METALS AND BULK OUTLOOK

"In 2015, base metals such as aluminum and zinc are set to be supported by muted production growth and an acceleration of global economic activity. In the precious metals complex, gold should average $1,200/oz next year, but may fall temporarily to $1,100/oz as the Fed further normalizes monetary policy. Meanwhile, the bulk materials will likely be challenged. Iron ore prices in particular should fall as large producers push more tonnages into the market to displace smaller, higher cost operators."

– Michael Widmer, Metals Strategist

Our view

Base metals led by aluminum and zinc: Base metals price movements are heavily influenced by global growth momentum and a reacceleration of economic activity through 2015 should support quotations. Aluminum remains in deficit following severe production cuts in World ex-China. Similarly, zinc is supported by a lack of mine production growth. Meanwhile, while Indonesia's ore export ban removed around 15% of nickel supply practically overnight, the metal is unlikely to rally until LME inventories stop rising and China imports more traditional products, either of which are our base case for 2H15. Although the wall of new copper supply is long behind us, the commodity has the weakest fundamentals among the base metals. Hence, we believe trading opportunities are very tactical; we see scope for a rally in 1Q15.

Precious metals to see gold stabilize and palladium outperform: The macro economic backdrop has given little incentive for investors to increase gold holdings. In our view, the monetary policy differential between the Fed and ECB/BoJ remains one of the most immediate headwinds. As such, we see further downside to prices and maintain a $1,100/oz target. Palladium has been in deficit for years and as such has the strongest fundamentals in the metals complex. This gives a firm foundation for further price gains going forward.

Iron ore and thermal coal face challenges among bulk commodities: Steel mills have arguably long been some of the least-loved operators in the materials space. Yet, pricing power has started to shift back to mills, driven by a confluence of factors. The bulk commodities remain challenged, with iron ore and thermal coal going through the painful process of supply rationalisation, which could take prices of the two commodities into the low $60s and $50s respectively.

Key calls

- Industrial metals should continue outperform other commodity sectors. Precious metals are trading sideways with a negative bias. The bulk commodities continue face immense headwinds, so further downside is likely.

- Industrial metal prices are driven by global growth momentum, and a reacceleration of activity through 2015 should push quotations higher; relative value within the complex will be influenced by substantial differences in individual market balances.

- Monetary policy and growth differentials are bullish U.S. dollar, and a normalization of monetary policy is underway in the U.S. These factors could push gold down to $1100 per ounce next year.

- Competitive dynamics on the supply side are bearish iron ore, which could fall towards $60 per ton in 2015.

- Risk premiums may rise given reduced policy support from the Federal Reserve. As a result, vols may spike higher periodically.