ETFS Trade idea

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Platinum – The night is darkest before the dawn?

ETFS Article

Key Takeaways:

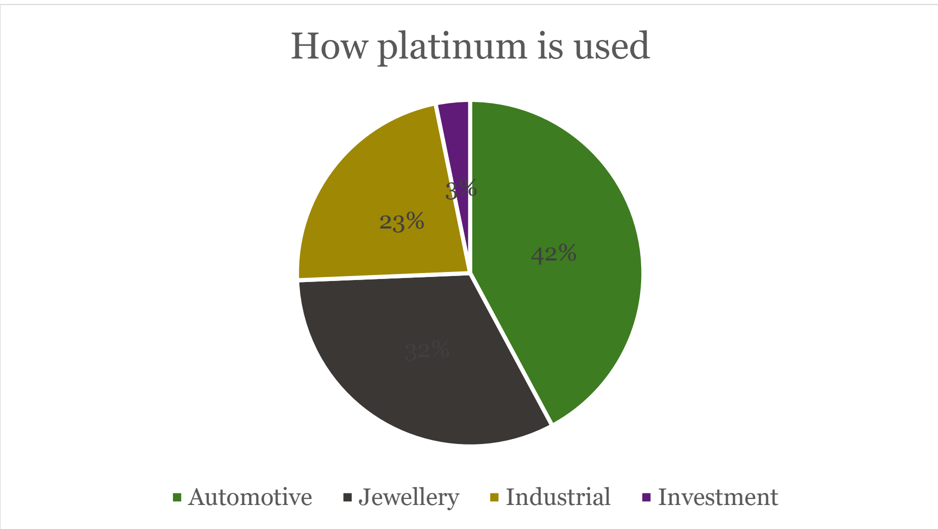
- Platinum, one of the rarest precious metals, could correct upwards in H2 2018 to $900 an ounce
- This is because the platinum supply deficit is being exacerbated by today's low prices
- South African politics – most platinum is mined in South Africa – has scared away mining investment, which also threatens supply
- Demand for platinum in auto catalysts, the mainstay of the metal's demand, has been increasing
- How to Invest:
    - **ETFS Physical Platinum (ETPMPT)** is the only pure listed exposure to platinum in Australia
    - MER: 0.49% p.a

In this week's *ETFS Trade idea*, we look at platinum, the rarest of the precious metals, whose price has been trending downwards in recent months. We take a look at whether platinum might be oversold and how fundamentals and macro trends support a near-term price rise. We finish by looking at ways investors can gain exposure to the rare metal.

Platinum – Some background

Platinum is a very rare metal. It is estimated that all the platinum ever produced would only go ankle-height in an Olympic sized swimming pool. (World Platinum Investment Council, 2018) South Africa produces 73% of the world's platinum and has the overwhelming majority of proven reserves. Within South Africa itself, two companies – Anglo American (Amplats) and Impala – produces almost half of supply. (Thomson Reuters, 2018)

Platinum's unique chemical properties make it a choice element in industry. Industrial uses include electrics, medical equipment and, most importantly, catalytic converters in diesel cars, buses and trucks. Platinum is also a popular metal in jewellery due to its resistance to warping.



Source: World Platinum Investment Council

A weak performance in 2018

Platinum has performed poorly in 2018, with its spot price sinking from a January peak of $1,016 per ounce to $790 as of mid-August. Year-to-date, platinum has fallen 23%, while gold has fallen roughly 10%. Taking a longer-term view, platinum's spot price seems to have peaked – like gold, with which it correlates quite closely – in 2011 at around $1,855 per ounce.

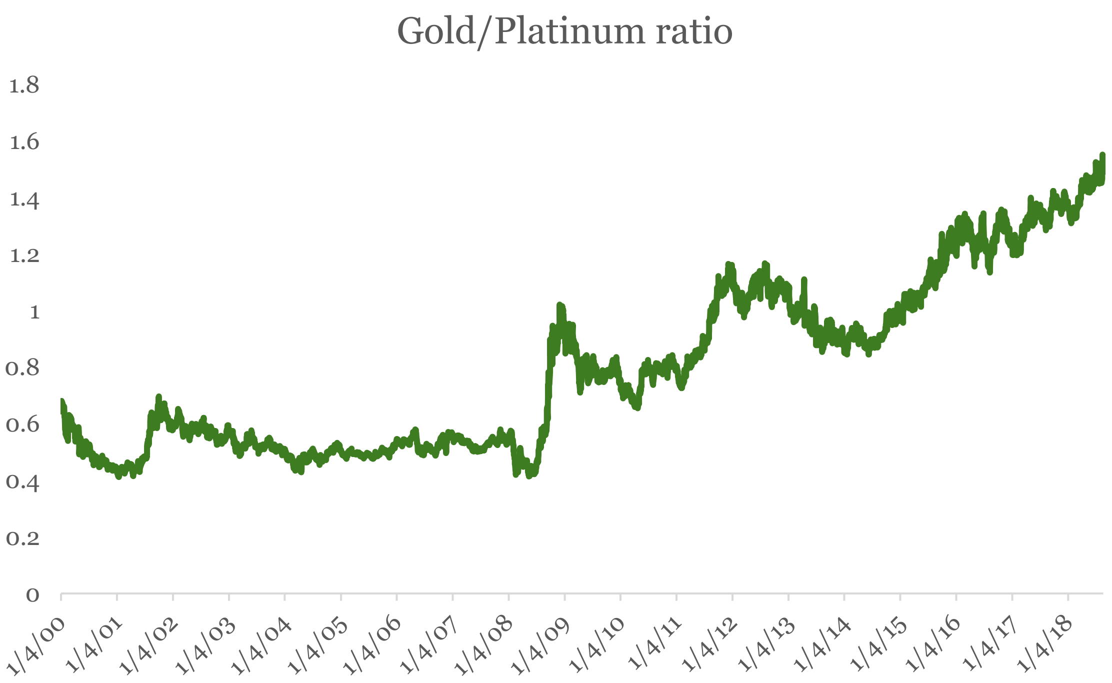
An upward correction seems possible

While platinum's recent performance has disappointed, some well reputed analysts believe it's possible for prices to hit $900 in various points of H2 2018, for the following reasons:

1. There could be some reversion to the mean in platinum's parity in gold: at present platinum is only tracking gold on the downside and not the upside.
2. Trends within South Africa itself are likely to support long-term a price hike. These include heightened political risks facing miners and higher utilities costs.
3. Diesel engine production continues to rise in absolute terms, especially given strong demand in Asia. Diesel cars are not "dead" in Europe, as is sometimes implied in the press.
4. Today's platinum prices in the $790s are below production costs, data suggests. This means that miners will likely cut back on production, which will widen out the already existing supply deficit. We expect that the supply deficit will grow until prices bounce back.

Parity with gold likely to be restored

For most of its history platinum has traded at a premium to gold (one suspects this owes to platinum being the rarer metal). Yet at present platinum trades at a 33% discount to gold. In the current cycle, platinum has only tracked gold price falls and not its upside, widening the discount. (Gupta, 2018)



Source: Bloomberg

In our view, some mean reversion in the near term is likely due to supply and demand dynamics (detailed below) but also due to renewed investor interest in response to these dynamics. As platinum correlates with

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gold, it offers similar portfolio diversification benefits and upside potential. (David Hillier, 2006) For this reason, we expect investor interest to rekindle as prices recover, helping stabilise demand.

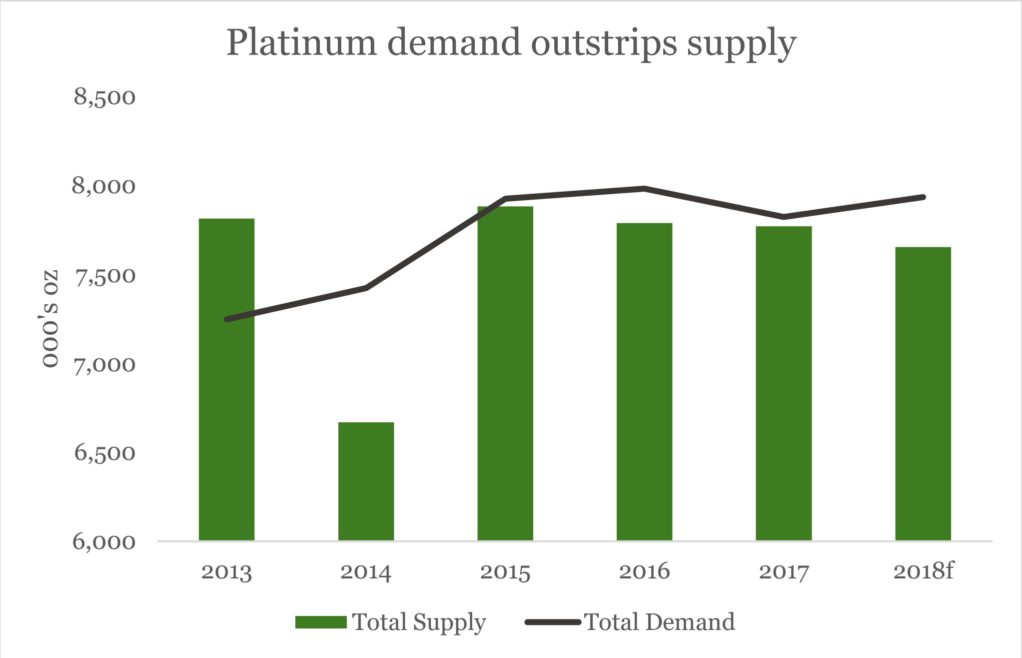
South African political risk and supply cuts

South African politics is likely an additional supply side pressure. Mine nationalisations have been threatened by the Economic Freedom Fighters, (Economic Freedom Fighters, 2018) South Africa's third-largest party, which is surging in the polls. (Umraw, 2018)

South Africa is a one-party state, with the African National Congress ruling since apartheid ended, making an EFF government unlikely. But, as is often the case in politics, the danger lies not so much in the minority party seizing power but in its ability to force mainstream parties to adopt part of its platform.

This year, we have already seen President Ramaphosa – under pressure from the EFF – outline proposals to give greater shareholdings to black owners, which would dilute current shareholders. These proposals, thus far, have been successfully challenged by miners in South Africa's courts. But fears of dilution and government intervention have dried mining investment and slowed production, adding another supply side pressure. (Hodgson, 2018)

Outside dilution fears, South African miners have hit a wall of difficulties: community unrest and union disputes over pay; skyrocketing electricity costs; and production disruptions from maintenance and safety stoppages. (Johnson Matthey, 2018) These ongoing difficulties – while not sufficient to drive up prices – are compounding the pressures caused by low platinum prices.

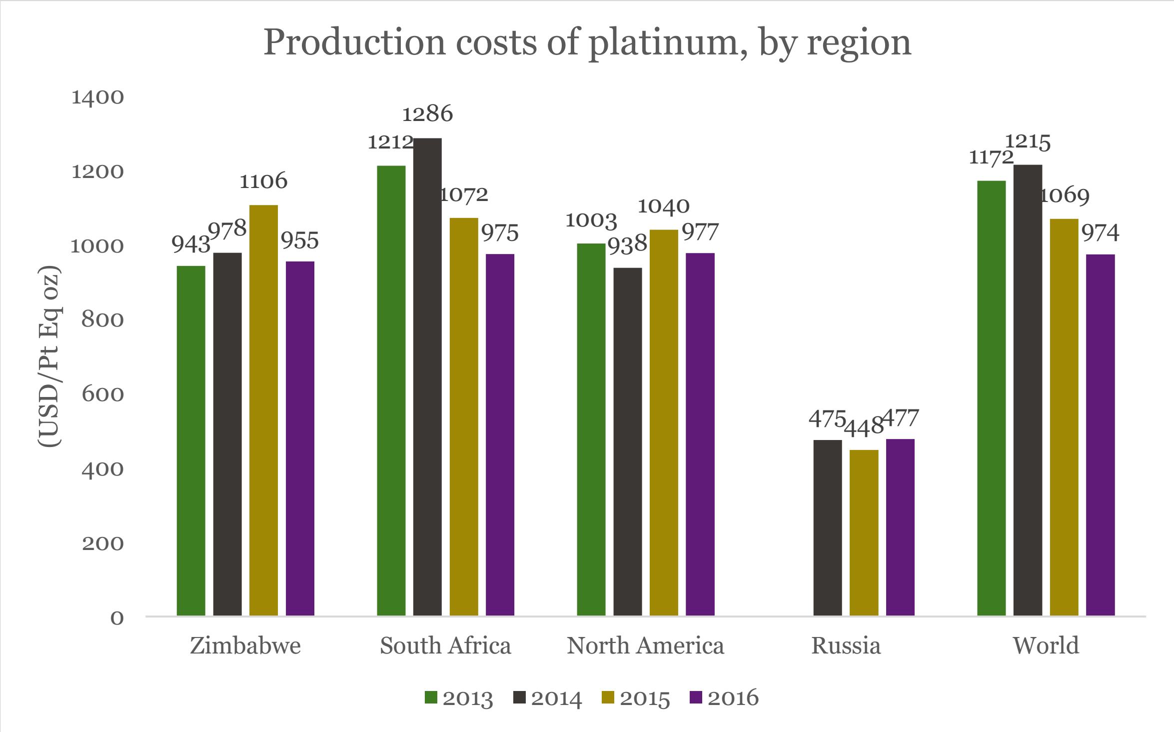


Source: Thomson Reuters

In response to these difficulties, the past two years has witnessed industry rationalisation. Lonmin, the third largest platinum miner, sold off much of its platinum assets to another miner. (Sanjeeban Sarkar, 2017) Impala, the second largest platinum miner, shut several platinum mines in March 2018 and has indicated it will fire 13,000 staff over 2018 and 2019. (Miller, 2018) Platinum Group Metals closed a major platinum mine mid-2017 due to it being unprofitable. (Seccombe, 2018) These shaft closures and production cuts, in our view, add to the likelihood of a sharpening platinum supply deficit, which in turn will place upward pressure on pricing.

Platinum trading below production costs

There is also evidence that platinum prices below $790 an ounce, as they are at present, are unsustainable as they fall below production costs. By general consensus, the all-in sustainability cost (AISC) to pull an ounce of platinum out of a South African mine is above $900 an ounce. (Thomson Reuters, 2018) A recent report from Anglo American – the world's largest and South Africa's most efficient platinum miner – said that its AISC was $955 an ounce in 2017. (Anglo American Platinum, 2017) Production costs in North America and Zimbabwe where platinum is also mined – albeit in significantly smaller quantities – are estimated to be similar. (Statista, 2016) Only in Russia, which is currently under strict US and EU trade sanctions, is platinum trading at below AISC. Russia produces platinum in too small a quantity to alter the world average.



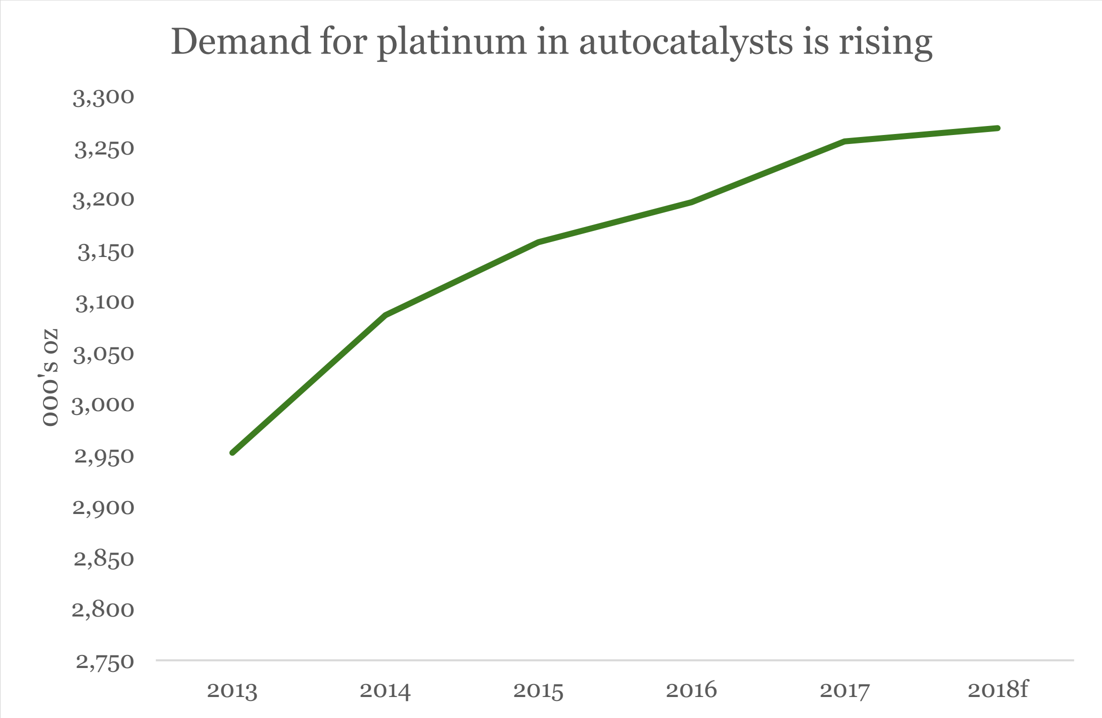
Source: Statista

Historically, commodities can and have traded below their AISC or marginal costs. But a situation where platinum is trading significantly below production costs – as it appears to be at present – will incentivise supply cuts and add upward pressure on prices.

Demand
Diesel cars and trucks are not dead

The most crucial pocket of demand for platinum comes from car catalysts in diesel engines in developed economies, especially Europe. Yet diesel cars are losing market share, thanks largely to the Volkswagen scandal of 2015. According to data from the European Automobile Manufacturers Association (ACEA), the European car industry lobby, in H1 2017 sales of gasoline powered cars in Europe overtook diesel for the first time since 2009. (ACEA, 2018) This trend has been taken by some commentators as signalling the "death of diesel". (Topham, 2018)

In our view, diesel cars will likely continue to lose market share in developed economies, but warnings of "dead" diesel seem overblown. In its GFMS Platinum Group Metals Survey 2018, the most comprehensive survey of its kind, Thomson Reuters noted that platinum use in diesel catalysts rose 7.1% in 2017 thanks to strong demand from Asia offsetting declining demand in Europe. (Thomson Reuters, 2018)



Source: Thomson Reuters

While in decline in Europe, European diesel cars still have a lot of "dying" left to do. According to the same numbers from the ACEA, diesel cars still make up 45% of Western European passenger cars. And although diesel's market share may be declining, in absolute sales terms the number of diesel cars being sold globally is increasing, suggesting the mainstay of platinum demand is well supported.

ETFS Physical Platinum (ETPMPT) – One of a kind

For any investors dicing up the opportunity platinum affords, ETFS Physical Platinum ETF (ETPMPT) offers a one-of-a-kind solution. ETPMPT is 100% physically backed by platinum bullion, held in HSBC's vaults in London. Every bar of platinum meets the London Platinum and Palladium Association's rules for Good Delivery, and every bar is segregated and allocated.

As ETPMPT is physically backed there is zero credit risk. And because it can be redeemed for platinum bars, any deviations from platinum's spot price will be quickly arbitraged out. ETPMPT is the only product of its kind available in Australia and offers a uniquely secure play on platinum.

How to invest in physical platinum?

ETFS Physical Platinum (ETPMPT)
MER: 0.49% p.a.
- ETPMPT is the only physically-backed platinum tracking ETF in Australia
- As ETPMPT is redeemable for physical bullion, it is anticipated to track to the platinum spot price
- ETPMPT trades on the ASX just like shares, meaning it is settled and held in brokerage accounts

Download Factsheet here

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