Tracking Copper – Glass Half Full?  
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Global demand and industrial metals have traditionally worked well together – there is a clear correlation, if not logical causality. The use of copper as a leading indicator for global growth seems embedded in many trading models. Copper rose aggressively in the last week as China data on trade and industrial production surprised to the upside. For copper specifically, China imports rose 8.1% in July. Other indicators in China – retail sales and social finance – weren’t as supportive. European data was also better than expected with this week’s 2Q GDP widely expected to be up 0.2% q/q – heralding the end of the recession there. The problem is that better copper prices didn’t fully translate into better industrials – the rotation trade from safety to new cycle shares didn’t fully evolve last week. The question to ask is whether this time is different or whether the global demand cycle has bottomed as one would traditionally expect from looking at Copper prices. The technical outlook is positive with prices likely to remain supportive until November with $3.50 and $3.75 next targets for the bulls. Expect $3.30 to be the pivot for more upside momentum with the declining 100-week average also significant resistance. The baseline for Copper at $3.00 should hold.

Some of the recent movement back up in copper – up 3.7% in just a week, biggest gain in 11 months, breaking the 100-day moving average – can be explained by factors other than a new sharp uptick in global demand. Separating summer and technical forces from fundamentals remains difficult. Nevertheless, the main correlation of the copper price as a forecasting tool for S&P500 continues.

1) Positioning. The copper short positions on the LME were put in place as a China hard-landing fears rose. The end of the commodity super-cycle dominates much of the trading still with overcapacity still an issue.
2) China tight money. The copper as money argument remains in play as the short-squeeze up in rates has brought another wave of collateral seeking lending. The rebuilding of inventories in China could be more about money demand than building demand. The tighter credit of China adds to growth concerns.

4) USD weakness. All commodities gained last week with Gold a leader with USD weakness driving on back of reflation stories in Europe and China. If the US QE tapering is going to be important it has to beat the speed of expectations change in rates in Europe and China – both saw higher rates in comparison to the US. The USD weakness follows rate differentials.

Distilling the forces of deflation from inflation is never easy. But the evidence for a fundamental shift in thinking in August from fear of a three-speed world to one that may be closer to two-speed is likely. Copper may be leading equities. First, the US and Japan outperformance in GDP seems to be slowing. The Japanese 2Q GDP shows a significant drop in deflation there -0.3% rather than the expected -0.6%. The drop in inventories led to the headline miss and this makes 3Q growth potential even better should Emerging Markets recover. Second, Europe is getting some real signs of bottoming, with the determination of the ECB to keep rates low adding to the “hope” process in recovery. Spain and Greece remain sore spots but the worst for Italy and France may be past. Finally, the data from China in July and the mini-stimulus of policy shown through plans for financial reform – as the SME focus leads to smaller banks competing for deposits and some of the NPL issues seem likely to lead to new bond issuance – all make China “soft-landing” stories – 7.4-7.6% 2H2013 GDP – seem likely. This keeps the metal demand
stable if not higher as plans for fixing up slums in Beijing and Shanghai hit the market. Copper reflects all the demand stories.

Bottom Line: Dr. Copper may be getting a bit stodgy as the preferred leading indicator as the relationship of warehousing metals and collateral gets to be more common. There are new ways of measuring potential global demand from global shipping rates to electricity usage. However, the relationship of credit to copper doesn’t refute the leading indicator as a harbinger of future growth. Credit expansion remains a key ingredient and copper continues to dominate the progression of new building and infrastructure demand globally. The role of the metal in a wide ranging set of key products from electrical wiring to household plumbing to high tech equipment make it central to macro economics.

Before joining Track.com as Chief Executive Officer, Mr. Savage served as Managing Director of FX Macro Sales at Goldman Sachs, where he published widely-read and insightful research focused on the foreign exchange markets and the macroeconomic environment. As well as twenty-three years at Goldman Sachs, Mr. Savage worked as the head of New York Foreign Exchange trading for Lehman Brothers and as a Director of Proprietary Trading at Bank of America Securities. Mr. Savage earned a BA in Political Philosophy from Yale University.

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