Copper: upside risks becoming more pronounced

Given both the recent macro and micro developments in Copper, below is a quick update on these, as well as positioning and technicals.

Its well-known that the market is lying very underweight with certain exchange positioning running net short (CME). While current Algo/CTA shorts may well be in the money with little impetus to cover, the recent headline risk and price reaction is insightful:

- **Trade risk:** Trumps comments today on trade ("very good telephone conversation with President Xi...We will be having an extended meeting next week at the G-20") and the subsequent rally in most trade sensitive assets (from SPX, Oil, CNH, Copper) indicates **there is little-to-no premium priced into a potential US/China trade deal at G-20**. Recent rhetoric - Wilbur Ross, etc - had centered on perhaps an 'agreement in principle' with an actual trade deal at G-20 very unlikely. Copper (and other trade sensitive assets) are simply not pricing in the (small) chance of a mini-deal.

- **Macro risk**: Draghi comments (rate cuts are an option in the absence of inflation improvement) was also somewhat out of left field if price reaction in the EUR was any indication. However, more importantly, the response from Trump claiming its "unfair to the US" was enough to **drive yields even lower and marginally lift expectations of a Fed cut tomorrow, as investors begin pricing in the serious threat of global currency depreciation talk / wars.**

- **Micro risk:** Codelco went on strike (and is operating at 50% capacity*) on Friday and Glencore announced they'd shut their Zambian Copper smelter until year-end. However, Copper continued to make new lows until today, indicating that the **micros matter less** with all the focus on top-down demand indicators (the effect of the trade dispute increasingly showing up in data and reaffirmed by Chinas Industrial output at lowest in 17 yrs and incredibly soft auto sales). The news that Codelco strike turned violent overnight was enough of a trigger for 3m prices to turn bid and probe upsides / ~$5900

How Copper prices decide *when* to react to news events/headlines and developments has become increasingly tricky and more unpredictable, but todays sharp $100 reprice to settle above $5900 hints, that at the very least, (weak) Copper shorts are exiting. Thus on Page 2 is a useful and (oversimplified) historical analysis of past short covering episodes*

Overall, the 5 factors driving a cautious purchase outlook and outlined in the recent piece [(a focus on Copper...)] are still largely applicable. The 3 increasingly important factors Copper shorts really need to contend with are 3) Chinese macro demand indicators show a range growth rates that seem out of sync with a 5-handle, 4) Chinas construction sector - thanks largely to the PBOCs recent stimulus package - has yet to impact Copper demand due to innate lagged effects, 5). Theres a growing belief that US and/or Chinese policy makers will respond with more easing measures. That is in conjunction with a new (and growing) belief and threat that a protracted trade war simply defers (or deters) necessary producer investment, required in an industry where Coppers uses are expanding, given the global shift to all things electric...

CONTACTS

Nicky Shiels

Commodity Strategist (Metals)

212-225-6724

Commodities Derivatives

nicky.shiels@scotiabank.com

Page 2: Graphs, HG Short Positioning & Technicals Analysis —

***On average, the size of buybacks is 45K contracts, over a ~40 day time-span, that results in an average HG rally of ~9%.**

HG Positioning:

- HG paper shorts "own" a record >100,000 contracts (graph 1, panel 2). Positioning has swelled to peak levels on 7 different occasions since 2015 (highlighted)
- **On average, the size of buybacks is 45K contracts, over a ~40 day time-span, that results in an average HG rally of ~9%.**
- The largest response - or 'squeeze' - is a +27% in Copper prices (Q4'16 where 52K lots were bought back); the smallest response is -1%.
- If current short positioning of 100K contracts has to revert back to recent historical floor seen in 2018/9, that equates to 51K of buybacks
- Gross *long* positioning is very underweight (bullish exposure has most likely been channeled into wingy upsides options instead)

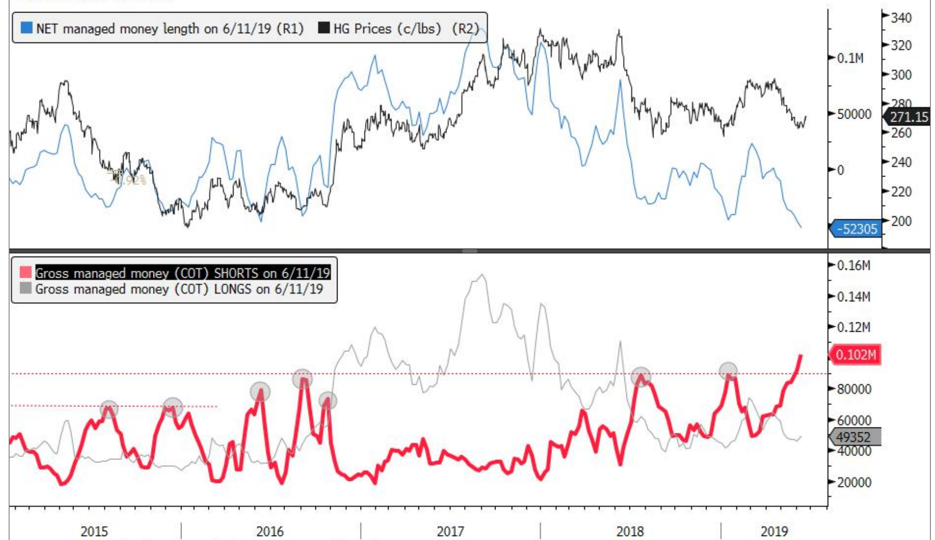
Technicals:

- LME Copper closed at $5949 (highest since end of May / pre-Mexican tariff threat).
- $5800 has been the notable floor (over 9 months, theres been 3 large attempts to convincingly break this handle, resulting in consolidation & an upswing)
- While $5800 has currently held (solid physical demand as noted by plenty of Copper producers & premium pricing), theres still a lurking death cross above ($6130-6170)
- We retain that the rough comfort zones for Copper, all else equal (steady macro risk/ sentiment and stable >200k mt deficit) are:
    - "Trade progress" = $6200 - $6500,
    - "Trade escalation" = $5800 - $6100,
    - "Trade neutrality": $6100—6400

**Chuquicamata mine produced 320K mt last year, or ~25% more than what Scotiabank has penciled as a deficit for 2019. Still this strike effects other mines/divisions as the smelter shut down processes ore from the northern division.*

***7 short covering episodes taken between 2015 and 2019 when gross HG shorts peaked at >70K contracts (2015) or >80K contacts (2016-19)*

HG Copper positioning
maxed out shorts



Source: Scotiabank Commodities Strategy, Bloomberg, CFTC,
CFFDTMMN Index (CFTC CMX Copper Managed Money Net Total/Disagg Futures Only) HG Copyright© 2019 Bloomberg Finance L.P. 20-Jun-2019 15:19:22

Copper technicals
$5800 broadly = 7 yuan / dollar

Source: Scotiabank Commodities Strategy, Bloomberg
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