INSIDE METALS

Tuesday, July 9, 2013

CHART OF THE DAY

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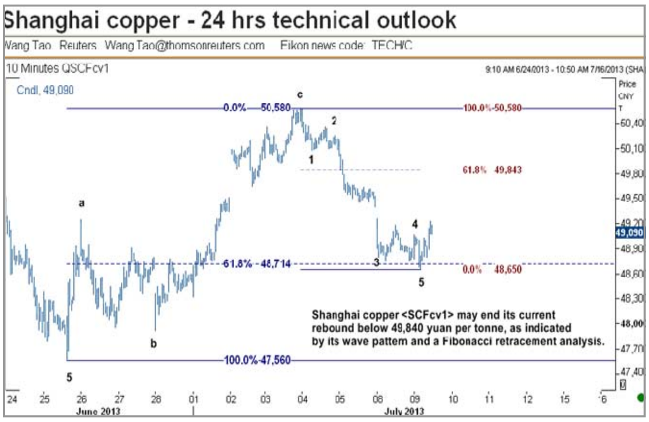

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BREAKINGVIEWS-Commodity traders need to show they're crisis-proof

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TODAY'S MARKETS

BASE METALS: London copper held steady not far off a three-year low hit in late June, with slowing demand growth from top consumer China and expectations the United States will rein in stimulus giving little upward momentum to prices.

"There's still the ongoing concerns about Fed tapering and when that will begin. If you see more positive data out of the U.S. that brings forward the potential tapering date," said Alexandra Knight of National Australia Bank (NAB) in Melbourne.

PRECIOUS METALS: Gold extended a rebound to a second day after breaking through a key technical level and as China inflation data boosted its appeal as a hedge against rising prices in the world's second-biggest buyer of the metal.

"There was some resistance at around $1,245 - that's the level we were at before the nonfarm payroll data came out. Since we broke through that resistance, gold is shooting up," said a trader in Hong Kong.

FOREX: The dollar held steady versus a basket of currencies and its broad uptrend was seen intact as the market positions for when the U.S. Federal Reserve will start to slow its stimulus.

"The policy divergences between the Fed and the developed countries like...UK and Japan are likely to widen over time and that will continue to favour dollar strength," said Sim Moh Siong, FX strategist for Bank of Singapore.

FEATURE

BREAKINGVIEWS-Commodity traders need to show they're crisis-proof

By Kevin Allison

LONDON, July 8 (Reuters Breakingviews) - It was July 2015, and Global Materials Partners (GLOMP), an unlisted Swiss commodities trader, was in trouble. Data showing a rapid slowdown in the Chinese economy had pushed the copper price down 15 percent in two days. Then one of GLOMP's star traders came clean: over the past several months, the former back office worker had built up a huge, unauthorised long position in copper derivatives.

GLOMP struggled to unwind the bad trades but the trader's losses quickly chewed through its thin capital, tipping it into bankruptcy. Its lenders' credit default swaps ticked higher as panicked investors struggled to assess the damage, sparking fears of a broader crisis.

This may be fantasy. But there are many reasons why real-world commodity traders should now be attracting greater scrutiny. Regulators think it's risky for investment banks to trade commodities. They are pushing banks out of proprietary trading in commodity derivatives, or forcing them to hold more capital against trades. Investment banks' retreat has left a bigger share of the commodities business in the hands of independent trading houses and other non-bank institutions. The question is whether these unregulated, often opaque firms - from secretive Swiss commodity houses to the marketing arms of the oil majors - could be a source of hidden risk.

But we're different

How could a commodity crisis start? The perception is that traders hold big positions, financed by borrowed money. But the reality is that traders like Glencore Xstrata , Trafigura and Vitol more closely resemble logistics companies than financial speculators. They make money not by betting on price movements, but by moving stuff around.

A metals trader might be aware that a mine operator in Peru is willing to sell copper for $100 below the benchmark London Metals Exchange price, while a customer in China is willing to pay $200 above the LME price. The margin on each such trade may be small, but by borrowing to finance many similar trades, a small team of well-connected traders can reap huge profits.

Despite the liberal use of leverage, in theory it's a pretty safe business. A trader might not be able to match a buyer and seller straight away, or customers may refuse shipments if prices fall sharply during transit. But such risks can be hedged in the derivatives markets. In fact, price volatility just increases the opportunities for profitable arbitrage.

That, at least, is the ideal. Occasionally, things go wrong. No hedge is perfect. In 2011, Glencore lost $330 million trading cotton after a series of wild price swings led to ineffective hedging, difficulty securing supplies, and some buyers refusing shipments. The financial hit was small - less than 10 percent of operating cashflows that year. Had the merger with Xstrata already taken place, it would have been less than 2 percent of the combined group's 2011 EBITDA.

The bigger worry is what happens when traders make outright bets on price moves. In 1999, a rogue trader at Andre & Cie, a big grain merchant, lost an estimated $200 million betting on soybean futures. It proved a terminal blow to the secretive 120-year-old family firm. The collapse wasn't immediate, but in 2001, after a failed turnaround bid, Andre's lenders threw in the towel. When it succumbed, Andre & Cie had $400 million of debt spread between 40 banks. Glencore Xstrata reported pro-forma net debt of $29 billion at the end of 2012, spread across more than 100 lenders.

In theory, even a struggling trader should be more resilient than a flailing bank. Banks and commodity houses both rely on short-term funding, but traders' assets tend to pay back faster - about a few weeks, or the time it takes for a cargo of ore, oil or grain to cross an ocean. The ability to unwind books quickly may be one reason the industry made it through 2008 without a big crisis.

Regulators need a hedge, too

The fact that the industry weathered the financial crisis fairly well doesn't mean it is truly safe. The sample size is too small and the history of modern, globally connected traders too short to rule out a blowup infecting the financial system or even the real economy. Trading companies have huge influence over the flow of essential raw materials. Disruptions to world trade could be significant, if only temporarily.

There are a few things overseers could do to make the industry safer. Standardised and rigorous rules for risk reporting, even for unlisted firms, could identify where tension is building up in the system. Extending new financial regulation to limit trading houses' use of use of derivatives to old-fashioned price hedging would be another obvious place to start. If the financial crisis taught regulators one thing, it's that they shouldn't rely on self-interested industry players' assurances that they have a handle on risk.

GENERAL NEWS

Indonesia allows Freeport to restart underground mining

JAKARTA, July 9 (Reuters) - Indonesia's energy and mineral resources ministry said on Tuesday it will allow Freeport McMoRan Copper and Gold Inc to resume underground operations at the world's second-biggest copper mine.

Freeport halted production at the huge Grasberg mine in remote West Papua on May 15, a day after a training area in a tunnel caved in, killing 28 people.

Freeport Indonesia President Director Rozik Soetjipto said at a media conference it would take one month for underground mining operations to hit full capacity. Earlier this month, the firm said open-pit mining was now running at full capacity after a prolonged closure.

Paulson's gold fund plunges 65 percent through June

By Svea Herbst-Bayliss and Katya Wachtel

BOSTON, July 8 (Reuters) - Hedge fund manager John Paulson's gold fund has lost 65 percent of its worth so far this year after the portfolio declined 23 percent last month, two people familiar with the fund said on Monday.

Gold had been one of the billionaire investor's winning bets a few years ago, but not this year. His investments in gold and gold miners have suffered double digit losses for the past three months.

In June, gold tumbled 12 percent in the wake of fears the Federal Reserve might taper its economic stimulus by cutting monthly bond purchases. It is unclear how a 12 percent drop in the price of the precious metal translated into a 23 percent fall in the fund in June, and whether it is the result of the bet having been leveraged up through borrowing and the use of derivatives

A spokesman for Paulson declined to comment.

With roughly $300 million in assets, the gold fund is the smallest portfolio in his New York-based firm's lineup with less than 2 percent of its assets and it invests mostly Paulson's personal money, the people familiar with the fund said.

The fund's assets have fallen from roughly $700 million at the end of the first quarter, according to those people.

They did not want to be identified because the information is private.

The gold fund, which at one point managed almost $1 billion, rose 35 percent in 2010 and contributed to Paulson's estimated $5 billion payday that year.

As the heavy losses made for outsized headlines in recent months, Paulson decided a few weeks ago to report the gold data only to the gold fund investors, not investors in his bigger and better performing funds. In April, Paulson garnered unwanted attention when the gold fund lost 27 percent as the price of the metal plunged 17 per cent over two weeks.

"Paulson's impact on the gold market is dramatic. In particular his size alone, on the way in or way out," said John Brynjolfsson, managing director of global macro hedge fund Armored Wolf LLC. "But one needs to look beyond his size alone because his positions are relatively widely publicized, and representative of how others are thinking, so thereby their impact gets magnified."

The gold fund is one of a handful of funds that make up Paulson's New York-based hedge fund, which at its peak in 2011 managed about $38 billion. The firm now oversees about $19 billion in investor money.

Most of Paulson's bigger funds are in the black this year, but the gold investments have weighed down returns of the Advantage Funds, which lost 3.06 percent last month, shrinking the year's gains to 1.17 percent.

Paulson & Co's largest holding by market value at the end of the first quarter was the SPDR Gold ETF, with 21.8 million shares, according to a regulatory filing. The firm also had large stakes in gold mining companies through March, those filings showed.

Paulson launched his gold fund in 2010, requiring outside investors to commit $10 million each. He hired gold industry experts Victor Flores, HSBC's former senior gold mining analyst, and John Reade, a former senior metals strategist at UBS. The fund is now called the PFR Gold Fund, in a nod to their last names.

Paulson's investments in gold are one reason he rose to prominence on Wall Street.

After earning billions betting against the housing market before the financial crisis, Paulson made roughly $5 billion in 2010 thanks to prescient bets on the economic recovery and gold.

Paulson is not the only brand-name manager hit by the gold rout. David Einhorn's Greenlight Capital Management's offshore gold fund fell 11.8 percent in June, bringing year-to-date losses in the fund to 20 percent, Reuters has reported.

MARKET NEWS

Alcoa sees aluminum demand growth; markets tightening

By Euan Rocha

TORONTO, July 8 (Reuters) - Alcoa Inc , the largest U.S. aluminum producer, still sees global demand for aluminum products growing 7 percent this year, signalling a potential price rise for the metal as bulging Chinese aluminum inventories begin to dwindle.

The solid demand, driven by the aerospace and commercial transportation sectors, should combine with industry-wide production cuts already in place to reduce a supply glut that has driven down aluminum prices by 13 percent this year.

Alcoa on Monday affirmed its demand forecast, even as it posted a net loss in the second quarter, due to restructuring costs related to plant closures.

On an adjusted basis, it achieved a larger-than-expected profit thanks to productivity gains and a strong performance from its engineered products business, which makes high-margin goods like aerospace fasteners, turbine blades and truck wheels.

"It was a good, solid quarter. Alcoa continues to show they can cut costs and will be a survivor," said Tim Ghriskey, chief investment officer of Solaris Asset Management, which owns some Alcoa bonds. "This is a company that remains profitable and strong despite the tough environment."

Shares of Alcoa, which closed at $7.92 on the New York Stock Exchange shortly after the results, were little changed in trading after the closing bell.

The stock has fallen nearly 9 percent this year in the face of stubbornly low aluminum prices, caused by a global surplus, and concerns about lackluster demand.

Alcoa expects a 9 to 10 percent increase in aluminum demand this year from the aerospace sector, driven by a recent flurry of aircraft orders at the Paris Air Show and an already-large backlog of orders within the aerospace industry. It also sees increased demand from the automotive, commercial transportation and construction industries.

INDUSTRY CHALLENGES WEIGH

But while Chinese stocks have fallen, stockpiles in London Metals Exchange-registered facilities rose to a record-high above 5.45 million tonnes at the end of June. This means that aluminum prices are not likely to stage a major rally anytime soon despite industry-wide production cuts.

Alcoa reported a loss from its aluminum smelting business, and said roughly a third of global aluminum is still produced at a loss, despite offsets from record high premiums above LME-prices, which end-buyers pay to take delivery of the metal.

"The primary (business) lost money in the quarter and that is symptomatic of the industry as a whole," Alcoa Chief Financial Officer William Oplinger told a conference call.

The London three-month aluminum price fell nearly 7 percent during the quarter ended June 30 and has tumbled around 13 percent in 2013. Aluminum touched a nearly four-year low late last month of $1,758 a tonne.

Given the plight of the aluminum industry, Alcoa's results are no longer viewed as a proxy for economic growth, but its quarterly results are still closely watched as they mark the unofficial start of the North American earnings season.

A component of the Dow Jones Industrial Average for more than 50 years, Alcoa is now by far the smallest company in the index. Its stock price has fallen more than 10 percent over the last 12 months, while the Dow has risen roughly 18 percent.

QUARTERLY RESULTS

Excluding the impact of restructuring costs and costs tied to a racketeering and fraud probe, the company reported second-quarter earnings of $76 million, or 7 cents a share. Analysts had been expecting earnings of 6 cents, according to Thomson Reuters I/B/E/S.

Quarterly revenue fell 2 percent to $5.85 billion, largely because of lower aluminum prices, but still topped analysts' expectations of $5.83 billion.

"It looks much better than expected. It is good to see that revenue is better than expected," said Alan Lancz, president of Alan B. Lancz & Associates, an investment advisory firm based in Toledo, Ohio. "It seems like the outlook is favorable so far."

The company said its net loss in the quarter ended June 30 was $119 million, or 11 cents per share. That compares with a loss of $2 million, or break-even per share, a year earlier.

Chile cuts copper output and price forecasts for 2013

SANTIAGO, July 8 (Reuters) - Chile cut its copper output forecast for the year to 5.53 million tonnes due to setbacks at certain mines, though production is still expected to jump from 2012 as a new deposit comes online, the mining ministry said on Monday.

In April, state copper commission Cochilco forecast the world No. 1 copper producer's red metal output would reach 5.58 million tonnes this year.

The lower estimate is due to delays at Japan's JX Holdings' Caserones mine and lower forecasts for output from the Spence and Esperanza deposits, run by global miner BHP Billiton and Chilean miner Antofagasta Minerals respectively, Cochilco told Reuters.

But production is still seen rising in 2013 as leading copper miner Codelco's new Ministro Hales mine comes on line at the end of the year and output grows at mega mines Collahuasi and Escondida .

MARKET NEWS *(Continued)*

In 2012, Chile boosted its copper production by 3 percent to 5.455 million tonnes.

The Andean country is seeking to boost results at its huge, aging mines, but sliding grades, soaring costs, labor unrest and energy woes could curb its ambitious plans.

Red metal output is seen climbing to 5.69 million tonnes next year, slightly down from Cochilco's previous forecast for 5.73 million tonnes.

COPPER PRICES

Cochilco also cut its view for 2013 average copper prices to $3.27 per lb from $3.57 due to a slowdown in top metals consumer China, the prospect of the U.S. Federal Reserve winding down its economic stimulus program, and a projected copper surplus in the period 2013-2017.

The price of copper, seen by some as a barometer for the health of the global economy, has fallen about 15 percent this year.

Copper prices are seen slumping further next year to average $3.15 per lb, the government said, down from a previous projection for $3.32.

A drop in metal prices poses a significant risk to the export-dependent Chilean economy, where copper accounts for roughly 60 percent of export revenue. Analysts have long warned commodities-focused Latin American countries should diversify their economies.

Indonesia June refined tin exports rise 20 pct on month - trade ministry

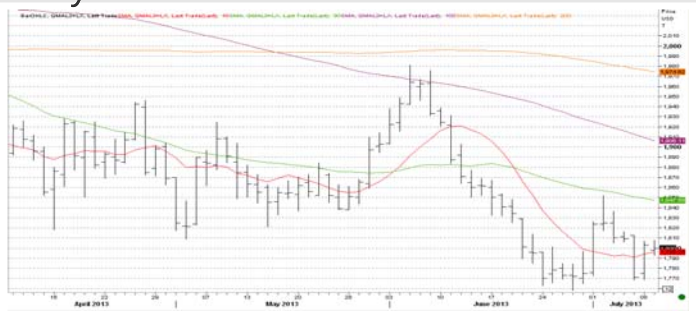
JAKARTA, July 9 (Reuters) - Refined tin shipments from Indonesia, the world's top exporter of the metal, rose 20 percent in June to 11,111.38 tonnes, from 9,242.05 tonnes in May, a trade ministry official said on Tuesday.

Refined tin exports from Southeast Asia's top economy climbed 15 percent from the same month a year ago.

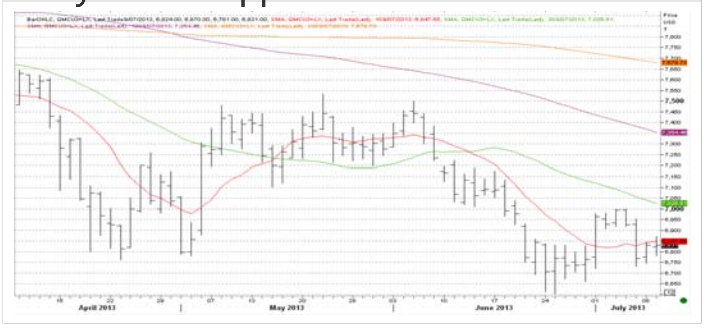
Indonesia's overhaul of tin trading rules that raises minimum purity levels is expected to slash shipments from the world's top refined tin exporter over the next few months, potentially pushing up prices for the metal used in electronic goods.

ANALYTIC CHARTS *(Click on the charts for full-size image)*

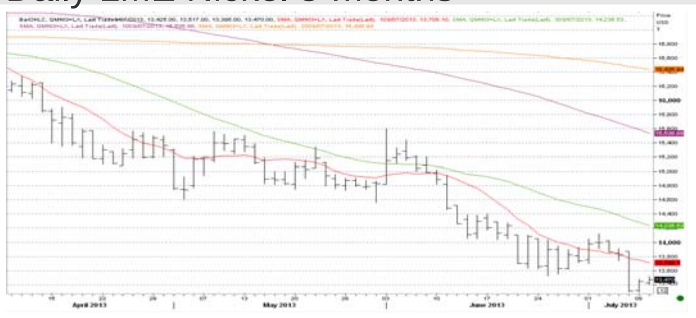
Daily LME Aluminium 3-months



Daily LME Copper 3-months

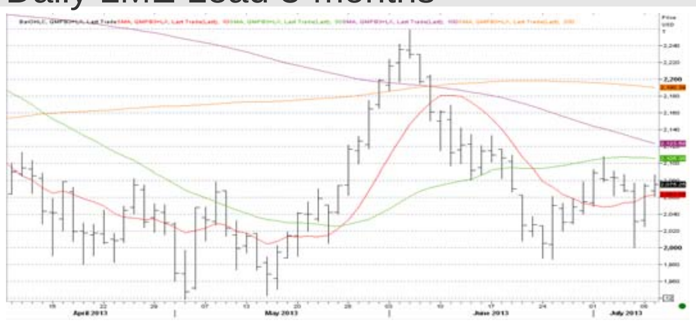


Daily LME Nickel 3-months

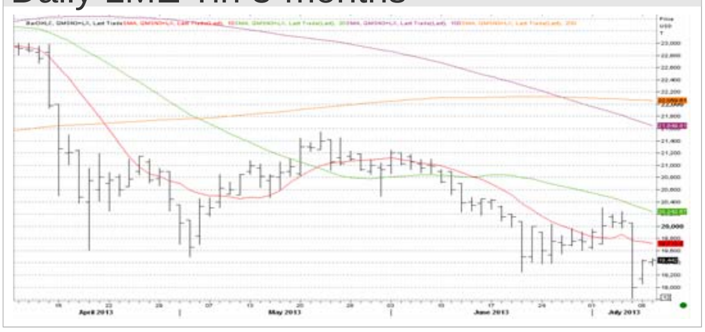


Daily LME Zinc 3-months

Daily LME Lead 3-months



Daily LME Tin 3-months



Daily LME Alloy 3-months

Daily LME Nasaac 3-months

MARKET REVIEW

METALS-Copper steady as Fed stimulus, growth worries weigh

By Melanie Burton

SINGAPORE, July 9 (Reuters) - London copper held steady not far off a three-year low hit in late June, with slowing demand growth from top consumer China and expectations the United States will rein in stimulus giving little upward momentum to prices.

China's copper consumption peaks in the second quarter with demand from factories easing over the northern summer, while economic data has given little hope for a robust recovery.

The drawback of liquidity from the United States meanwhile means less capital is available to cushion industry in the world's biggest economy, and also that less cash is on hand for commodities investment.

"There's still the ongoing concerns about Fed tapering and when that will begin. If you see more positive data out of the U.S. that brings forward the potential tapering date," said Alexandra Knight of National Australia Bank (NAB) in Melbourne.

U.S. job growth was stronger than expected in June cementing expectations that the Federal Reserve may start winding down its massive stimulus program as early as September.

Three-month copper on the London Metal Exchange was little changed at $6,845 a tonne by 0315 GMT, up 0.22 percent. It logged gains of less than 1 percent in the previous session.

Copper prices have struggled to get any traction after inching away from a three-year low of $6,602 a tonne reached on June 25. Prices have gained only about 3.7 percent from there and are still down almost 14 percent for the year.

The most-traded November copper contract on the Shanghai Futures Exchange climbed 0.80 percent to 49,130 yuan ($8,000) a tonne.

China's resolve to revamp its economy for the long-term good will be tested this month when a slew of data is expected to show growth is grinding towards a 23-year low. China trade data is due on Wednesday.

"Generally we're seeing data coming in below expectations and showing some softening in the Chinese economy ... and that could have a significant impact on metals demand," Knight said.

NAB revised down its GDP forecasts for China for this year and next by 0.25 percent to 7.5 percent and 7.25 percent, respectively.

PRECIOUS-Gold climbs 1 pct for second day on technical buying

By A. Ananthalakshmi

SINGAPORE, July 9 (Reuters) - Gold extended a rebound to a second day after breaking through a key technical level and as China inflation data boosted its appeal as a hedge against rising prices in the world's second-biggest buyer of the metal.

Bullion came under renewed pressure late last week as a strong U.S. jobs report raised fears of an early end to the U.S. Federal Reserve's bond buying stimulus which was seen as stoking inflation.

But it rose 1 percent on Monday after the dollar eased from three-year highs and on some bargain hunting.

Spot gold rose 1.2 percent on Tuesday to $1,250.86 an ounce by 0301 GMT. It may keep rising to $1,261 per ounce, according to Reuters technical analyst Wang Tao.

"There was some resistance at around $1,245 - that's the level we were at before the nonfarm payroll data came out. Since we broke through that resistance, gold is shooting up," said a trader in Hong Kong.

The trader also said China continued to show buying interest as prices were near three-year lows.

Comex gold rose about $15 to $1,249.40.

Bullion has fallen nearly 10 percent since Fed Chairman Ben Bernanke said last month the economy was recovering strongly enough for the U.S. central bank's $85 billion monthly bond-buying stimulus to be reduced as soon as later this year.

Gold for immediate delivery fell to $1,180.71 on June 28 to its lowest since August 2010.

CHINA INFLATION

Data on Tuesday showed that China's annual consumer inflation accelerated more than expected in June as food costs soared.

Its central bank is seen keeping policy largely neutral in the near term to balance the need to keep the world's second-largest economy on an even keel while warding off consumer inflation as well as possible property bubbles, analysts said.

But gold continues to be undermined by liquidation in the metal-backed exchange traded funds. SPDR Gold Trust , the world's largest gold ETF, said its holdings fell 1.56 percent to 946.96 tonnes on Monday - the lowest since February 2009.

MARKET REVIEW *(Continued)*

"The unwound gold positions increase gold supply and put gold under downward pressure, which in turn triggers more liquidations. We expect the spiral of liquidation will extend to 2014," said Helen Lau, senior metals and mining analyst at UOB Kay Hian Research.

FOREX-Dollar holds steady, seen supported by Fed policy view

By Masayuki Kitano and Ian Chua

SINGAPORE/SYDNEY, July 9 (Reuters) - The dollar held steady versus a basket of currencies and its broad uptrend was seen intact as the market positions for when the U.S. Federal Reserve will start to slow its stimulus.

Expectations that the Fed will reduce its bond-buying as early as September should keep the dollar buoyant, although there is caution about its near-term outlook in the wake of recent gains.

"The policy divergences between the Fed and the developed countries like...UK and Japan are likely to widen over time and that will continue to favour dollar strength," said Sim Moh Siong, FX strategist for Bank of Singapore.

In the short term, however, the dollar could retreat as it approaches technical resistance, he said, adding that he was in favour of waiting for such a pullback before buying the dollar.

While the Fed is seen heading toward reducing the pace of its monetary stimulus later this year, the European Central Bank has said it would keep interest rates at record lows for an extended period, and the Bank of England has indicated that it is in no hurry to raise interest rates. The Bank of Japan is expected to continue with its aggressive monetary stimulus.

The dollar index, which measures the greenback's value against a basket of currencies, held steady at 84.183. The dollar index had set a three-year high of 84.588 on Monday following Friday's upbeat U.S. jobs report.

The euro rose 0.1 percent to $1.2884 , edging away from a seven-week trough of $1.2806 hit on Friday.

Sim at Bank of Singapore said the euro has support on technical charts in the $1.2700 to $1.2750 area.

Against the yen, the dollar rose 0.3 percent to 101.23 yen . On Monday, the dollar had hit a high of 101.54 yen on trading platform EBS, its highest level in nearly six weeks.

BULLISH ON THE DOLLAR

Gains in the dollar, however, could be tempered if there is any position unwinding in the wake of recent gains. Currency speculators hugely increased their bets in favour of the U.S. dollar in the week ended July 2, while turning negative on the euro.

Investors had grown increasingly bullish on the dollar after the Fed laid out a roadmap for scaling back its asset-purchase programme as the economy improves.

In contrast, the European Central Bank last week broke with tradition by declaring it would keep interest rates at record lows for an extended period, a pledge ECB President Mario Draghi reiterated on Monday.

"We remain bullish USD versus the currencies where central banks are signalling continued policy easing, most notably the EUR, GBP, CHF and JPY," analysts at BNP Paribas wrote in a report.

"We are more cautious versus the currencies of commodity exporter economies, where short positioning is generally stretched and where better U.S. data may provide some cushion against the negative effects of China's slowdown in the months ahead."

The Australian dollar held steady at $0.9138 , staying above a 34-month trough of $0.9036 set last week.

Investors largely shrugged off data showing inflation in China quickened in June.

(Inside Metals is compiled by Pradip Kakoti in Bangalore)