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Talking commodities as things get a little bit better

EXTRACTS of a conversation with Stephen Meintjes, head of research at Imara SP Reid:

Well, right now everyone's still all a cock-a-doodle-do about China and the leadership's attempts to rejig that economy—which is going to be a good thing in the long term.

They're going to make interest rates more realistic so that capital goes to the private sector instead of the less efficient state-owned enterprises, which means China should be able to maintain a snappy rate of growth for another decade or so. But the problem lies with what's going to happen in the next six months to a year.

And just in the last few days the leadership has announced plans to protect the stated growth objective of 7%-7.5%. One of the items on the agenda is to build more railways. In the hinterland and in the north and the west, they've got vast open territories that are sparsely covered by

Michel **Pireu** In the **MARKETS**

rail. So that will be good for steel consumption, which everyone is saying is going to diminish as China moves from fixed investment to a consumer-based economy.

But China is clearly still the swing factor in most economies, although we may be seeing the first signs of green shoots in Europe; there are persistent reports that things are getting a little bit better. It certainly doesn't look like they're going to get worse.

The UK has also come out with better looking numbers, and America continues to improve slowly but surely.

The point being that a positive outlook for commodities is still very much dependent on an uptick in global growth in the next year or so. And, right now, most commodity shares are pricing in a late resumption in demand for commodities — in other words, they're still pretty cheap.

So the big question is whether to buy (commodity stocks) now or wait another six months, maybe longer.

If you are going to buy, what should you be looking at?

Let's start with the big gorilla commodity, which is iron ore. The price of iron ore has held up quite well, at around $130 a tonne, but a number of forecasts are now predicting that iron ore will decline in price in the second half of the year. Some forecasts even go as low as $90, on the basis that the Chinese have been restocking, and their growth is likely to slow as an enormous increase in supply comes on stream — with the likes of Vale, Billiton, Fortescue and Rio Tinto vying for supply dominance.

Given this thinking, one maybe has to be a little cautious about a pure iron ore play such as Kumba. There are alternatives, if you want to hedge your bets, such as Assore and ARM (African Rainbow Minerals) which each have a 50% holding in Assmang, the iron ore and magnesium ore producer. ARM is a little bit more diversified because it also has coal interest, along with copper, gold, platinum and nickel. So if there's going to be a general recovery in commodities, ARM is well placed, and it's a share the market tends to undervalue.

The magnesium-ore story could also be an interesting one. The ore's price collapsed in the Great Recession and didn't pick up like other commodities, but is now getting to a level where (producers) can make a reasonable profit.

Exarro is another interesting player in the iron-ore space because it gets a big fat dividend every year from Kumba, which it puts to good effect. And, of course, it's one of the biggest coal producers in SA and when Medupi finally comes on stream it will be selling another 14-million metric tonnes of coal per annum to Eskom, which will make a nice addition to its coal revenues.

It also has a new iron-ore mine in West Africa, which is set to become highly profitable. Plus they've got good things going in renewables ... they have great partners in that area. Cennergi is one, Tronox is another. They have about a 46% holding in Tronox, which is listed in New York. It's in mineral-sands which had a quiet first half last year, but has been picking up this year and should show good growth after this year.

Then, if we go to steel, there's ArcelorMittal. It's been getting negative news for as long as we can remember; it's continually being attacked by the government and it's had production glitches and accidents ... But, for that reason, it may be attractively priced, because while steel prices have come off tremendously in the first half of the year, as we've already said, there is good news for steel coming out of China. And a good slug of ArcelorMittal's production goes to export — mainly into Africa, the one area of the world that everyone is optimistic about right now ... besides which, our own economy must eventually recover.

And so we should see a pretty decent recovery over the next year or two in steel.