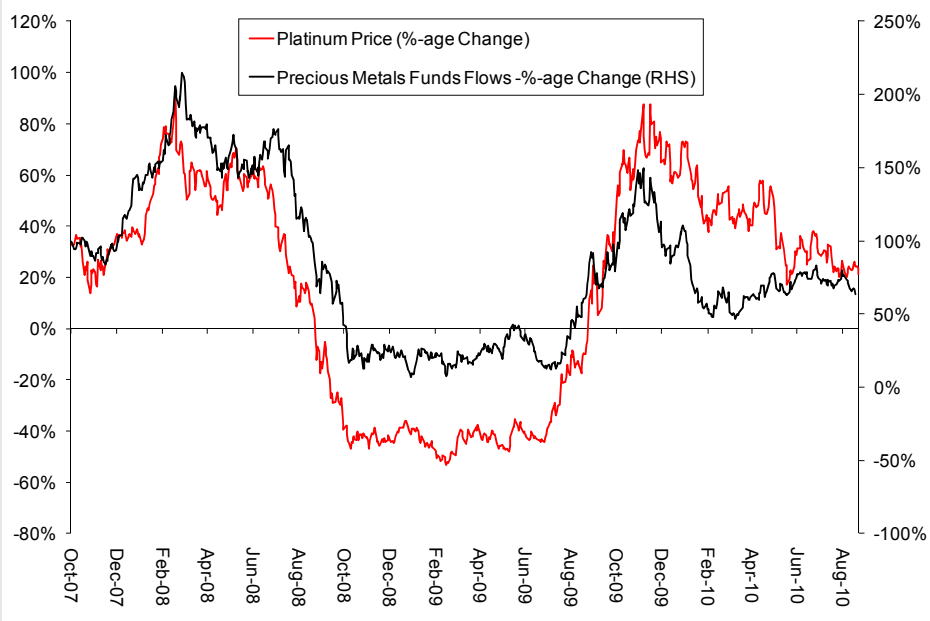
CHART NO. 23 | FUND FLOWS INTO PLATINUM VS. THE PLATINUM PRICE (US\$/OZ & US\$BN)



**FUND FLOWS INTO PLATINUM HAVE COME OFF**  
 The platinum price seems to be that bit more vulnerable now

Source: MF Global UK Limited, ETF Securities & Other Providers

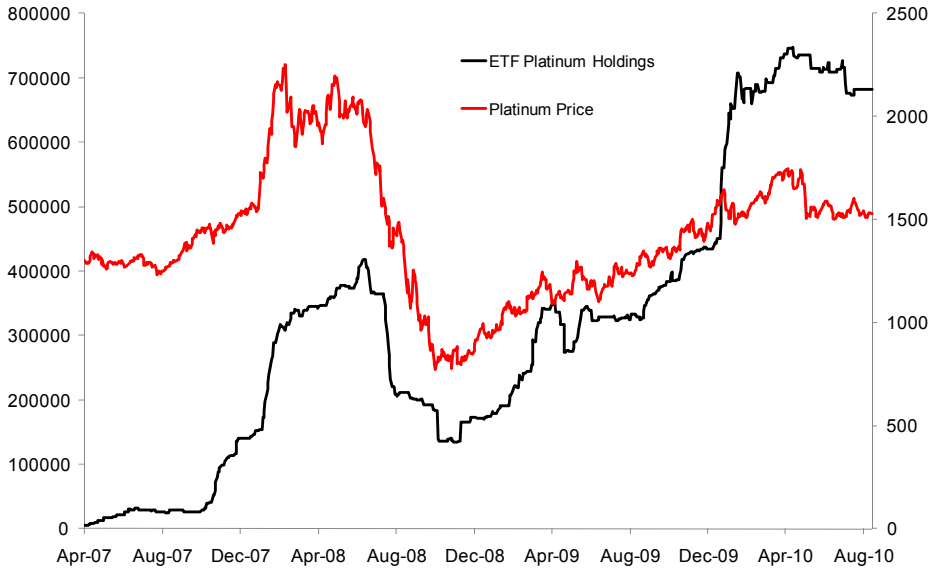
CHART NO. 24 | FUND FLOWS VS PRICE MOMENTUM FOR PLATINUM



**FUND FLOW MOMENTUM INTO PLATINUM HAS COME OFF TOO**  
 The price could be at risk, in our view.

Source: MF Global UK Limited, ETF Securities & Other Providers

CHART NO. 25 | ETF PLATINUM HOLDINGS VS. THE PLATINUM PRICE (US\$/OZ)

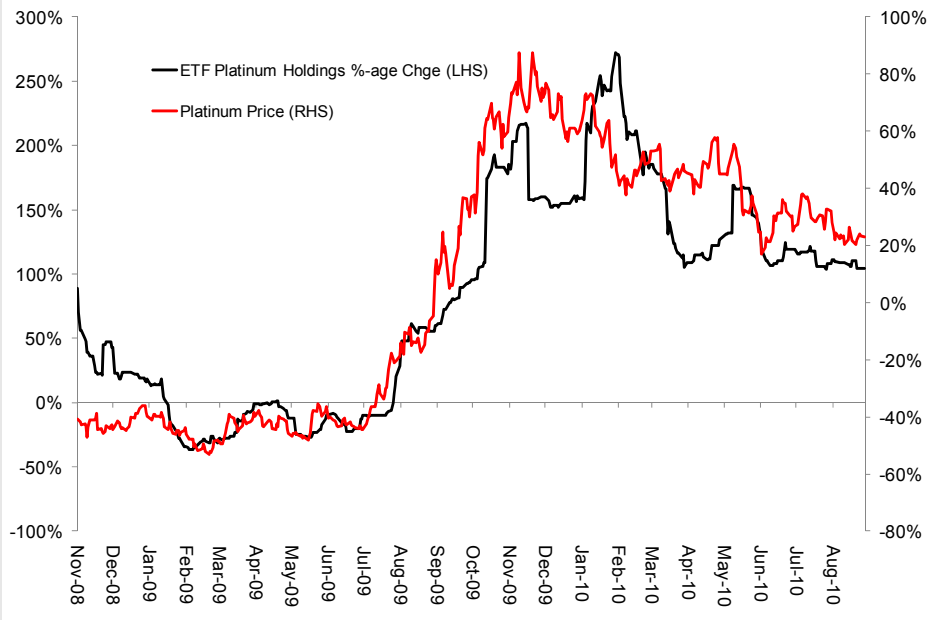


**ETF HOLDINGS IN PLATINUM HAVE FALLEN BACK**

This matters as this was an incremental driver of demand.

Source: MF Global UK Limited, ETF Securities & Other Providers

CHART NO. 26 | ETF HOLDINGS VS PRICE MOMENTUM FOR PLATINUM



**THE MOMENTUM IN EFT HOLDINGS FOR PLATINUM REMAINS DOWN**

How long can the platinum price withstand this?

Source: MF Global UK Limited, ETF Securities & Other Providers

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