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**THE METALS
MONTHLY**

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VM GROUP

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Prices and stocks

Price forecasts

			1-month	2-month	3-month	12-month
Gold	\$/oz		1,020-1,120	1,150	1,250	975
Silver	\$/oz		14.50-16.50	18.00	19.50	13.75
Platinum	\$/oz		1,450-1,550	1,570	1,400	1,300
Palladium	\$/oz		390-440	440	400	380
Aluminium (3-month)	\$/tonne		1,900-2,150	2,200	2,100	2,250
Copper (3-month)	\$/tonne		6,100-7,000	7,500	7,250	7,650
Lead (3-month)	\$/tonne		1,800-2,175	2,125	2,075	2,550
Nickel (3-month)	\$/tonne		15,500-19,500	20,005	19,000	21,500
Tin (3-month)	\$/tonne		15,000-18,000	18,000	16,500	18,000
Zinc (3-month)	\$/tonne		1,850-2,225	2,400	2,300	2,450
Steel: (3-month) Med	\$/tonne		425	400-460	460	600
		2010 av	2011 av	2012 av	2013 av	2014 av
Gold	\$/oz	1,154	954	950	800	800
Silver	\$/oz	18.00	13.80	13.80	10	10
Platinum	\$/oz	1,375	1,427	1,500	1,400	1,300
Palladium	\$/oz	362	352	350	350	350
Aluminium (3-month)	\$/tonne	2,181	2,652	3,050	3000	2,900
Copper (3-month)	\$/tonne	7,279	7,788	8,500	8,200	7,200
Lead (3-month)	\$/tonne	2,087	2,803	2,900	2,800	2,400
Nickel (3-month)	\$/tonne	20,375	26,250	24,000	21,000	20,000
Tin (3-month)	\$/tonne	17,125	19,854	20,500	19,500	17,500
Zinc (3-month)	\$/tonne	2,217	2,992	2,950	2,750	2,400
Steel: (3-month) Med	\$/tonne	525	900	1,100	1,050	1,000

Source: VM Group

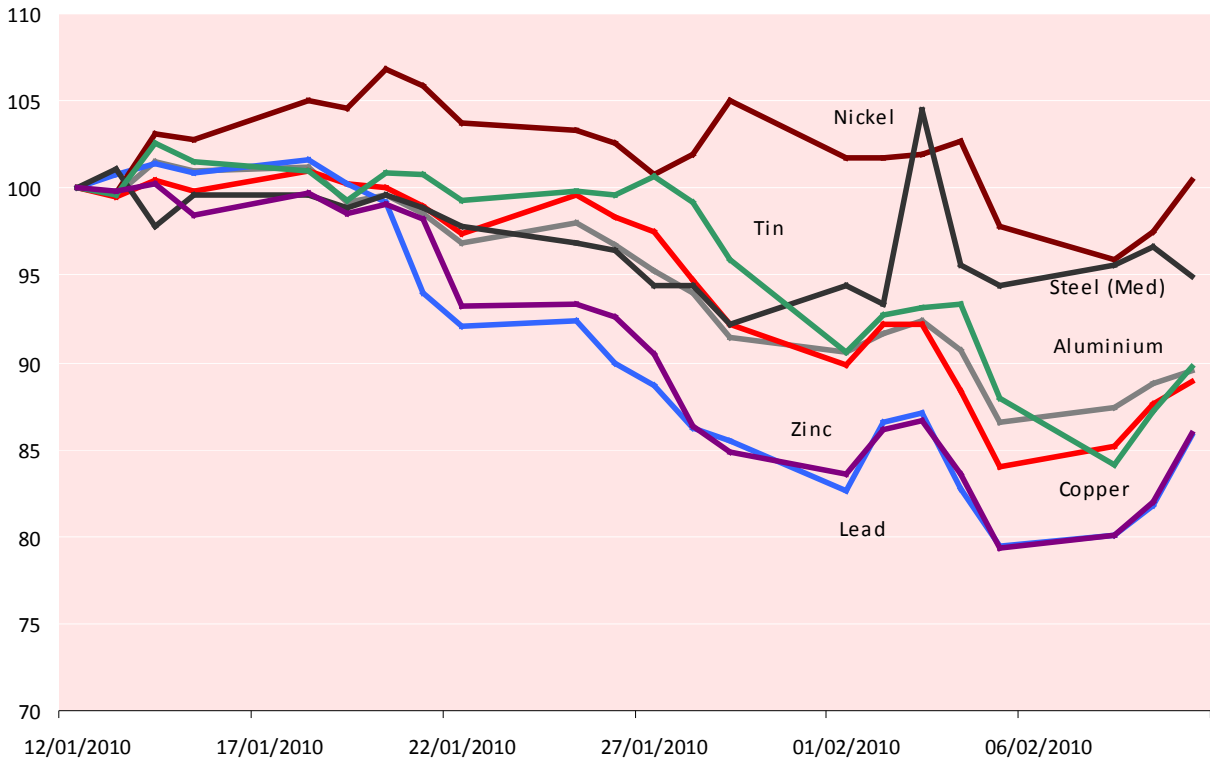
italics denote revision from previous month

Historic prices & base metal stocks

Prices	11 Feb	Most recent price	Past 12 months			1 week ago	WoW (%)	1 month ago	MoM (%)	12 months ago	YoY (%)	Av. 2009	Av. 2008
			Average	High	Low								
Gold	\$/oz	1,076	999	1,213	870	1,058	1.72	1,153	(6.66)	943	14.10	973	873
Silver	\$/oz	15.37	15.28	19.18	11.98	15.2	1.32	18.8	(18.42)	13.3	15.22	14.7	15.15
Platinum	\$/oz	1,511	1,273	1,627	1,039	1,475	2.44	1,593	(5.15)	1,067	41.61	1,205	1,599
Palladium	\$/oz	418	291	462	191	395	5.82	429	(2.56)	214	95.33	264	357
Aluminium	\$/tonne	2,045	1,790	2,357	1,289	1,983	3.13	2,357	(13.24)	1,382	47.97	1,703	2,659
Copper	\$/tonne	6,705	5,633	7,700	3,172	6,261	7.10	7,700	(12.92)	3,395	97.50	5,186	7,030
Lead	\$/tonne	2,070	1,871	2,620	1,000	1,938	6.84	2,596	(20.26)	1,150	80.00	1,738	2,136
Nickel	\$/tonne	18,005	15,560	21,155	9,480	17,450	3.18	18,350	(1.88)	10,255	75.57	14,762	21,689
Tin	\$/tonne	16,025	14,075	18,290	9,950	15,680	2.20	17,900	(10.47)	11,050	45.02	13,382	18,766
Zinc	\$/tonne	2,143	1,820	2,660	1,088	1,993	7.50	2,611	(17.94)	1,145	87.20	1,687	1,924
Steel (Med)	\$/tonne	427	374	470	270	430	(0.70)	445	(4.04)	325	31.38	364	747
Steel (Far East)	\$/tonne	440	421	510	270	445	(1.12)	450	(2.22)	320	37.50	406	695
LME Stocks		Most recent stocks	Past 12 months			1 week ago	WoW (%)	1 month ago	MoM (%)	12 months ago	YoY (%)	Av. 2008	Av. 2007
			Average	Average	Average								
Aluminium	Tonnes	4,561,275	4,263,286	4,640,750	2,927,925	4,580,225	(0.41)	4,604,225	(0.93)	2,927,925	55.79	4,037,328	1,231,093
Copper	Tonnes	545,300	399,572	548,400	256,900	541,100	0.78	517,175	5.44	519,550	4.96	388,201	176,337
Lead	Tonnes	158,075	106,370	158,375	55,650	157,875	0.13	150,150	5.28	56,175	181.40	94,440	62,174
Nickel	Tonnes	166,356	121,171	166,476	89,328	166,476	(0.07)	159,726	4.15	89,328	86.23	111,852	51,857
Tin	Tonnes	26,630	19,582	27,905	8,665	27,135	(1.86)	26,865	(0.87)	8,820	201.93	17,440	7,314
Zinc	Tonnes	499,850	401,655	500,350	317,750	500,350	(0.10)	489,275	2.16	351,250	42.31	379,530	150,777

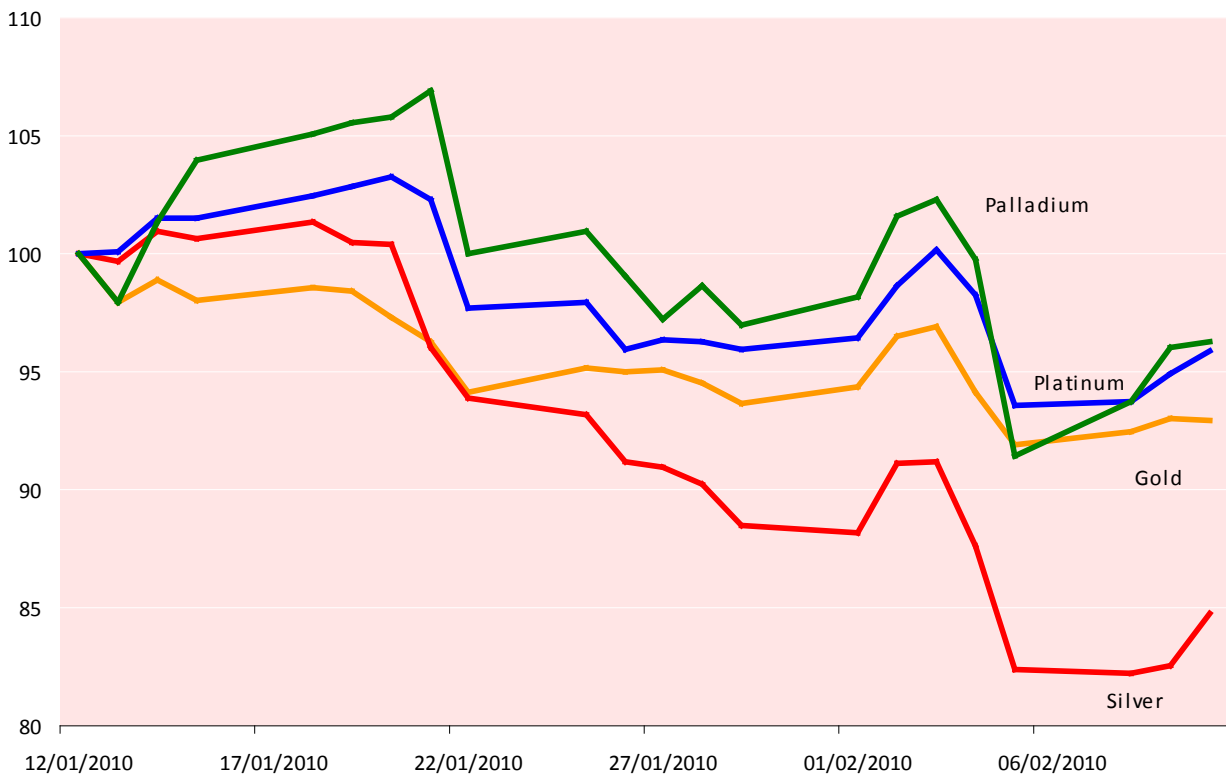
Source: VM Group

London fix precious metal prices, over past month: re-based to 100



Source: VM Group

LME 3-month base metal prices, over past month: re-based to 100



Source: VM Group

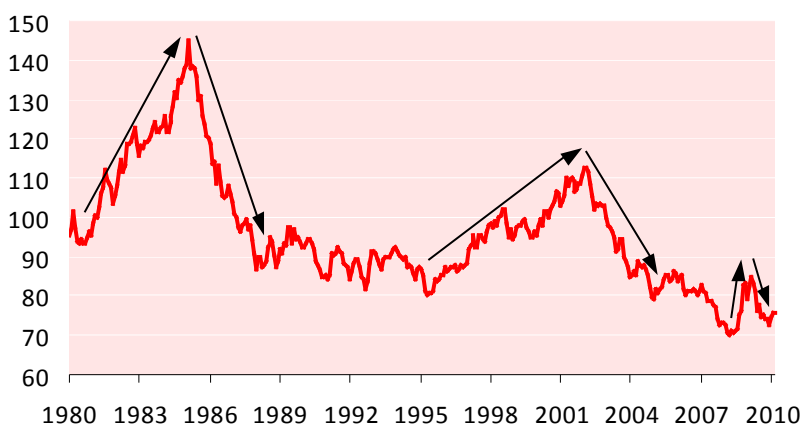
Feature

What impact a resurgent dollar?

The dollar's rise to a seven month high against the euro in early February provoked sharply lower gold and base metals prices. Yet from its trough on 25 November 2009 the dollar's latest rally has seen it rise by just 7% - not much by historic moves. Could this be the start of a dollar bull period? If so, much bigger shifts up in the dollar's strength can be expected over the next few years. Previous such dollar rallies have seen a rise of between 20% and 56%. If that sort of rise came to pass, what might happen to metal prices?

Using a broad gauge of the US dollar's strength, the Federal Reserve's trade-weighted major currencies index, it is clear that the US dollar has seen a slow decline in its external value over the past 30 years. However this decline has been erratic, punctuated by (sometimes lengthy) periods of dollar strength.

US dollar major currencies index, March 1973 = 100



Source: VM Group

We have identified since 1980 two great dollar bull markets, two significant bear markets, and, more recently, two shorter periods of dollar bull and bear markets, as indicated by the arrows on the chart above.

The first bull market occurred between September 1980 and February 1985, when the dollar rose on its major currencies index from 93.3 to 145.1, an increase of 56%. The second was from June 1995 to January 2002, when it rose from 80.6 to 112.6, an increase of 40%. The two periods of dollar decline followed those booms, and extended from February 1985 to December 1987, when the dollar fell an astonishing 40% in two and a half years (partly due to the September 1985 *Plaza Accord*, which saw concerted government forex intervention), and then much more recently from January 2002 to April 2008, over which period it fell 38%. From then there was a short but sharp dollar recovery, which saw it rise by 21% from July 2008 to February 2009, and then another bear market, in which it slipped 15% from March 2009 to November 2009. Since then it has risen by about 7%, suggesting another bull run might be developing.

What will happen to metals' prices if we see another major dollar rally, similar to those of the recent past? The table below shows the change in commodity prices in dollars over the previous periods of dollar strength and weakness. Clearly, the dollar price of metals does badly when the dollar is rising, with only zinc in the first dollar bull period, platinum and palladium in the second, and gold in the third, managing to rise in price. All of the other metals in each time period saw substantial price falls. Similarly, in the dollar bear markets most

metals saw major price gains, with only zinc and tin falling in the first period, and none declining in the second.

Metal price (nominal \$) movements, %, in dollars during dollar bull/bear periods

	Dollar bull periods			Dollar bear periods		
	Sep-1980 to Jan-1985	June-1995 to Jan-2002	July-2008 to Feb-2009	Feb-1985 to Dec-1987	Feb-2002 to April-2008 %	Mar-2009 to Nov-2009
Dollar index, major currencies	56%	40%	21%	(40%)	(38%)	(15%)
Dollar/Euro	110%	55%	25%	(49%)	(46%)	(16%)
Gold	(57%)	(27%)	2%	68%	231%	24%
Silver	(72%)	(20%)	(27%)	17%	321%	37%
Platinum	(45%)	3%	(53%)	102%	352%	52%
Palladium	(51%)	130%	(56%)	14%	20%	88%
Aluminium	(34%)	(25%)	(56%)	85%	117%	56%
Copper	(33%)	(51%)	(60%)	131%	462%	101%
Lead	(58%)	(21%)	(63%)	83%	472%	123%
Zinc	11%	(24%)	(53%)	(2%)	200%	107%
Nickel	(24%)	(28%)	(68%)	87%	396%	66%
Tin	(37%)	(44%)	(46%)	(36%)	434%	35%

Source: VM Group

Of course correlation does not mean causation, and, as always, there are four possibilities. As well as (1) our conjecture that the dollar move is causing the metal prices' move, the metal prices' move could be causing the dollar moves (2); another common factor could be causing both to move (3), or it is simply a matter of coincidence (4).

We can probably rule out (2), as the metals' markets, even gold and copper, are simply not large enough to impact on currency movements, particularly the US dollar. Of the commodities only oil, given the US's huge trade deficit, could have such an impact.¹ The role of (4) is always going to have an influence to some degree, but the uniformity of our findings probably rules it out as the main explanation. That leaves (1) and (3) and – at least to some extent – we *know* (1) has to be the case.

This is because the price of metals is not set in the US, but worldwide, for although producers and consumers in the US and other dollar-linked countries are major players in these markets, they are not the entire market. Thus if for whatever reason the dollar was to fall by 10% in one day against every other currency in the world, then unless the price of each metal also falls 10% when measured in those other currencies, the dollar price of the metals *must* by definition rise. If the dollar price rises by 10%, then the price in other currencies would be unchanged.²

There is a good reason to believe the price of metals in other currencies will fall a bit, because there will be a real impact from a rise in the dollar price of a commodity, and the dollar area is important for producers and consumers of most metals. Put simply, a 10% rise in the dollar price after a 10% dollar devaluation will see demand from dollar-based consumers decline, and production from dollar-based producers increase. This will have the impact of reducing the world price (for world demand has fallen and world supply has risen) and so the price in other currencies will fall by a certain amount, meaning the dollar price will rise by somewhat less than 10%. Of course the fall in price in non-dollar areas will also have an impact on production and consumption

¹ One could perhaps imagine a scenario in which China said it would buy gold not US dollars and the dollar would fall, but even this is not a direct relationship between the two.

² To put some numbers on it – imagine gold is trading at \$1,000/oz and there are 1.5 dollars to each euro, making the euro price of gold €666.66/oz. The US announces a bond auction has failed, and the dollar falls 10%, to 1.65 dollars to one euro. If the dollar price of gold remains at \$1,000/oz then the euro price of gold would, by definition, fall to €606/oz. Instead if the dollar price was to rise to \$1,100/oz, the euro price would remain unchanged.

there, and so the balance will presumably depend on the patterns of production and consumption between dollar and non-dollar areas. It seems reasonable to assume that the more important the dollar area is to a commodity, the smaller the change in the dollar price will be – after all, if the dollar area accounted for all production and consumption of a commodity, the exchange rate would be largely irrelevant.

So there is certainly an impact on metals' prices from dollar moves. Yet in many of the examples above, the move in metals prices has been far in excess of what could have been 'predicted' by the dollar move. To put it another way – the swing in either direction, up or down, has been more extreme. This could be explained in a number of ways. It might be the case that the dollar did cause the impact expected, but that the other factors were even more important. In this scenario the commodity prices would have gone up or down, even if the dollar hadn't moved. This would mean that it is simply a coincidence that they tended to move in the expected direction (and on occasion, when the metal price move was smaller than the dollar move, they didn't). Another explanation is that the dollar move was a catalyst for an even larger move. For example, if the dollar is strengthening and the gold price is falling, investors in the US and other dollar-areas take fright and sell their holdings, thus putting more pressure on the gold price, meaning it declines more than the dollar rose. Thus in this explanation the metals' prices moved in the direction they did because of the dollar move, but in an exaggerated fashion.

Finally there is always the possibility that a third factor was influencing both – such as in the rally of 2008-2009, when it was the financial crisis propelling both the dollar higher (on safe-haven demand) and metal prices lower (with the exception of gold, which benefited from its own safe-haven).

Much of this is unpredictable. The most that can be said with confidence is that this 'mechanical' effect of a stronger dollar does seem to hit metal prices. Yet for many people around the world who don't think in dollars this will be irrelevant. A wider issue is whether, for whatever reason, large dollar moves impact on the 'world price' of metals – that is, the price in other currencies as well as the US dollar. The concept of a 'world price' however is rather nebulous. The most obvious way to calculate it would be to look at the prices of metals using a basket of currencies weighted for each metal's consumption and/or production profile.

This is a complex undertaking to do for each metal. As a shortcut we have instead simply looked at the prices of metals in a basket of other OECD currencies, calculated by using the inverse of the dollar index quoted above. In essence this removes the 'mechanical effect' of the dollar moves, and so the price movements give a flavour of how the prices have moved for non-dollar consumers around the world.

The results are rather different than when looking purely in dollar terms. During dollar bull periods, the prices of commodities in other currencies have tended to fall, especially in the first and third periods, but not universally. In the first period aluminium, copper, zinc and tin all gained in price, and in the second period all but copper and nickel gained. In the final period all but gold fell. The dollar bear markets were more uniform, with most commodities still gaining in price, although less so in the first period, when silver, palladium, zinc and nickel all fell.

Metal price movements, %, in 'dollar index' during dollar bull/bear periods

	<i>Dollar bull period</i>			<i>Dollar bear period</i>		
	Sep-1980 to Jan-1985	June-1995 to Jan-2002	July-2008 to Feb-2009	Feb-1985 to Dec-1987	Feb-2002 to April-2008 %	Mar-2009 to Nov-2009
Gold	(33%)	2%	22%	0%	106%	6%
Silver	(57%)	12%	(10%)	(30%)	163%	17%
Platinum	(14%)	44%	(44%)	20%	182%	30%
Palladium	(24%)	222%	(50%)	(32%)	(25%)	61%
Aluminium	3%	5%	(50%)	11%	35%	33%
Copper	5%	(32%)	(54%)	38%	251%	72%
Lead	(35%)	10%	(29%)	9%	257%	91%
Zinc	73%	6%	(31%)	(42%)	87%	77%
Nickel	(2%)	(22%)	(44%)	(62%)	233%	15%
Tin	17%	1%	(47%)	11%	209%	42%

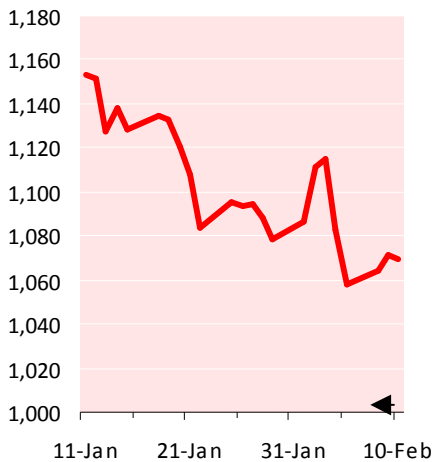
Source: VM Group

What does this tell us? Essentially, that although a dollar recovery will undoubtedly see the dollar price of metals decline, (which will be bad news for US investors or US producers but good news for US consumers), we cannot say with any certainty what will happen to the price of those metals when measured in other currencies. In the 1995-2002 dollar bull market, metals' prices measured in a basket of other leading OECD currencies actually tended to *increase*. In the 2008-2009 one, however, they (except gold) all fell. Clearly one can see reasons why this was – China's enormous demand for commodities in the early one outweighed the dollar collapse, while the financial and economic collapse in the second reinforced it.

So while the headlines are quick to sound the alert when/if the dollar rises, all tend to focus on the collapse of metals' prices. To the extent that dollar areas are involved in the production, consumption and investment of metals this will be true but the dollar's rise does not automatically mean that the price paid for or received by most of the world's producers and consumers of metals will also fall. That will depend on both why the dollar is rising, and also factors entirely unrelated to the dollar's behaviour vis-à-vis other currencies.

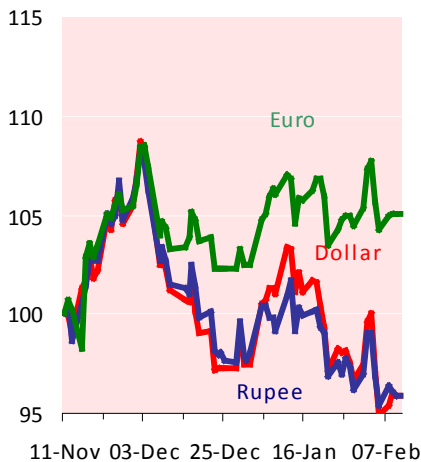
Gold

Gold, London PM fix, \$/oz



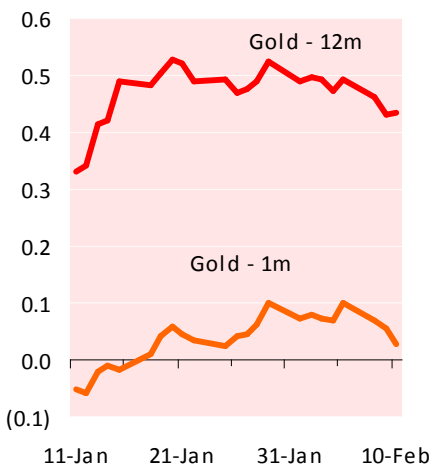
Source: LBMA, VM Group

Gold price in various currencies, three months ago = 100



Source: LBMA, VM Group

Lease rates, 1m and 12m, % per annum

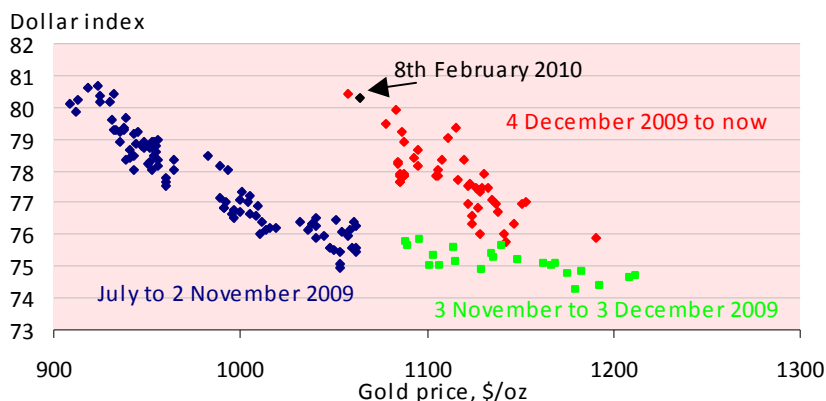


Source: VM Group

Key events & analysis

- Gold shed \$57/oz over two days in early February**, falling to its lowest fix since October 2009 on 5 February, at \$1,058/oz. The immediate cause was a stronger dollar, but although the US currency has appreciated significantly against the euro and other currencies so far in 2010, the extent of gold's move on those two days was significantly larger than the change in the value of the dollar – the US currency gained 2.1% on its dollar index between 3-5 February, and 1.8% against the euro, but gold lost 4.8%.
- Gold was not the only asset to fall** – other commodities fared worse, e.g. LME base metals (on their index) fell by 5%, the S&P GSCI commodity index lost 6%, and other 'risky' assets such as emerging-market equities suffered, with the MSCI Emerging Markets index falling 6%, and the HSBC Emerging Markets index down 7%.
- The reason for the rout seems clear enough**, and was the same reason that pushed up the dollar. An increase in 'risk aversion' caused by fears over the credit-worthiness of Greece and other European countries, plus signs that the Chinese authorities were taking actions to rein-in the country's rampant growth, created a flight-to-safety, of which the US Treasury bonds and the dollar were the main beneficiaries.
- Why didn't this help gold, which after all is seen as a safe-haven?** The answer seems to be "it depends". On each of the 11 trading days since 2004 when the MSCI Emerging Markets index has fallen by more than 5%, gold has risen on six and fallen on 7; excluding the effect of the dollar, which tends to rise on such occasions, gold has risen on eight and fallen on five. But on three of those five it has fallen by a hefty 3-4%, similar to this time around.
- These occasions seem to be when there has been a rein-in of carry-trade positions (dollars borrowed in the US to fund more lucrative investments elsewhere).** As investors liquidate assets to obtain dollars the price of those assets fall, and gold is no exception. The fall would make sense if gold investors fit into broadly two categories – those who hold gold for "safe-haven" reasons over the medium to longer-term, and those with a shorter-term outlook that are holding it merely because it is going up. If the latter sell when risk aversion rises, then the extent to which the gold price falls on such occasions will depend on what proportion they make up of the investment community; given gold's tremendous run since September 2009 it was probably higher than normal before the most recent correction.
- Yet there is another puzzle and problem – the lack of obvious investment flows into the ETF, either inflows or outflows.** The market-leading SPDR ETF by 8 February had seen an outflow on the week earlier of only 5t, and this was due to an outflow of 7t before the price crash on 4 February – after that there was an inflow of 2t. This perhaps suggests ETF holders are more long-term investors. Nevertheless the lack of investment inflows is a problem for the gold market – across all 17 gold ETFs we track there was a net outflow of 21.4t in January, and about 7t so far in February. Small as these are they are a problem. At this time last year there were huge inflows, 105t in January 2009 and an enormous 221t in February 2009. Unless inflows pick up in the next few weeks that will be a gap of about 350t in two months alone – and one that needs filling elsewhere.

The big question now is – can gold fall further? Despite the stronger dollar gold has held onto some of the gains it made in Q4 2009. Compare the gold price now (\$1,060/oz) when the dollar index is just over 80.4, with what it was (\$930/oz) when the dollar index was last over 80.4, in early July 2009. This can also be seen on the following chart, which plots the dollar index against the old price for each trading day since July 2009. It's evident how the gold price responds to the dollar; in 2H 2009 up to 2 November rising as the dollar fell in a pretty consistent way. Then, although in November/early December the dollar fall slowed, the gold price increase accelerated. Now, after 4 December, the dollar has been gaining and the gold price falling, but gold is now at a consistently higher level.



Short term outlook

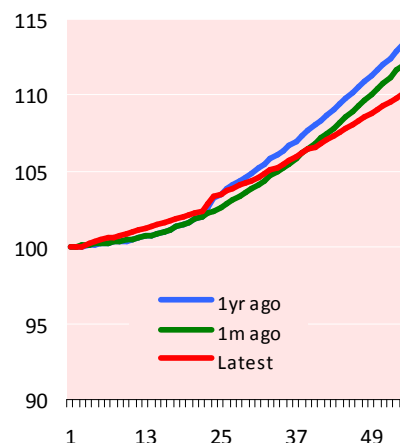
There are two risks for gold: further dollar gains, and/or a realignment of gold prices at every dollar level. The former is probably not too worrisome; currencies go up and down. The latter would be worse, if for example investors decide it's time to take profits and run. Certainly there seems little inclination to add to positions. We think this scenario is unlikely while the debt/deficit situation is so severe and inflation one possible remedy. In the short-term then nervousness about the dollar's recovery will dominate: \$1,020/oz-\$1,120/oz.

Gold supply & demand balance, tonnes

	2008	2009	2010f
Supply			
Mine supply	2,356	2,432	2,435
Scrap recycling	1,185	1,408	1,500
Hedging	33	38	20
Central Bank sales	298	351	260
Total supply	3,871	4,229	4,215
Demand			
Jewellery fabrication	1,976	1,798	1,600
Legal tender coins	201	215	201
Electronics	422	366	390
Other end uses	313	284	250
ETFs	320	576	700
Central Bank purchases	191	380	250
Dehedging	374	229	120
Total demand	3,796	3,848	3,511
Residual	75	397	704

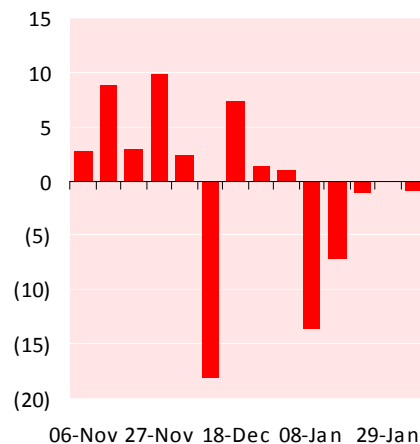
Source: VM Group

Gold forward curve (Comex), 1st position = 100, various dates

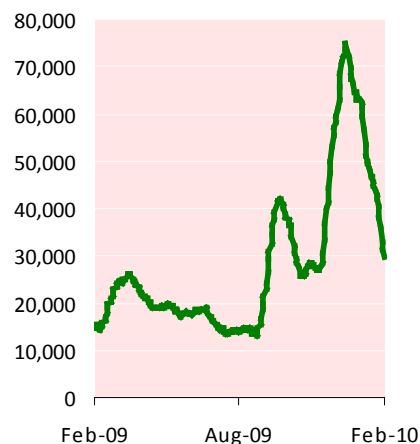


Source: VM Group

Gold ETF offtake, tonnes



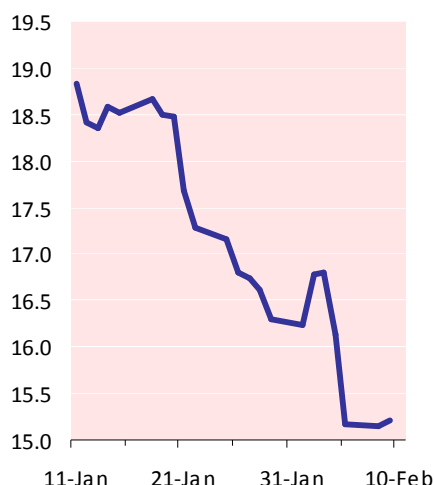
Shanghai Gold Exchange trading, lots/day (average past 22 days)



Source: VM Group

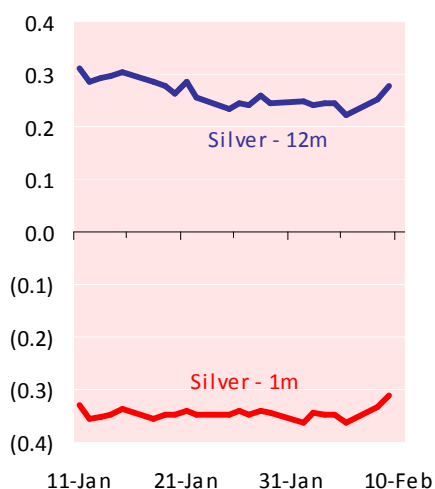
Silver

Silver, London fix, \$/oz



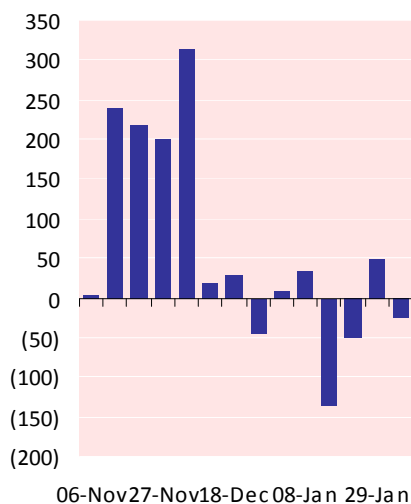
Source: LBMA, VM Group

Lease rates, 1m and 12m, % per annum



Source: LBMA, VM Group

Silver ETF offtake, weekly, tonnes



Source: VM Group, ETF providers

Key events & analysis

- Other forms of offtake are about to surpass photographic demand for the first time.** Total silver offtake from expanding end-use sectors such as solar panels, batteries, wound care dressing, radio frequency tags and hygiene will, for the first time, surpass that of the photographic sector in 2010. We estimate photographic demand will account for 3,930t of silver (~126 Moz) in 2010, compared with more than 3,972t from these new end use sectors. The photovoltaic sector will see the greatest growth, up 44% on 2009 to 802t, owing to the huge and growing level of investment into alternative energy sources. Radio frequency identification tag demand will rise 42% year-on-year, to 51t, and silver use in reflective mirrors will increase by 39%, to 723t. By 2011, the difference between photographic demand and total new end-user demand will widen to more than 800t, as the former declines and latter expands rapidly. Silver should therefore receive much more support from industrial demand in the medium to long term, after many years of stagnant consumption, and this will be reflected in higher prices.
- Investment declines.** Recovery in the US and other OECD economies has yet to materialise as anticipated and sovereign default risk in Greece and some other EU nations has led investors to seek the safety of the US dollar and Japanese yen. This has not benefited silver, with Comex investment down by more than 50 Moz since the start of this year and ETFs off by about 4.5 Moz, as at 8 February. Until the EU deals firmly with the debt problems in Greece and recovery becomes clearer in the US and elsewhere, we expect prices to be volatile.

Short term outlook

For several months silver has tracked the gold/dollar play; as the US dollar has weakened the gold price has strengthened. But fears over the strength of global economic recovery and EU member state debt burdens has led to a dash for cash not seen since the peak of the financial crisis. We see little else to preoccupy the markets in the short term, and expect silver prices to be extremely volatile on the ebbs and flows of positive and negative data. Short-term London fix: \$14.50/oz-\$16.50/oz.

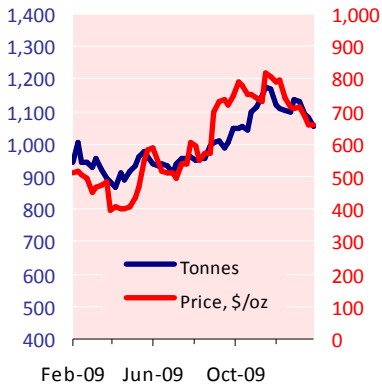
Silver supply & demand balance, tonnes

	2008	2009e	2010f
Supply			
Mine supply	21,353	21,907	22,565
Recycling	13,058	13,132	12,972
Government	500	500	250
Total supply	34,910	35,539	36,570
Demand			
Jewellery and Silverware	7,784	7,996	8,044
Photographic	4,349	3,604	3,930
Electrical/Electronics	4,349	3,604	3,930
Brazing Alloys	1,293	1,287	1,285
Catalysts	1,516	1,501	1,516
Others	3,127	3,288	4,011
ETF	2,325	3,107	3,000
Coins	1,470	1,955	2,443
Total demand	28,460	28,955	30,487
Residual	6,450	6,584	6,084

Source: VM Group

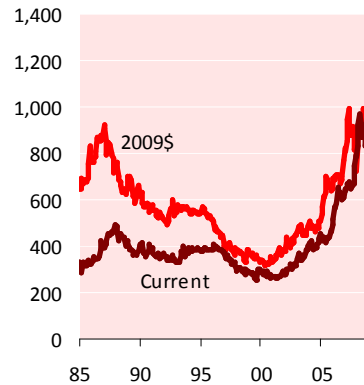
Gold and silver data

Gold CFTC net long position & price



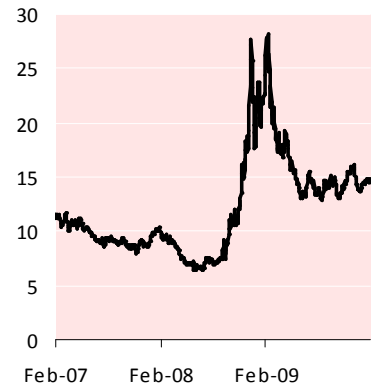
Source: VM Group, CFTC

Gold in current \$/oz and 2009 \$/oz



Source: VM Group

Gold/oil ratio, past 3 years



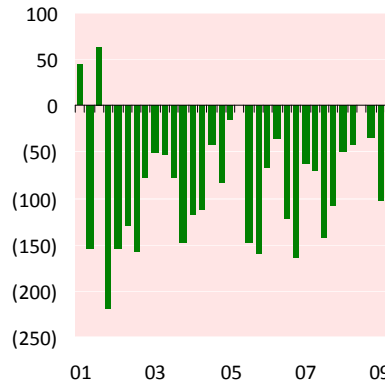
Source: VM Group

Gold/silver ratio, past 3 years



Source: VM Group

Gold dehedging, tonnes/quarter



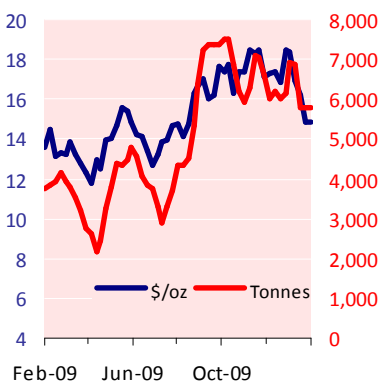
Source: VM Group.

Latest central bank data (Dec 09)

Country/institution	Tonnes
Kazakhstan	(1.6)
Malta	(0.2)
Total sales	2.1
Russia	23.9
Total purchases	24.0
Net change	20.9

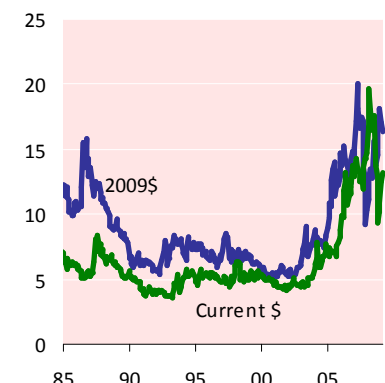
Source: IMF, International Financial Statistics & national country website. Not all country changes shown

Silver CFTC net long position & price



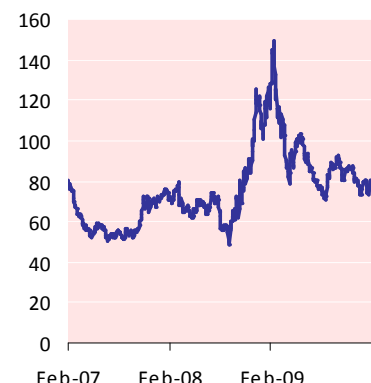
Source: VM Group, CFTC

Silver in current \$/oz and 2009 \$/oz



Source: VM Group.

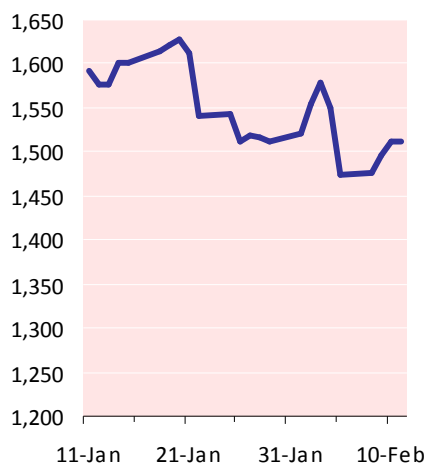
Silver/copper ratio, past 3 years



Source: VM Group.

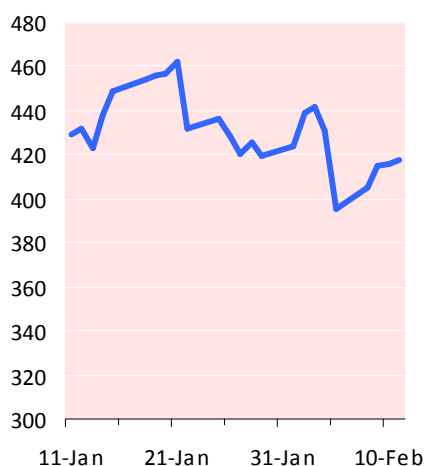
Platinum and palladium

Platinum price, PM fix, \$/oz



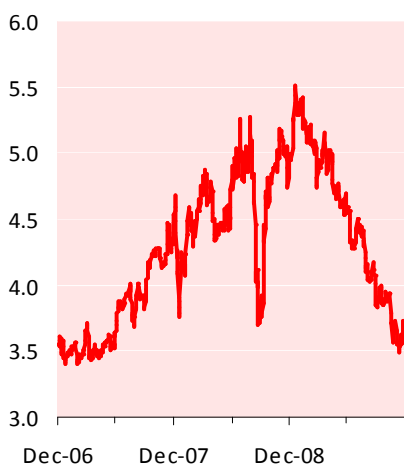
Source: LPPM, VM Group

Palladium price, PM fix, \$/oz



Source: LPPM, VM Group

Platinum/palladium price ratio



Source: VM Group, ETF Securities

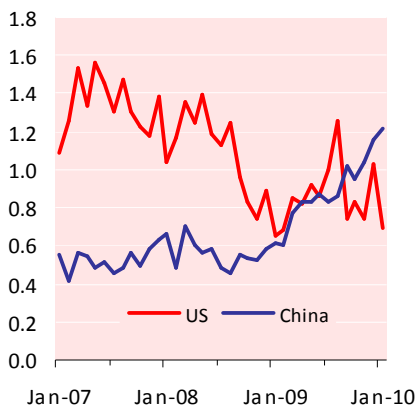
- Platinum and palladium** enjoyed a fantastic first half of January on the back of surging US ETF demand. This took platinum to \$1,627/oz on the London fix by 20 January, and palladium \$462/oz on 21 January – their highest prices since July 2008.
- It wasn't to last however.** An easing off of the US ETF throttle, a stronger dollar and a generalised flight from risky assets saw both platinum and palladium prices decline in late January and then tumble in early February, fixing on 8 February at \$1,477/oz (platinum) and \$405/oz (palladium) respectively, essentially back where they ended 2009.
- Offtake in the US ETFs** as of 5 February there were 265,000 oz in the platinum ETF and 430,000 oz in the palladium. These are large amounts – it took the UK ETF almost two years to get a similar amount of platinum and longer for palladium. However there has been some selling from the other ETFs, with the UK platinum ETF shedding about 25,000 oz and the UK palladium ETF falling slightly more than 70,000 oz. This might be normal buying and selling, or it could be – as we suggested in our forecasts of US PGM ETF offtake made in the last issue of the Metals Monthly that the US ETFs are taking market share from previously existing products.
- Car sales data has been mixed.** China continues to record remarkable figures – January 2010 saw 1.22m passenger cars sold, the highest monthly figure on record and exactly double the amount sold in January 2009. US sales were 896,417 units, 12.2% higher than in January 2009, the best year-on-year comparison since July 2005. However the market perhaps overreacted to this seemingly good news – January 2009 was an appalling month for US car sales. Compared with a more normal January 2008, sales were 30% down, the same as in December and not much better than in the worst months of 2009.
- Europe** saw a mixed picture, with December car sales down 3.3% year-on-year but data from January – which is incomplete – suggesting a reasonable performance from France (14% year-on-year) and the UK (30% year-on-year), with less positive sales from Germany (down 4% year-on-year). These year-on-year comparisons for Germany in particular will suffer from now on, as sales get compared with incentive-boosted figures from 2009. However for platinum a key statistic has been a rebound in sales of diesel vehicles in December, taking 51% of the market, up from 46% in November.

Short term outlook

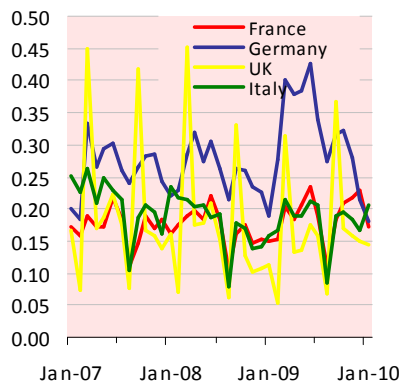
We've been relatively negative on PGMs due to our view that car sales had been artificially boosted and would begin to decline, especially in Europe. It's too soon to say, but China's efforts to surge ahead to help palladium and Europe's diesel bounce-back will support platinum. Production woes will also provide a floor, and so were slightly more positive than we were. A lot will depend however on the US ETFs. Short-term London fix, platinum: \$1,450/oz-\$1,550/oz, palladium: \$390/oz-\$440/oz.

PGMs data

US & China car sales, monthly, million units



Top four European car markets sales, monthly, million units

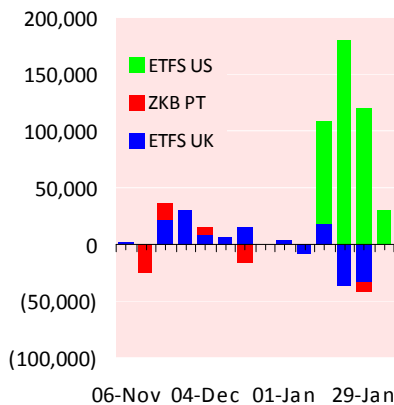


Platinum turnover on the SGE, rolling 3m average, annualised, oz

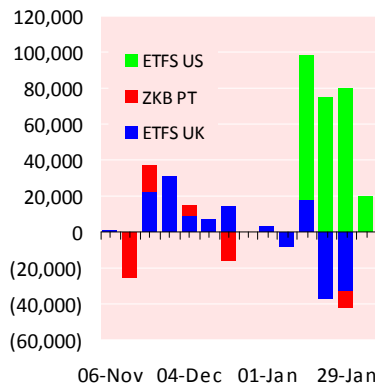


Source: VM Group

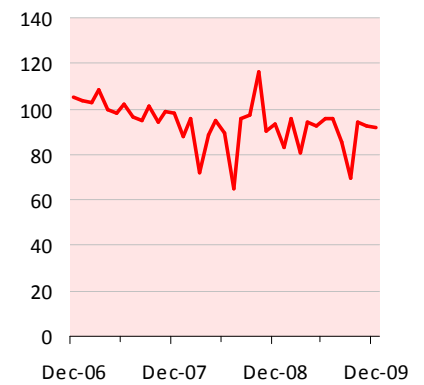
Palladium ETFs weekly offtake, oz



Platinum ETFs weekly offtake, oz



South Africa PGM output, 2005=100



Source: VM Group

Platinum supply & demand balance

	Platinum	2008e	2009f	2010f
Supply				
Mine supply		5,964	6,120	6,120
Scrap recycling		875	735	740
Total supply		6,839	6,855	6,860
Demand				
Autocatalysts		3,538	2,950	3,000
Jewellery		1,396	2,200	1,500
Other industrial		1,912	1,371	1,571
Total demand		6,846	6,521	6,071
Residual		(7)	334	789
<i>Stock movements</i>				
ETF inflows		102	280	750
Other investment		440	175	175
Unknown/implied investment		(549)	(121)	(136)

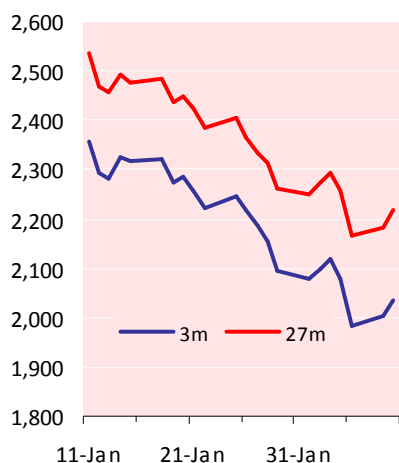
Palladium supply & demand balance

	Palladium	2008e	2009f	2010f
Supply				
Mine supply		6,242	6,169	6,200
Scrap recycling		1,392	1,150	1,150
Total supply		7,634	7,319	7,350
Demand				
Autocatalysts		4,411	4,000	4,150
Jewellery		1,022	1,075	1,000
Other industrial		2,234	2,092	2,140
Total demand		7,667	7,167	7,290
Residual		(33)	152	60
<i>Stock movements</i>				
ETF inflows		367	485	1,000
Russian stock sales		(1,000)	(950)	(950)
Unknown/implied investment		600	617	10

Source: VM Group, Johnson Matthey

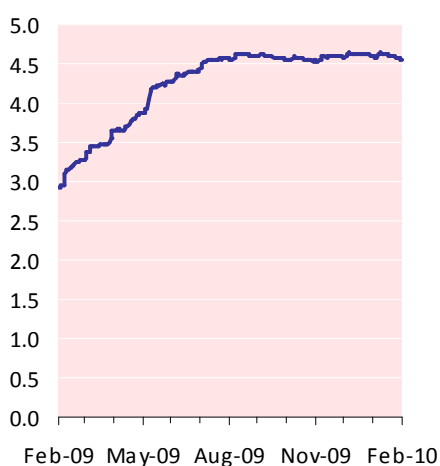
Aluminium

Aluminium price, LME, \$/tonne



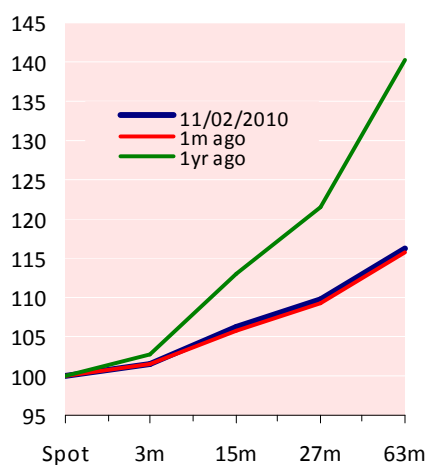
Source: LME, VM Group

Aluminium stocks, LME, Mt



Source: LME, VM Group

Aluminium forward curve, LME, various dates, spot price = 100



Source: LME, VM Group

Key events & analysis

- Have fundamentals come home to roost?** From a high of \$2,390/t on 6 January, three-month aluminium fell to a low of \$1,970/t on 5 February. This correction is not surprising given that the aluminium market remains in structural oversupply and prices above \$2,000/t are unjustifiable in supply-demand terms. Falling LME warehouse stocks might indicate that demand, at least in the form of restocking, is picking up. But it is more likely just stock reallocation into term financing deals, thanks to the steep contango structure in the nearby forward spread. It is certainly not a recovery in demand, which remains weak.
- China's annualised aluminium production hits 16 Mt/y.** According to the International Aluminium Institute, China produced 1.331 Mt of primary aluminium in December, which when annualised suggests that China is on course to produce as much as 16 Mt in 2010. Current capacity stands at about 17 Mt/y, with as much as 3 Mt/y more scheduled to come online should conditions be profitable. One obvious hurdle is costs. We estimate marginal costs of production in China stand at more than \$2,100/t including VAT, from \$2,000/t in November 2009 for grid-connected smelters, and against \$1,550/t in Q1 2009. This is largely due to higher power tariffs and alumina prices. SHFE spot aluminium was trading at \$2,318/t (~\$1,981/t excl VAT) on 8 February, down 10% from mid-January, meaning marginal grid-connected producer costs are not being met. For smelters with integrated power, representing more than half of total Chinese smelters, marginal costs are currently \$1,900/t-\$1,950/t. Chinese aluminium consumption will however remain strong and we do not expect SHFE prices to languish at current levels long after the Chinese New Year holiday period ends.
- Alcoa's Italian job.** Alcoa's attempts to force the Italian authorities to offer cheaper power tariff rates could pay off, as the government attempts to avert job losses before regional elections in March. If Alcoa succeeds it will be a coup for the company, but in the longer term the shift of aluminium production centres to regions offering cheaper electricity costs will continue to expand at the expense of US and EU operators.

Short term outlook

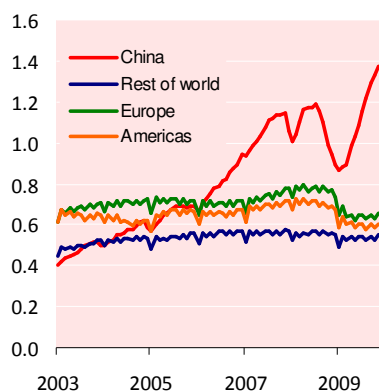
The market was surprised at the severity and rapidity of the correction, but sentiment is a fragile thing and there appears little in the immediate term that will see aluminium prices do more than consolidate at their current levels. Short term price: \$1,900/t-\$2,150/t.

Chinese aluminium and alumina prices, yuan/t

	10 February 2010	Current	YoY % chg	Last mth	YoY % chg
SHFE spot price	16,285	16,285	36%	17,540	66%
SHFE three-month price	16,595	16,595	40%	17,985	69%
SHFE six-month price	16,860	16,860	42%	18,225	32%
SHFE stocks, tonnes	307,453	307,453	64%	297,098	42%
Chinese aluminium ingots (99.7%min)	16,125	16,125	34%	17,325	40%
Chalco alumina prices	3,000	3,000	36%	3,000	50%
Chinese alumina (Australian import)	2,875	2,875	42%	3,075	48%

Aluminium data

Aluminum output by region, monthly, Mt



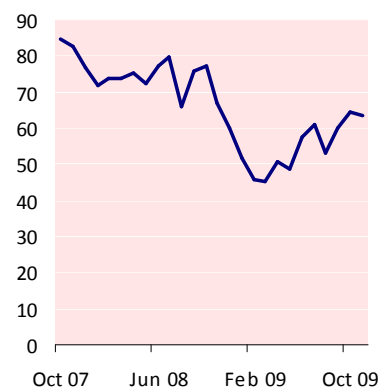
Source: IAI, VM Group

SHFE/LME price differential, \$/t



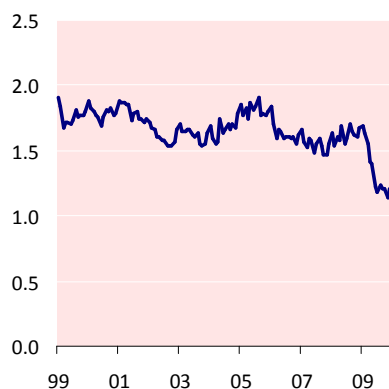
Source: SHFE, LME, VM Group

Japanese domestic shipments of extruded products, 000t



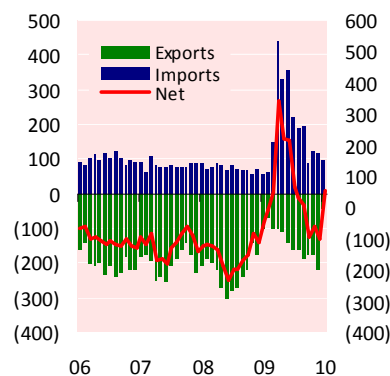
Source: Japan Aluminium Association

Unwrought aluminium producer stocks, Mt



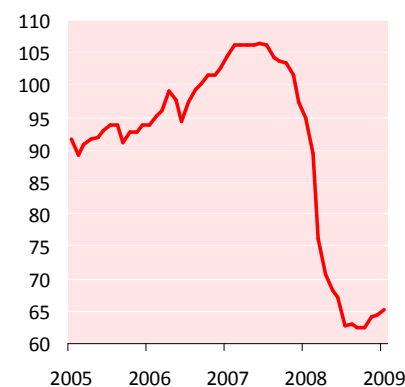
Source: IAI, VM Group

Chinese imports/exports of unwrought aluminum and aluminum products, 000t



Source: China Customs

US output, alumina and aluminium, 100=2002



Source: Federal Reserve, VM Group

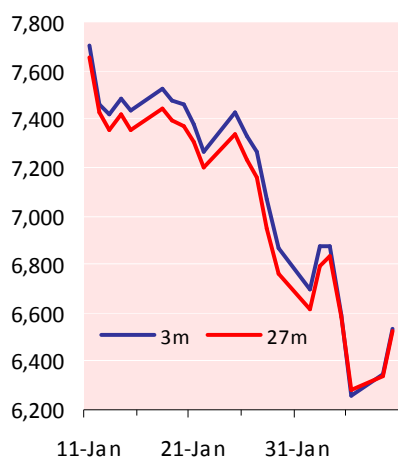
Aluminium supply & demand balance, 000t

	2006	2007	2008	2009e	2010f	2011f
Supply						
China	9,352	12,605	13,247	13,483	16,250	17,885
North America	5,334	5,643	5,783	4,762	4,721	4,801
Europe & CIS	9,197	9,665	9,997	8,774	8,412	8,482
Rest of world	10,029	10,181	10,588	10,438	10,485	11,100
Total world output	33,912	38,094	39,615	37,457	39,868	42,268
Year-on-year % chg	6%	12%	4%	(5%)	6.4%	6.0%
Demand						
Total world consumption	34,121	37,765	38,265	35,722	38,651	41,434
Year-on-year % chg	7%	11%	1%	(7%)	8.2%	7.2%
Implied market balance	(209)	329	1,350	1,735	1,217	834
Total stocks	3,671	4,248	4,987	6,695	7,858	8,438
Average 3-m LME price (\$/t)	2,593	2,662	2,626	1,703	2,250	2,500

Source: IAI, WBMS, VM Group

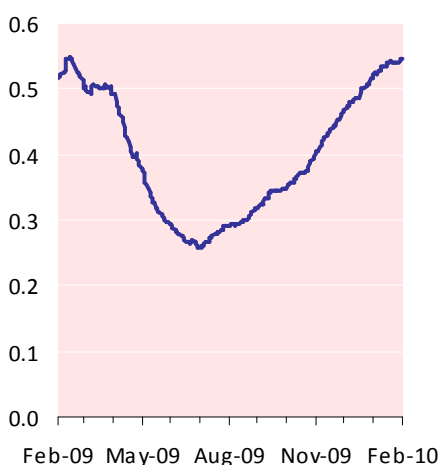
Copper

Copper price, LME, \$/tonne



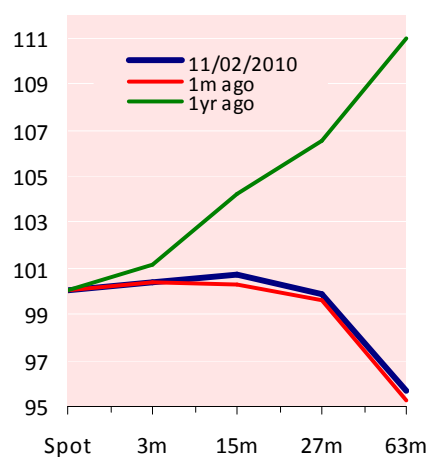
Source: VM Group

Copper stocks, LME, Mt



Source: VM Group

Copper forward curve, LME, various dates, spot = 100



Source: VM Group

Key events & analysis

- Chinese copper smelting capacity to expand rapidly but fall short of real consumption in the short to medium term.** Almost 2 Mt/y of new copper smelting capacity will come online within the next two years, according to estimates, lifting China's total copper smelting capacity above 7 Mt/y. But China's real consumption of copper could rise by 9% year-on-year in 2010, to more than 7.4 Mt; with utilisation rates likely to remain at approximately 80-90% including unforeseen disruption and planned maintenance, there is plenty of room for strong refined imports ahead, especially in the short term should the current SHFE/LME arbitrage window remain open. But the large bonded warehouse inventories will likely be depleted first and we anticipate 2010 import volumes will be lower, at about two-thirds of 2009, or ~2 Mt.
- Copper prices dive on reversal in sentiment.** The fall was overdue. Prices had got ahead of fundamentals in 2009 and early 2010, betting on sustained Chinese demand growth and a swift return to growth in the OECD economies. But Beijing's recent measures to rein-in lending sparked fears that its demand for raw materials would falter year-on-year, while recently less than pleasing data from the US and EU has dented confidence in the strength of recovery outside China. The subsequent sell-off by CTAs, system traders and funds saw the copper price fall by about 20% from its high on 11 January, to a low of \$6,240/t on 5 February. Conversely, the US dollar and Japanese yen firmed on safe haven buying, yet their strength came more from the threat of sovereign default in the EU, as well as Chinese credit tightening, than any recovery in their respective economies. The debt risk in a number of EU member nations is a concern and while it remains so we see little possibility of the US dollar weakening, and hence see little support for the copper price.

Short term outlook

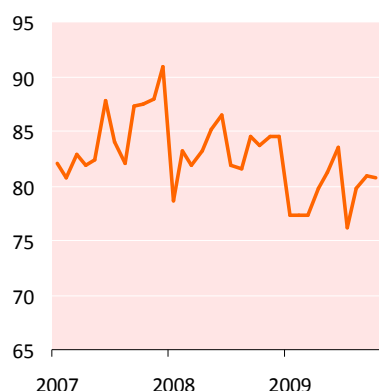
There appears little prospect of copper prices rebounding during and shortly after the Chinese New Year holiday period. Furthermore, short term indicators offer little support for prices to surprise on the upside. Total exchange stocks are rising and were 0.76 Mt on 8 February, while LME cancelled warrants at <1% of total LME stocks suggest little will leave in the near future. H1 2010 is shaping up to be a mighty tussle between bears and bulls and hence we expect prices to be volatile, but we maintain our view that H2 will see prices once again rise on OECD recovery and sustained Chinese demand. LME 3-month short-term price: \$6,100/t-\$7,000/t.

Chinese copper prices, yuan/t (unless stated otherwise)

	10 February 2010	Current	YoY %chg	Last mth	YoY %chg
SHFE spot price		54,190	87%	61,120	145%
SHFE three-month price		54,140	90%	61,490	164%
SHFE six-month price		54,450	90%	61,870	175%
SHFE stocks, tonnes		114,302	237%	98,814	335%
Chinese copper cathode (99.95%)		55,250	90%	61,250	105%
		Current		Last mth	6m ago
Copper TC (cif) China (\$/t)		10.5		10.5	27.5

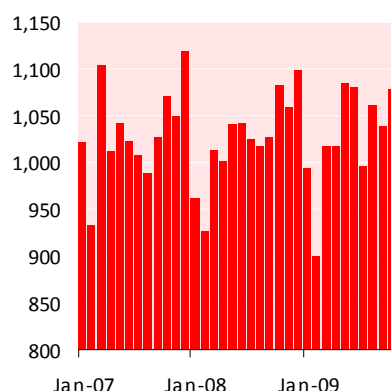
Copper data

World mine capacity utilisation, %



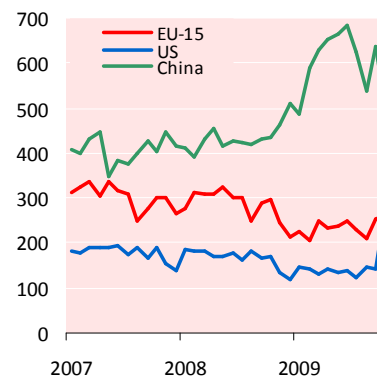
Source: ICSG, VM Group

Global copper concentrate output, monthly, 000t



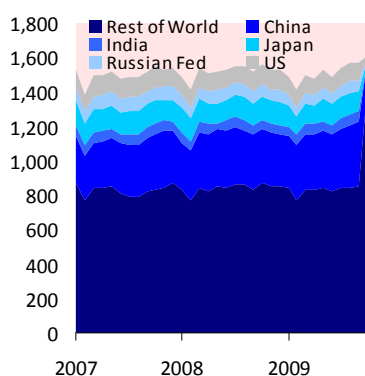
Source: ICSG, VM Group

Apparent copper usage, monthly, 000t



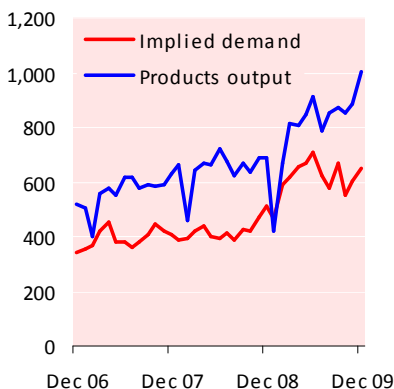
Source: ICSG, VM Group

Monthly refined copper production (primary and secondary), 000t



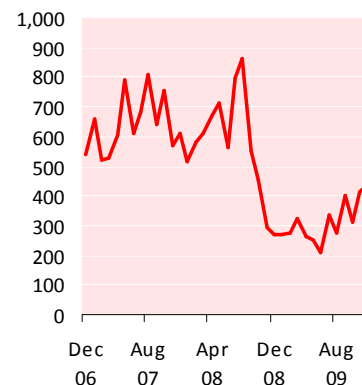
Source: ICSG, WBMS, VM Group

China implied copper demand & copper output, monthly, 000t



Source: China customs, NBS, VM Group

US copper imports in million dollars



Source: US Census Bureau, VM Group

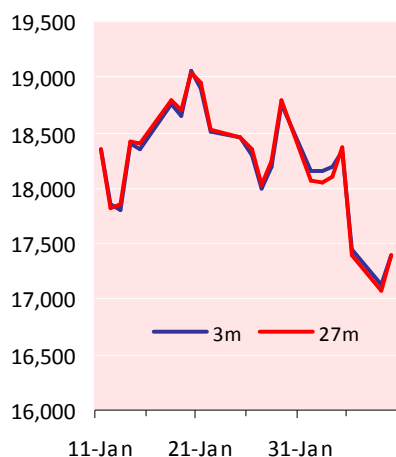
Copper supply & demand balance, 000t

	2006	2007	2008	2009f	2010	2011
Supply						
Total mine production	14,983	15,439	15,450	15,262	15,924	16,028
Year-on-year %change	0%	3%	0%	-1%	4%	1%
North America	2,150	2,169	2,182	2,011	2,045	2,151
Latin America	3,555	3,600	3,515	3,564	3,601	3,604
Asia (ex China)	3,974	4,167	4,121	3,952	4,056	4,065
China	2,822	3,222	3,597	4,011	4,178	4,047
Europe	3,551	3,578	3,698	3,562	3,621	3,680
Total refined production	17,361	18,011	18,232	18,288	18,564	18,917
Year-on-year %change	5%	4%	1%	0%	1.5%	1.9%
Demand						
Total refined consumption	17,148	18,048	18,027	17,821	18,312	18,918
Year-on-year %change	3%	5%	0%	(1%)	2.8%	3.3%
Implied balance	213	(37)	204	467	252	(2)
Total stocks	1,093	1,422	1,158	1,263	1,515	1,513
Average 3-m LME price (\$/t)	6,861	7,096	6,871	5,186	6,970	7,788

Source: ICSG, WBMS, VM Group

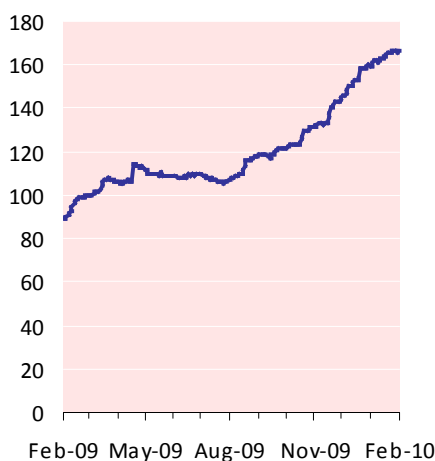
Nickel

Nickel price, LME, \$/tonne



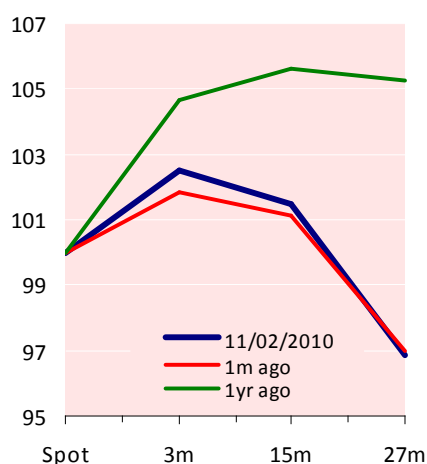
Source: VM Group

Nickel stocks, LME, 000 tonnes



Source: VM Group

Nickel forward curve, LME, various dates, spot = 100



Source: VM Group

Key events & analysis

- Chinese stainless steel production rose 26.8% to 8.8 Mt in 2009**, according to the Stainless Steel Council of China. China's apparent consumption of stainless steel increased by almost 32%, to 8.22 Mt. The near 0.6 Mt gap between production and consumption supports our view that stainless steel stockpiles in China are vast, and could dampen apparent demand for nickel in the near term. Moreover, China's production and net imports of nickel, excluding low-grade nickel ore, rose 66% in 2009, to 0.43 Mt, which implies similar vast off market stocks also exist. Nevertheless, we anticipate Chinese stainless steel production will rise by as much as 20% in 2010 to 10.5 Mt, which should see most of these stocks eroded within H1.
- Stalled nickel supply set to return.** A crucial support to nickel prices will be largely removed if Vale follows through with its threat to restart full production at its strike-stalled Sudbury operation in Canada. The company has already partially restarted two of its nickel mines and the first of two furnaces at its main Sudbury smelter using contracted workers. Its next step, which has as yet no timetable, is to ramp-up Sudbury to full production. In addition Xstrata has settled wage talks with workers at its Sudbury operation, removing yet another potential support to prices.
- Stainless demand outside China remains weak.** There is little to shout about concerning nickel consumption outside of China in the near term. This was recently summed up by Finnish stainless steel producer Outokumpu: "No major improvement in the underlying demand for stainless steel is yet visible." It is surprising therefore to see that nickel prices have fallen only 5% since the start of the year, compared with double digit declines in aluminium, copper, lead and zinc.

Short term outlook

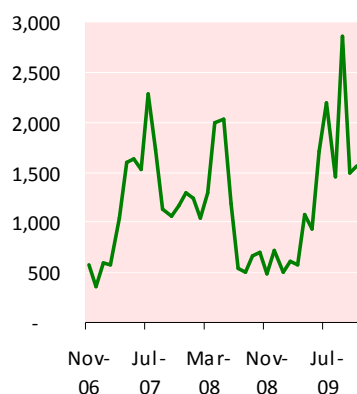
We expect nickel prices to fall in line with corrections in the other base metals over the coming weeks. The fact that they have not, as at 9 February, may be due to expectations that the OECD restocking phase is likely to be vigorous and remove much of the visible stock. However, judging by the mood of many stainless steel producers, this is unlikely to happen any time soon. Furthermore, LME stocks are still rising, albeit at a slower pace than in December, and this too is negative. We expect nickel to break below \$16,300/t in the very near future and then possibly decline to \$15,500/t, but we maintain that nickel prices will average more than \$20,000/t in 2010. LME 3-month short-term price: \$15,500/t-\$19,500/t.

Chinese nickel and stainless steel prices, yuan/t

	10 February 2010	Current	YoY %chg	Last mth	YoY %chg
Nickel cathode (Jinchuan, 99.9% min)		141,500	51%	141,500	56%
Nickel cathode (Norilsk 99.9% min)		141,000	54%	141,000	59%
Nickel cathode (Vale Inco, 99.9% min)		160,500	51%	443,500	68%
Stainless steel					
Hot rolled sheet (304)		19,550	38%	19,050	31%
Cold rolled coil (304)		22,950	35%	22,250	26%

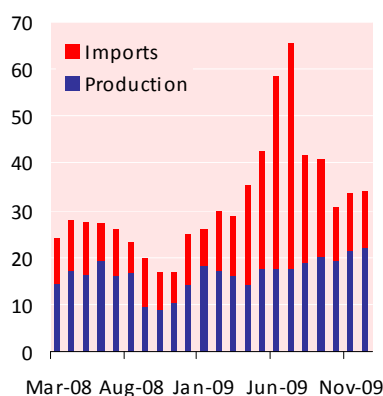
Nickel data

Chinese imports of nickel ore, 000t



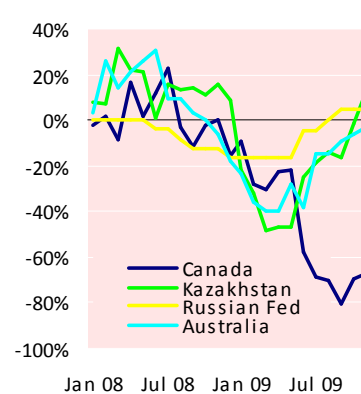
Source: China Customs

Chinese refined nickel output and imports, 000t



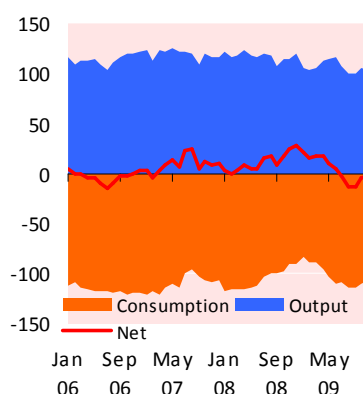
Source: China Customs, NBS

Nickel mine production, year-on-year % change



Source: INSG, VM Group

World primary output and refined consumption, 000t



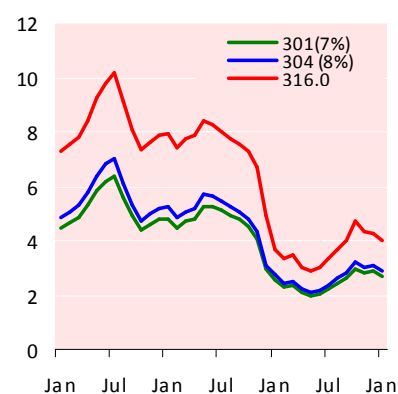
Source: INSG, VM Group

Chinese stainless CR Sheet (304 2b, 1mm), yuan/t



Source: Asian Metals, VM Group

US stainless steel prices for flat rolled coil, \$/kg



Source: Metal Prices

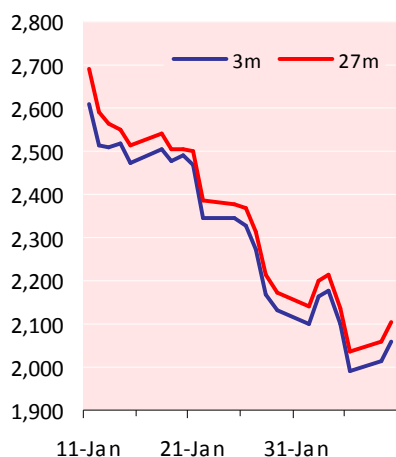
Nickel supply & demand balance, 000t

	2006	2007	2008	2009f	2010	2011
Supply						
Total mine production	1,469	1,595	1,476	1,331	1,395	1,468
% chg y-o-y	5.9%	8.6%	(7.5%)	(9.8%)	4.8%	5.2%
Canada	147	154	168	116	155	165
China	137	199	200	240	265	267
Japan	152	162	158	142	152	161
Russian Fed.	286	272	258	244	250	265
Australia	114	111	104	112	114	118
Total refined production	1,368	1,395	1,375	1,319	1,405	1,449
% chg y-o-y	7.3%	2.0%	(1.4%)	(4.1%)	6.5%	3.1%
Demand						
Total refined consumption	1,398	1,351	1,319	1,238	1,364	1,445
% chg y-o-y	12.0%	(3.4%)	(2.4%)	(6.1%)	10.2%	6.0%
Implied balance	(31)	44	57	81	41	4
Total stocks	95	146	182	263	304	338
Average 3-month LME price (\$/t)	23,266	36,217	21,240	14,762	20,375	26,250

Source: INSG, WBMS, VM Group

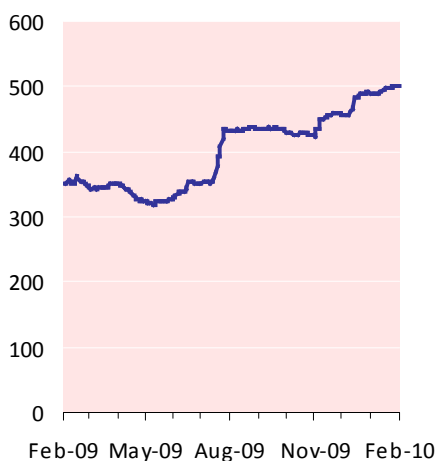
Zinc

Zinc price, LME, \$/tonne



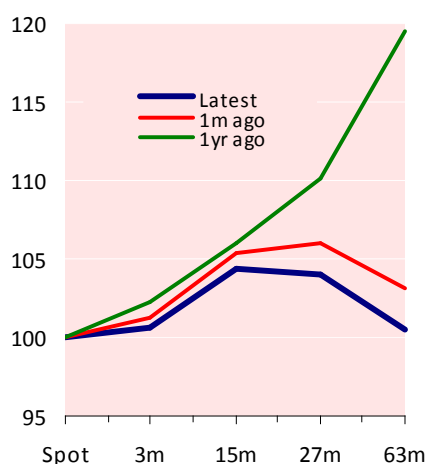
Source: VM Group

Zinc stocks, LME, 000 tonnes



Source: VM Group

Zinc forward curve, LME, various dates, spot = 100



Source: VM Group

Key events & analysis

- LME zinc stocks pass 0.5 Mt for the first time since October 2005.** Rising exchange stocks on both the LME and SHFE paint a bleak picture, especially with cancelled warrants on the LME representing just 0.7% of total inventories. Zinc prices started the year on a positive note, gaining 7% to reach a high of \$2,730/t on 7 January, as expectations of continued Chinese demand growth and OECD demand recovery supported the idea that zinc offtake within the construction and automobile sectors might be recovering. But prices have since fallen 29% to reach a low of \$1,938/t on 5 February, tracking declines in copper and lead. We view this as a positive for zinc's price prospects later on this year, since we were concerned that zinc miners would have been encouraged to switch on idled and new production capacity over and above the actual level of demand. This would have inflated the already copious volumes of visible and off market inventories, leading to an even greater surplus by year-end. Should zinc prices consolidate around \$2,000/t then the surplus estimated by us at the start of 2010 of 330,000t is still feasible, but considering the anaemic economic data emanating from the US and EU, we have revised down our projections for global consumption to 11.16 Mt, with the resulting market balance to show a surplus of 370,000t.
- Chinese zinc TCs rise.** There appears to be no shortage of zinc concentrate in China, with some smelters holding as much as three months of working stockpiles. But with as much as 1 Mt of additional smelter capacity due to come online this year, we expect zinc concentrate imports to remain strong despite domestic mine supply rising to more than 3.3 Mt. China produced a record 461,700t of refined zinc in December 2009, up 4% month-on-month and 47% year-on-year, with total 2009 output at 4.3 Mt. In 2010 we expect China's refined zinc output to rise to almost 4.7 Mt, but consumption could fall short by as much as 0.4 Mt, leaving the door open for exports to rise significantly on 2009 levels of just 29,275t. Rising zinc exports do not bode well for the LME zinc price considering that stock builds in US based warehouses so far this year indicate that demand still remains weak.

Short term outlook

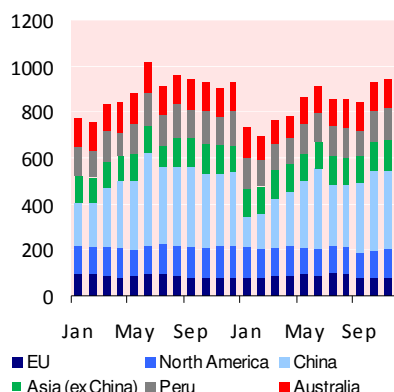
Our medium-term forecast for zinc remains bullish but our short term view is that prices may need to slip further to stimulate necessary supply cuts by marginal operators. Like copper we envisage a great play among bulls and bears in the next few months and thus plenty of volatility. LME 3-month short-term price: \$1,850-\$2,225/t.

Chinese zinc prices, yuan/t, unless otherwise stated

	10 February 2010	Current	YoY %chg	Last mth	YoY %chg
SHFE spot price		17,380	62%	20,775	78%
SHFE three-month price		17,645	70%	21,145	79%
SHFE six-month price		18,020	72%	21,685	53%
Chinese zinc ingot (99.995% min)		17,300	61%	20,950	95%
Chinese zinc conc (55% min) S China		11,250	83%	14,050	118%
Chinese zinc conc. (55% min) N China		10,950	81%	13,650	118%
Zinc conc TC (50% min, cif) China (\$/t)		205	116%	195	11%

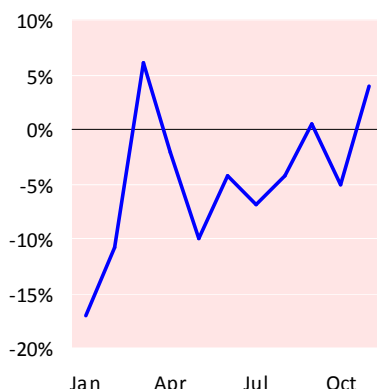
Zinc data

Zinc mine production, 000t



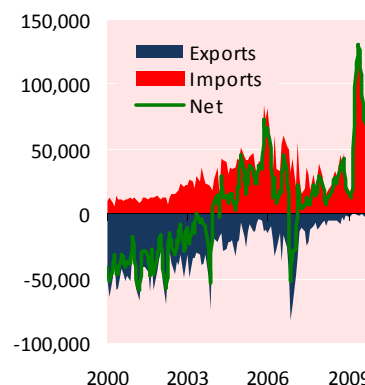
Source: ILZSG, WBMS, VM Group

World zinc demand, Jan 2009-Oct 2009, y-o-y % change



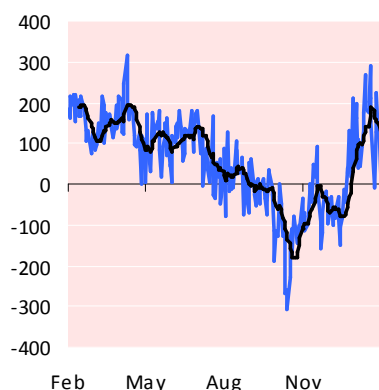
Source: ILZSG, CHR Metals, VM Group

China: imports and exports of unwrought zinc, 000t



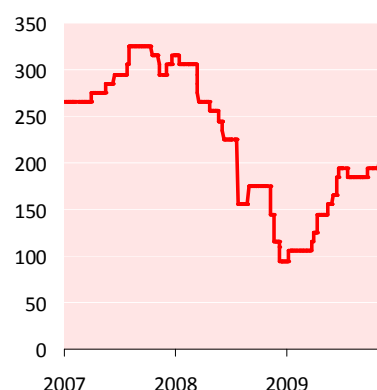
Source: China Customs

SHFE/LME price differential (incl VAT)



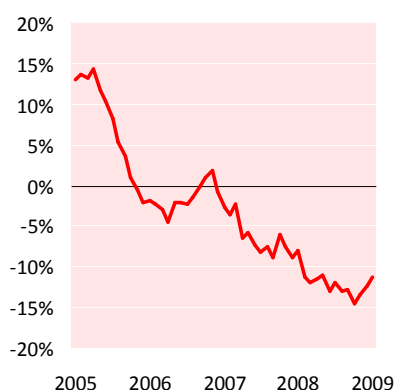
Source: SHFE, LME, VM Group

Zinc concentrate TC, cif China, \$/t



Source: Asian Metal, VM Group

US construction spending, y-o-y % change



Source: USCB

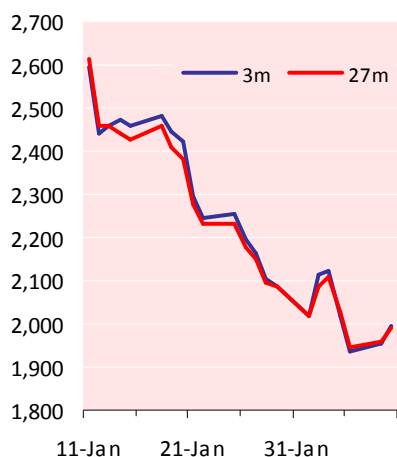
Zinc supply & demand balance, 000t

	2006	2007	2008	2009f	2010	2011
Supply						
Total mine production	10,321	10,975	11,501	11,204	11,484	11,886
% chg y-o-y	5.9%	6.3%	4.8%	(2.6%)	7.9%	6.8%
China	3,117	3,740	3,829	4,323	4,676	4,727
North America	1,371	1,388	1,356	1,022	1,074	1,322
South America	491	471	475	450	489	500
Europe	2,436	2,486	2,429	2,020	2,227	2,303
Australia	463	498	498	500	520	520
Total refined production	10,573	11,189	11,481	11,214	11,528	11,985
% chg y-o-y	5.5%	5.8%	2.6%	(1.6%)	2.8%	4.0%
Demand						
Total refined consumption	11,005	11,250	11,048	10,534	11,158	11,935
% chg y-o-y	5.9%	2.2%	(1.8%)	(4.7%)	5.9%	7.0%
Implied balance	(432)	(61)	433	680	370	49
Total stocks	851	641	825	1,123	1,404	1,401
3-month LME price (\$/t)	3,252	3,243	1,894	1,687	2,217	2,896

Source: CHR Metals, ILZSG, WBMS, VM Group

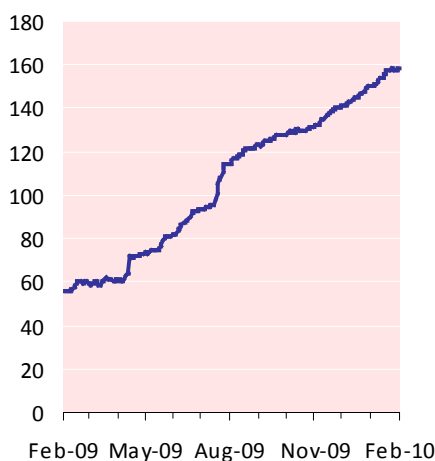
Lead

Lead price, LME, \$/tonne



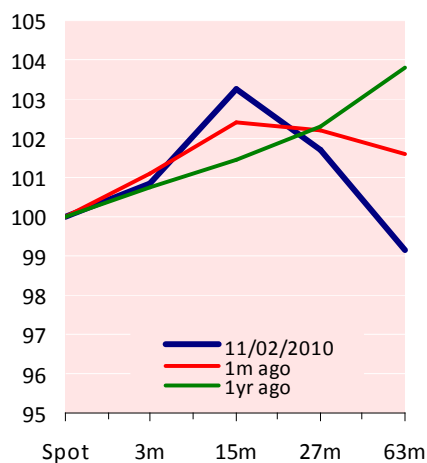
Source: VM Group

Lead stocks, LME, 000 tonnes



Source: VM Group

Lead forward curve, LME, various dates, spot = 100



Source: VM Group

Key events & analysis

- Lead prices plunge, LME stocks build rise relentlessly.** Lead prices have fallen 20% since the start of 2010; a justifiable correction considering the level of LME stock builds during a period that should traditionally see demand for lead-acid replacement batteries soar. This is even more damning considering that the northern hemisphere winter has been so severe. Moreover, although LME cancelled warrants have risen this year to represent about 9% of total inventories, as at 5 February, with most of this cancelled tonnage in the US, we suspect that this could be more to do with term financing arrangements than a pick up in demand, especially since the US market is well supplied by lead scrap.
- Scrappage schemes.** China's extension of its car scrappage scheme in 2010 will give a much needed boost to lead demand, and is perhaps the one area to feel positive about lead's prospects outside the recession-proof replacement battery sector. Chinese car sales are projected to rise to more than 14m units this year, from 10.3m units in 2009. This compares with 6.7m units sold in 2008 and 6.4m in 2007. This will partly offset continued weakness in the US and EU markets, especially since we expect recovery in car sales to be dampened due to the end of car scrappage schemes in these particular markets, which may have brought some sales forward.

Short term outlook

We are cautious as to lead's prospects in 2010, especially since China has lined up a slew of new lead smelters to bring on line in the next 18 months. On a positive note, China's Henan province has had to reduce lead output further due to power issues, with production already falling due to reduced supplies of lead concentrates from northern mines due to the freezing winter temperatures. This however will only impact immediate supply, and we doubt under current market conditions whether it will offer much support.

Lead's short term outlook has therefore deteriorated considerably, but we remain positive for its prospects later this year due to China's soaring vehicle and e-bike sales and, expectantly, to some sort of recovery in US and EU car sales. Replacement battery demand will form a natural floor, which should weather any prolonged turn in sentiment, but rising LME stocks and supply could see prices test levels of \$1,770/t in coming weeks.

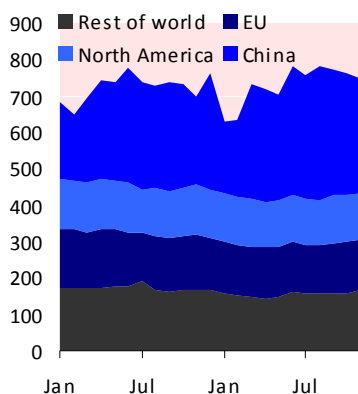
LME 3-month short-term price: \$1,800-\$2,175/t.

Chinese lead prices, yuan/t, unless otherwise stated

	10 February 2010	Current	YoY %chg	Last mth	YoY %chg
Lead ingot (>99.99%)		15,500	22%	16,500	36%
Lead concentrate (60% min)		12,850	43%	13,750	31%
Lead concentrate TC (cif) China (\$/t)		160	88%	140	65%

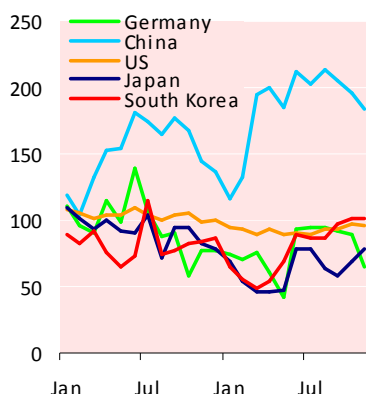
Lead data

World refined lead output, 000t



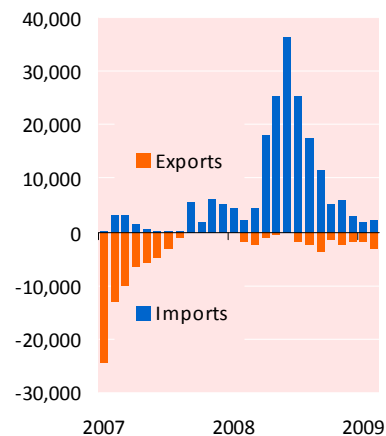
Source: ILZSG, WBMS, VM Group

Refined lead consumption, 100-Aug 2005



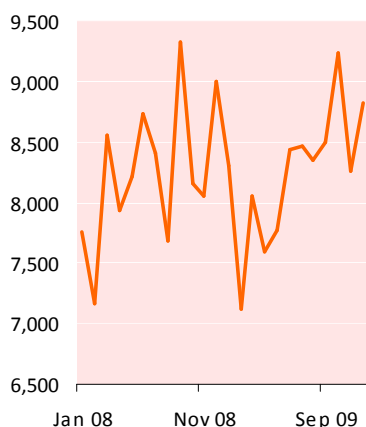
Source: ILZSG, WBMS, VM Group

Chinese lead trade, past two years, tonnes



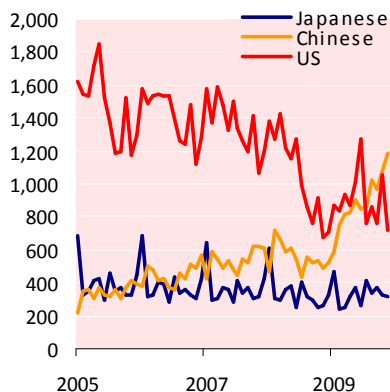
Source: China Customs

North American battery shipments, 000 units



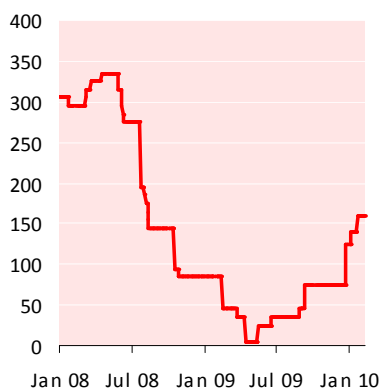
Source: Battery Council International

Passenger cars sold or produced, 000 units



Source: JAMA, NBS, BEA

Lead TC, cif China, \$/t



Source: VM Group

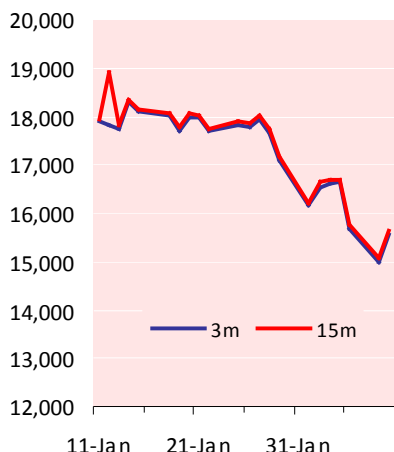
Lead supply & demand balance, 000t

	2006	2007	2008	2009f	2010	2011
Supply						
Total mine production	3,573	3,690	3,985	3,864	4,249	4,515
% chg y-o-y	3.5%	3.3%	8.0%	(3.0%)	10.0%	6.3%
China	2,715	2,788	3,121	3,605	4,002	4,121
US	1,313	1,303	1,282	1,276	1,275	1,271
Europe	1,625	1,745	1,780	1,702	1,695	1,769
Rest of world	2,328	2,341	2,365	2,135	2,271	2,426
Total refined production	7,981	8,177	8,548	8,805	9,243	9,587
% chg y-o-y	4.8%	2.5%	4.5%	3.0%	5.0%	3.7%
Demand						
Total refined consumption	8,054	8,357	8,481	8,583	9,141	9,571
% chg y-o-y	3.7%	3.8%	1.5%	1.2%	6.5%	5.8%
Implied balance	(72)	(179)	67	222	102	16
Total stocks	284	234	301	521	623	730
3-month LME price (\$/t)	1,282	2,558	2,089	1,738	2,087	2,652

Source: WBMS, ILZSG, VM Group

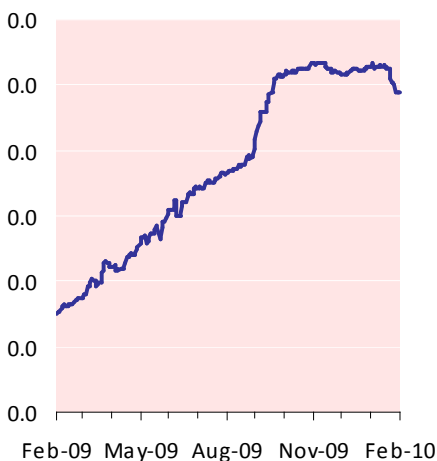
Tin

Tin price, \$/tonne



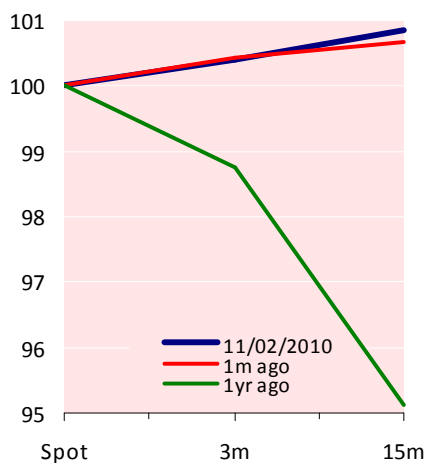
Source: VM Group

Tin stocks, LME, \$/tonne



Source: VM Group

Tin forward curve, LME, various dates, spot = 100



Source: VM Group

Key events & analysis

- Low LME prices, premiums rise.** Weak LME tin prices coupled with rising tin premiums imply that end-user demand has improved and is taking advantage of the weaker pricing environment. Premiums for Chinese tin are currently at \$410/t-\$450/t and that for Malaysian tin at \$280/t-\$350/t, levels not seen since 1998. LME tin prices are conversely down 15% from their high on 14 January, to \$15,550/t as at 9 February. Although supply could hardly be considered tight, we suspect once tin decouples itself from the negative macroeconomic factors that have affected the other base metals, then prices could well eclipse its previous high this year and outperform the pack.
- LME tin stocks fall.** LME tin stocks have finally begun to slip after inching up throughout 2009. Stocks, as of 9 February, stood at 26,670t, their lowest since 18 December 2009. Meanwhile cancelled warrants have built up to 2,190t by 9 February, from a low of 435t a month earlier. This supports our view that tin consumption will expand this year by 8.6%, from the contraction of 9.7% in 2009.
- Indonesian authorities' tussle with illegal tin ore mining will continue to support prices.** We anticipate global tin supply to remain flat, year-on-year, in 2010. One of the main reasons for this will be Indonesia's prolonged fight against illegal tin mining, which will continue to impede production and could lead to Indonesia exporting less than its targeted quota for 2010 of 100,000t. With the slew of Chinese tin plant maintenance closures so far this year, we expect Chinese production to rise by just 3% in 2010, to 135,000t. Rising demand will therefore see the market balance move into a slight deficit.

Short term outlook

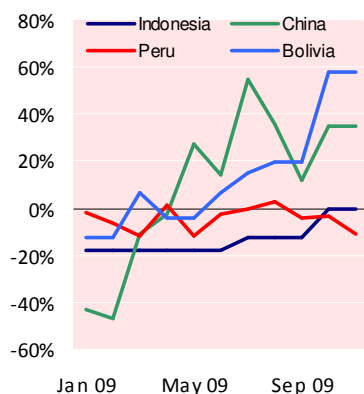
We are warming to tin's short-term fundamentals, more so than some of the other base metals. We expect tin will be the only base metal in deficit this year. While demand is expected to grow by almost 8%, supply will be unable to keep up – plagued as it has been by Indonesia's fight against illegal tin ore mining and also its moves to keep prices above a pre-determined floor of \$15,000/t. LME stocks are also finally falling and cancelled warrants rising and it will not take long for the market to take note. We have revised up our 2010 average three-month tin price estimate to \$16,935/t in. LME 3-month short-term price: \$15,000/t-\$18,000/t.

Chinese tin prices, yuan/t, unless otherwise stated

	10 February 2010	Current	YoY %chg	Last mth	YoY %chg
Chinese tin ingot (99.9%)		133,500	38%	130,500	35%
Chinese tin concentrate (60% min)		116,000	58%	119,500	72%

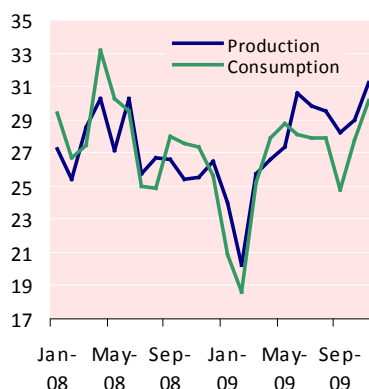
Tin data

Tin mine production, year-on-year % change



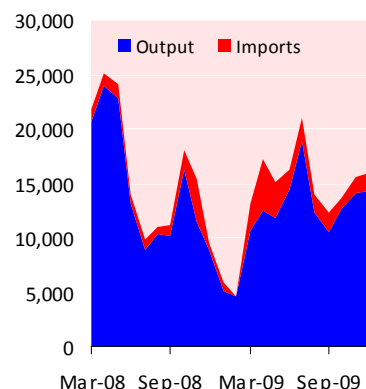
Source: WBM, VM Group

World refined tin production and consumption, 000t



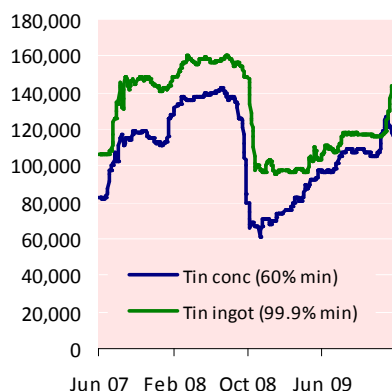
Source: WBMS, VM Group

China tin output and imports, tonnes



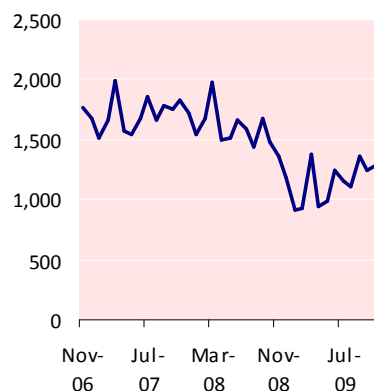
Source: China Customs, NBS

China tin concentrate and ingot prices, yuan/t



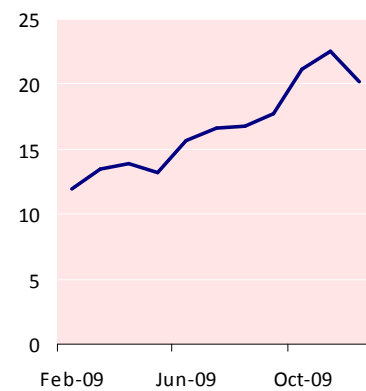
Source: Asian Metal

Japan electronics production, billion yen



Source: JEITA

China computer production, million units



Source: NBS

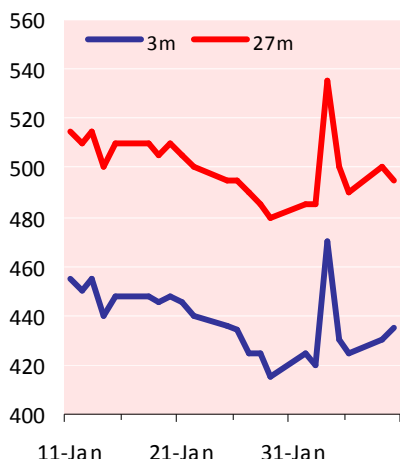
Tin supply & demand balance, 000t

	2006	2007	2008	2009f	2010	2011
Supply						
Total mine production	334	353	314	306	313	329
% chg y-o-y	(4.4%)	5.7%	(11.0%)	(2.7%)	2.3%	5.2%
China	132	147	129	131	135	141
Indonesia	77	78	70	62	65	73
Malaysia	23	25	32	38	36	35
South America	65	58	61	58	57	60
Rest of world	54	40	43	40	41	40
Total refined production	351	348	334	329	334	349
% chg y-o-y	0.5%	(0.9%)	(4.1%)	(1.5%)	1.5%	4.5%
Demand						
Total refined consumption	363	354	341	308	335	355
% chg y-o-y	6.1%	(2.5%)	(3.5%)	(9.7%)	8.6%	6.0%
Implied balance	(12)	(6)	(7)	21	-1	-6
Total stocks	34	32	31	52	44	37
3-month LME price (\$/t)	8,758	14,532	18,442	13,382	16,935	19,854

Source: WBMS, VM Group

Steel

Steel price, LME, Med, \$/tonne



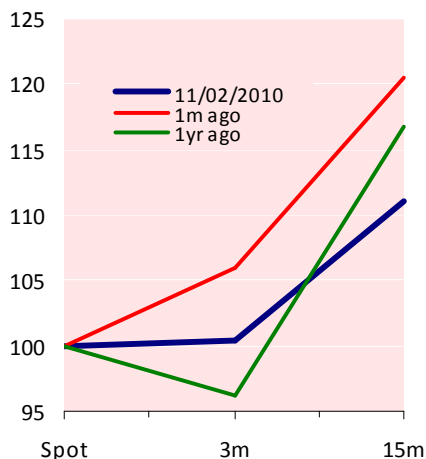
Source: VM Group

Steel stocks, LME, Med, 000 tonnes



Source: VM Group

Steel forward curve, LME, Med, various dates, spot = 100



Source: VM Group

Key events & analysis

- Steel demand recovery to limp on.** According to a number of major steelmakers steel demand recovery will be slow during the early months of 2010. ArcelorMittal said in presenting its worse than expected Q4 2009 results that Q1 2010 would be tough, with only “slow recovery underway,” and rising costs. This sentiment was echoed by the US Steel Corporation, which anticipates another quarterly loss in Q1 2010, while Eurofer, the European Steel group, expects that by the end of 2010 steel consumption will have risen by 12.5% year-on-year, from a 35% slump in 2009. This is a modest recovery indeed, at least in the mature Western world markets. In the immediate term, prices are likely to rise only modestly as orders increase, but rising costs for iron ore and coking coal will increasingly be passed on to steel prices as demand strengthens.
- Chinese iron ore imports fall 25% in January to 46.62 Mt.** This collapse in the world’s biggest importer of iron ore has more to do with bad weather, and a slowdown in steel output due to the Chinese New Year period happening early on in the year, rather than a sign that Chinese demand for iron ore is drying up. However it is a figure that the Chinese iron ore importers will no doubt do much to promote in the run-up to the always-fractious discussions with their suppliers over the annual price-setting contract talks. The China Steel Association (CISA) has already stated it wants to reduce China’s dependence on iron ore imports, but that’s wishful thinking, since China’s crude steel output will likely exceed 610 Mt this year – up from 570 Mt in 2009. However, with CISA helping to add supplementary rules to the recently released ‘Chinese Iron Ore Import Trading Self-Regulations’, affecting about 70 steel mills and 42 traders, there might be less room for speculatively-driven imports than in the past. According to CISA’s estimations, China imported 68 Mt more iron ore than required in 2009. Nevertheless, we expect the annual iron ore contract price to rise by at least 25% for the contract year starting 1 April 2010.

Short-term outlook

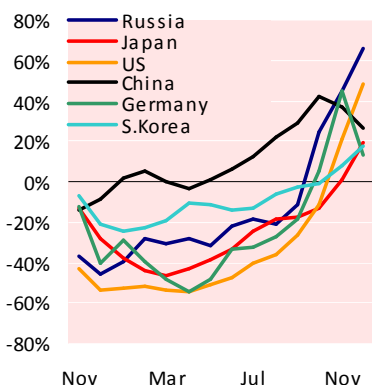
Rising costs for raw materials and electricity will weigh on margins and demand will be too weak for prices to rise too fast too soon. We do not expect 2010 therefore to be a comfortable year for steel producers, but it will be light years ahead of 2009. Furthermore we do not expect 2010 or 2011 production (outside of China) to approach 2008 levels, but prices will surely lift so long as OECD economies steadily improve. LME 3-month short-term price: Steel Med: \$425/t.

Chinese steel prices, yuan/t, unless otherwise stated

	10 February 2010	Current	YoY %chg	Last mth	YoY %chg
SHFE spot rebar		3,998	-	3,674	-
SHFE 3m rebar		4,186	-	3,886	-
SHFE 6m rebar		4,562	-	4,376	-
SHFE 12m rebar		4,824	-	4,754	-
16mm Med plate (Q235b) China (\$/t)		547	(10%)	555	(9%)
Iron ore (Indian 61%, cnf China), (\$/dt)		116	91%	119.5	98%

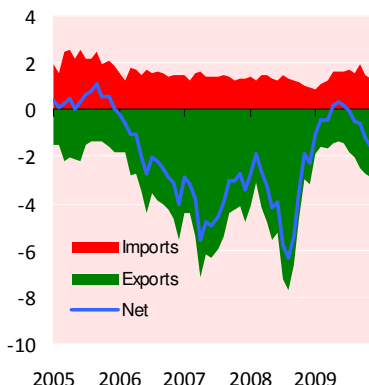
Steel data

Crude steel production, yoy %chg



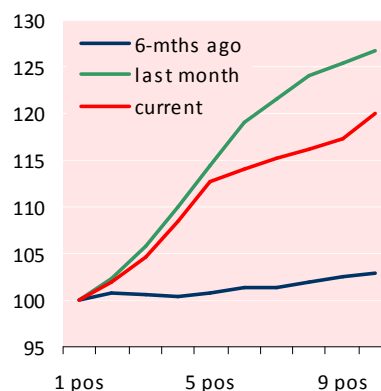
Source: WSA, VM Group

Chin export/imports, steel products, Mt



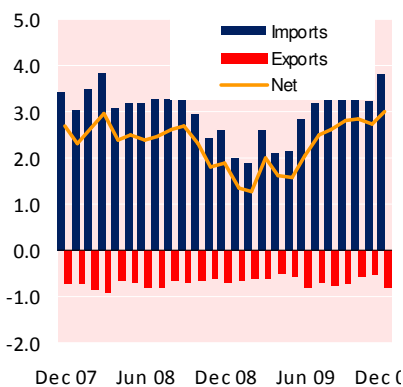
Source: China Customs

SHFE steel rebar price curve, 100=spot



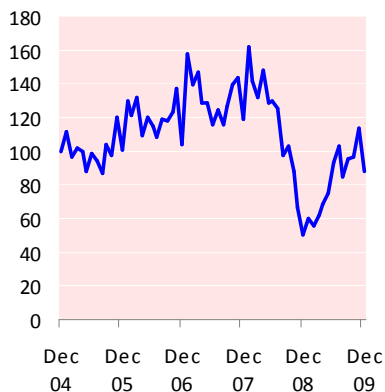
Source: SHFE, VM Group

Japan steel products trade, Mt



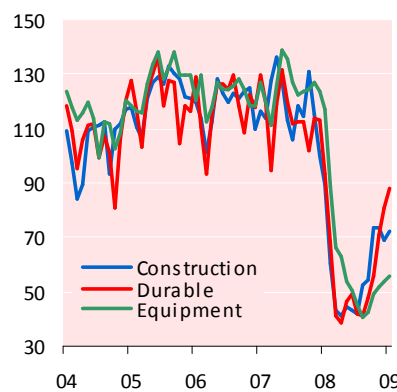
Source: Japan Customs

Germany, new orders of first processing of steel, constant prices, euro, 2005=100



Source: German Federal Statistical Office

US construction, consumer durable and equipment steel output, 100=2002 (\$)



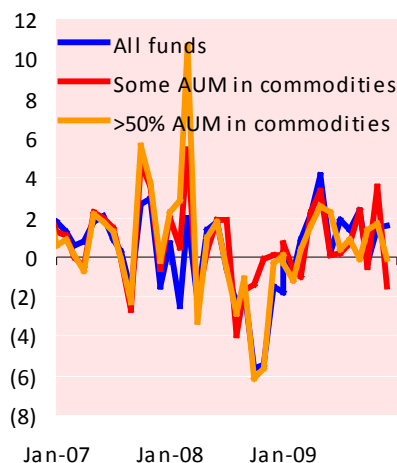
Source: Federal Reserve

Crude steel production, Mt	H1 07	H2 07	H1 08	H2 08	Q1 09	Q2 09	Q3 09	Sep	Oct	Nov	Dec
China	239.5	252.1	262.4	236.1	126.7	139.3	153.7	50.7	51.7	47.3	47.7
Year-on-year %change	19.4%	13.1%	9.5%	(6.3%)	1.9%	0.9%	20.8%	28.0%	44.1%	34.3%	26.1%
US	48.5	49.7	50.9	40.4	12.0	12.5	15.6	5.4	6.0	5.7	5.8
Year-on-year %change	(4.3%)	3.8%	5.1%	(18.7%)	(52.9%)	(51.1%)	(37.9%)	(31.4%)	(11.4%)	21.5%	48.2%
Russia	36.6	35.8	38.4	30.1	12.9	13.9	14.9	4.9	5.6	5.4	5.5
Year-on-year %change	4.8%	(0.1%)	4.8%	(15.8%)	(32.9%)	(27.3%)	(19.9%)	(20.3%)	24.2%	44.6%	66.3%
Germany	24.5	24.0	24.4	21.4	7.3	6.6	8.8	3.2	3.5	3.5	3.0
Year-on-year %change	5.2%	0.4%	(0.5%)	(10.8%)	(39.7%)	(46.9%)	(25.4%)	(21.7%)	(11.0%)	8.1%	23.7%
India	26.1	27.0	27.2	27.9	13.4	13.9	14.1	4.6	4.9	4.8	5.0
Year-on-year %change	20.9%	7.5%	4.2%	3.3%	(6.2%)	7.7%	1.2%	(0.2%)	2.6%	3.2%	10.2%
South Korea	25.7	25.9	27.6	26.1	10.5	12.3	12.7	4.4	4.6	4.3	4.4
Year-on-year %change	7.4%	5.6%	7.4%	0.8%	(22.4%)	(12.2%)	(8.4%)	(2.5%)	(0.1%)	10.3%	18.0%
Japan	59.4	60.8	61.9	56.8	17.6	19.1	24.2	8.3	8.8	8.9	9.0
Year-on-year %change	4.3%	2.6%	4.2%	(6.5%)	(42.9%)	(38.5%)	(20.4%)	(18.0%)	(12.8%)	0.5%	19.5%
Ukraine	21.4	21.5	22.2	14.9	6.8	6.8	7.9	2.6	2.7	2.7	2.7
Year-on-year %change	8.1%	2.2%	4.2%	(30.9%)	(38.0%)	(39.6%)	(15.7%)	3.9%	42.9%	67.1%	35.4%
Brazil	16.3	17.5	17.5	16.3	5.0	5.6	7.8	2.6	2.8	2.7	2.6
Year-on-year %change	12.8%	6.3%	6.9%	(6.9%)	(42.1%)	(36.8%)	(17.2%)	(13.6%)	(3.5%)	15.1%	56.7%
Rest of world	159.6	153.3	164.7	136.7	51.0	54.6	57.7	20.4	22.8	21.9	20.8
Year-on-year %change	3.6%	1.6%	3.2%	(10.8%)	(36.9%)	(34.8%)	(25.9%)	(20.8%)	(4.6%)	11.3%	36.6%

Source: World Steel Association

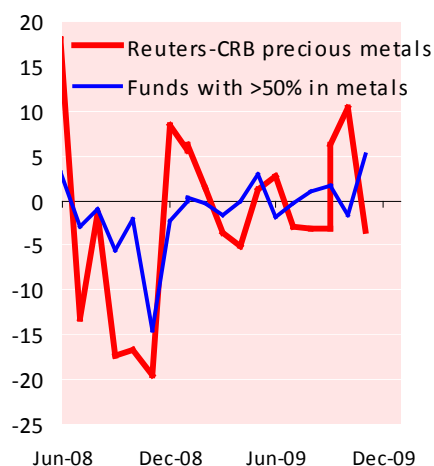
Fund activity

Hedge fund returns by commodity weighting, % monthly



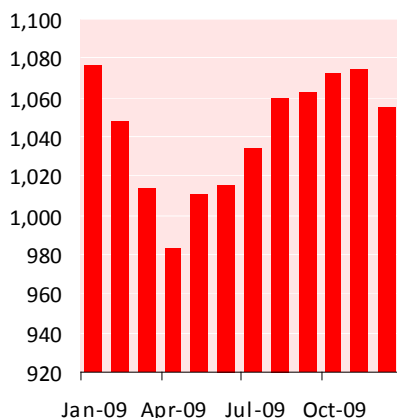
Source: VM Group, Barclay Database

Hedge fund returns in metals, % monthly



Source: VM Group, Barclay Database

Hedge funds AUM, \$bn



Source: VM Group, Barclay Database

Key events

- Feb 8:** As the EU Parliament prepares to debate an epic 1,300 amendments put forward to its draft Alternative Fund Managers Investment Directive (AIFM) The UK Financial Services Authority (FSA) has warned that the directive risks causing rather than alleviating market risk and uncertainty. After assuming the EU Presidency Spain has proposed changes to the directive which have not been welcomed in the EU's hedge fund heartland. "I would not underestimate the significant risks that still exist in this draft directive. It could still go badly wrong in some important areas," said Dan Waters of the FSA. City Minister Lord Myners has been holding talks with his Spanish counterpart to voice concerns about the possible migration of hedge funds from the EU as a result of the restrictions on their activities the directive contains. The Financial Markets Law Committee, set up by the Bank of England has warned that the proposed directive would cause "systemic failure and widespread market disruption" if it became law. The EU Parliament will debate the much maligned AIFM from Feb 22 before sending it to a vote in April.
- Feb 3:** President Obama's efforts to reform the banking sector continue; the latest proposal, dubbed "The Volcker Rule" seeks to prohibit banks from investing in hedge funds and private equity funds and to crack down on banks' proprietary trading activities. The details of reform have yet to be defined but any move to limit banks' proprietary trading abilities could help hedge funds - fewer players operating in the same strategies will improve margins and profits. In his testimony to The Senate Banking Committee Volcker proposed that hedge funds and private equity funds should be "free to trade, to innovate, to invest – and to fail." This would be a welcome situation, but hinges on authorities understanding that not all financial animals are equally threatening and that hedge funds do not pose the systemic risk they have been allocated in the past.

Short term outlook

Final December data now available shows that the hedge fund sector overall returned 16% over 2009 while funds with commodity investment returned 10%. Funds finished the year with average monthly returns of 1.52% but after a strong showing in November commodity strategies suffered a negative run at the close of the year. Energy funds lost 2.13%, Metals funds lost 2.21% while Softs funds lost 2.52%. Funds suffered net outflows in December, with AUM levels dipping to just over \$1.5 trillion, a drop which can be put down to year end redemption requests. Preliminary January data suggests that the downturn in commodity funds' performance foreshadowed a dip in the performance of the sector overall. Negative returns are expected all round for the first month of 2010. The rumblings around the EU's AIFM are worrying, with 1,300 proposed amendments it seems impossible that anything resembling a clear and sensible regulatory framework will emerge anytime soon, but it is in the fiscal interests of the EU to agree a favourable compromise- according to estimates from the Alternative Investment Managers Association the European Hedge Fund Industry generates tax revenues of around €4bn each year. ECB data shows that Eurozone hedge funds may already be losing out – assets declined from €81.5bn in April 2009 to €77bn in September 2009 while funds in other regions were enjoying solid growth rates.

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VM Group is a commodities research consultancy that covers not just conventional energy, but also renewable energy, carbon, base and precious metals, and agricommodities. The VM Group comprises a uniquely skilled team that is highly experienced in the analysis of the fundamentals of commodities and their geopolitical impact and contexts.

VM Group work excels in macro-economic analysis, the generation of supply and demand scenarios, costs analysis, derivative research and price forecasting. Confidentiality, experience and independence are key elements in this advisory capacity. We deliver excellence to those in need of external expertise, as well as those who wish to supplement their own in-house resources. Our extensive international contacts mean we are able to span the globe.

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