



# Rockstone

Research

December 14, 2015

**Research**

Macroeconomic Outlook



## 2016: There's Something in the Air

As is the case this time of year, we start to close the books on 2015 and position for 2016. While we have effectively and indefinitely moved “to the sidelines” with respect to stock picking in the junior mining space, there were some notable successes, in particular with the merger between Western Lithium (WLC:TSXV) and Lithium Americas. This combination positions the new company in a unique strategic light as electrification, underpinned by the lithium ion battery, gathers steam in 2016. Galaxy Lithium’s (GXY:ASX) restructuring is another positive development. We’ll be watching the developments with these two companies closely.

### Analyst Profile & Contact



**Chris Berry**

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and Co-Editor of the Disruptive  
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Chris Berry is a well-known writer, speaker, and analyst. He focuses much of his time on Energy Metals - those metals or minerals used in the generation or storage of energy. He is a student of the theory of Convergence emanating from the Emerging World and believes it will have profound effects across the globe in the coming years. Active on the speaking circuit throughout the world and frequently quoted in the press, Chris spent 15 years working across various roles in sales and brokerage on Wall Street before shifting focus and taking control of his financial destiny. He is also a Senior Editor at Investor Intel. He holds an MBA in Finance with an international focus from Fordham University, and a BA in International Studies from The Virginia Military Institute. Please visit [www.discoveryinvesting.com](http://www.discoveryinvesting.com) and [www.house-mountain.com](http://www.house-mountain.com) for more information and registration for free newsletter as well as his [disclaimer](#).



In 2015, there was very little to be cheerful about in the metals markets and to be blunt, we expect this malaise to continue into 2016. China's RMB devaluation last summer and subsequent popping of its equity bubble opened many people's eyes to the extent of the structural issues both inside and outside the country. As we have written about many times before, these twin structural headwinds are excess capacity and slack (or slower) demand. We see no reason why China won't continue to export deflation all over the world and keep an effective "lid" on many commodity prices for the next two years.

On a positive note, producers do seem to be "getting religion" and making painful decisions around cuts in capacity, headcount, and dividends with Anglo American (AAL:LON) and Freeport McMoran (FCX:NYSE) serving as the two most visible examples. AAL's decision to reduce headcount by 85,000 is shocking but necessary to rebalance the metals markets and heal the damage done during the super cycle.

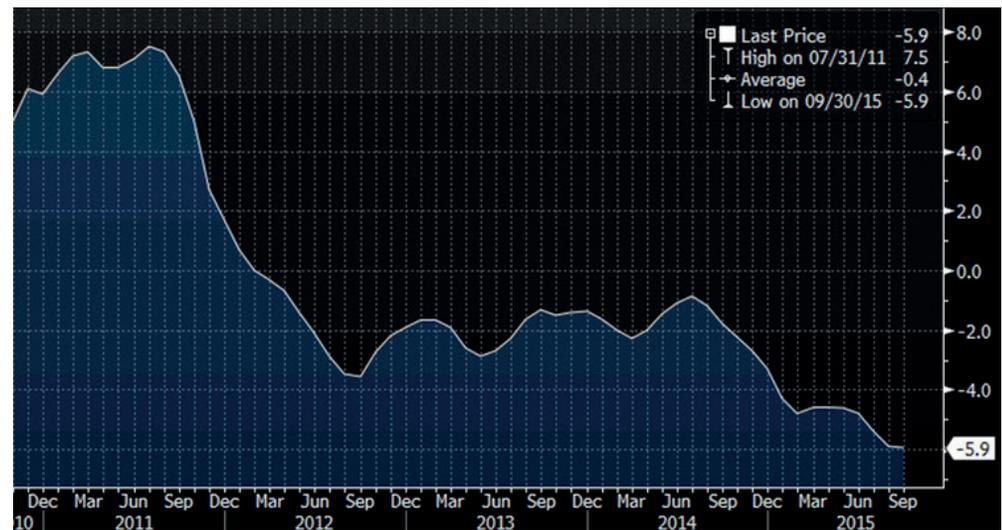
While we could go on about the many challenges in 2015, we prefer to look forward to 2016 and uncover situations to take advantage of or alternatively, land mines to avoid altogether. What follows is a quick take on some of the major themes we see playing out in 2016 and beyond. The title of this note "There's Something in the Air" is meant to point out both the positive and negative trends we see unfolding.

First, **the carnage in the metals sector isn't over**, though the worst is likely behind us. While the moves by AAL and FCX mentioned above are good first steps, they are just that – first steps. It seems that metals producers both inside and outside China are finally ready to face the painful decisions to cut capacity, but this has yet to affect metals prices. With over 60% of the nickel cost curve underwater on a cash basis, this is unsustainable over the long term, but precisely when this will turn has many on Wall St, Bay St, and Mayfair scratching their heads. Junior mining survival strategies will be of paramount

importance in 2016. We still firmly hold on to the conviction that in this era of excess supply and muted demand, only lowest cost producers warrant your attention.

**We expect deflation to become a more pervasive force in 2016.** While we have been very clear on this for several years, the tsunami of deflation being unleashed by China can no longer be ignored. An article in the Wall Street Journal earlier this year quoted UBS analysts stating that there was enough excess steel capacity in China to build 75,000 Eiffel Towers. This cannot change overnight.

The Producer Price Index (PPI) in China:



Source: Bloomberg

It would appear that **secular stagnation**, popularized by former US Treasury Secretary Larry Summers, is a force to be reckoned with.

The **uncertainty about China's true growth rate** will also loom large over global growth in 2016. While it is true that the slower growth rate (6% perhaps?) is unfolding over a \$10 trillion economy, the excessive debt burden in the country, estimated at \$28 trillion, will act as a drag on this growth. We wouldn't be surprised to see the Renminbi devalued in 2016 as Chinese economic policy makers begin to run out of policy tools to reinvent the economy. Further to this, the RMB inclusion in the IMF's SDR basket is a symbolic first step in China minimizing its dependence on

the USD.

The utter collapse in the oil market was certainly the story of 2015 and **we see the oil price staying range bound or heading lower** as OPEC and the US shale industry continue their game of chicken. Additional supply from Iran ought to only maintain the downward momentum in the oil price. The IMF has reported that Saudi Arabia can withstand low oil prices for the next several years. Will the US shale business be able to do the same as much of it was financed with cheap debt? How much of the US shale business is profitable at \$35 WTI? One facet of the oil market we'll be watching in 2016 is whether or not

the US shale business really is the new "swing producer". Any uptick in the oil price ought to shed some light on this thinking. Should this be the case, OPEC's pricing power will certainly be greatly diminished.

**Central Bank policy divergence will be a major issue in 2016** as the Federal Reserve prepares for a short term rate hike while the rest of the developed and developing world takes a more dovish tone. Are Emerging Markets, saddled with USD denominated debt, prepared for liftoff? Only time will tell. The USD has likely plateaued here, and any additional strength will likely come more from weakness in other currencies (CAD, AUD, COP) rather than underlying strength in the US economy. One of the biggest immediate-term risks we see is the threat of increased financial markets



volatility from any Fed rate moves.

**A wave of M&A in the mining space** ought to surface starting in 2016 making bankers happy and taking many long suffering shareholders out of their misery. This is all dependent on the direction and levels of metals prices, as well as the relative debt loads on various company balance sheets. Watching how the majors such as Glencore (GLEN:LON) or others we mentioned above de-lever and right size their businesses during this ongoing commodity rout will provide valuable clues to the depth and breadth of any M&A.

Despite the many issues listed above, there are several positives which offer opportunities in 2016.

We are comfortable stating that we believe that **2016 is the year that the lithium ion battery revolution gets underway**. We further believe that the next five years will determine how we generate, store, and use electricity for the next twenty five and this will put Energy Metals under the microscope. Lithium ion battery costs are decreasing by as much as 14% per year and this is due to a mixture of scale and technological advancement. We see no significant impediments to this trend currently.

Solar power is experiencing similar cost declines and this has us believing in a new model (solar plus storage) of energy generation and storage which will become more competitive with traditional fossil fuel generated power. The recently completed Paris COP21 negotiations act as a significant tailwind here though the dust is still settling how countries will shift to less carbon-intensive sources of energy. We don't expect to see 100% renewable energy anytime soon, but the momentum behind renewable energy is unmistakable.

Given this move, **we are focused on lithium, cobalt, and scandium and associated supply chains**. These metals are going to become increasingly crucial in next generation energy technology and we think you will do yourself a favor by learning as much as you can about the supply chains around these

commodities. We will be writing much more about all three in 2016.

We're not as certain about graphite and uranium for separate reasons, but will be watching them for any signs of price increases nonetheless.

**We expect to see solar power deployment explode** (pun intended) in 2016 as the ITC, a 30% tax credit on residential and commercial properties in the US, potentially is scaled back. Additionally, with pollution in Chinese cities at unheard of levels, a more aggressive push towards solar (and other renewable sources) is obvious.

**We think that in five years, we'll look back and realize that 2016 is the year electrification took hold.** The numerous benefits and tail winds far outweigh the threats in our opinion and are setting 2016 up to be a pivotal year vis-à-vis global electrification. The opportunities which we see emerging in this admittedly giant space will be a major focus of our work in 2016. A deeper focus on lithium ion battery technology advances, new financing models for power generation and storage, and mineral bank models are three such areas. Until the metals markets recover, moving "up" the value chain will be prudent.

There is indeed "something in the air" in 2016 as the title of this note indicates. Despite the rather gloomy commodities markets and macro uncertainties, there are exciting opportunities within the theme of global electrification. More to come. In the mean time, we wish you all a healthy, happy, and prosperous 2016.

## Our Thinking and What We Do



We are believers in the theory of Convergence. As the quality of life between East and West slowly merges due to advances in technology, continued urbanization, and changing demographics, opportunities across numerous industries will arise which we can take advantage of.

We aim to point out the strategic opportunities in the commodity space which arise from these themes.

Throughout history, no society has sustained a higher quality of life without access to cheap commodities or materials. As global population increases, putting stresses on resource availability, efficiency and technology must come to the fore to continue to provide for a higher quality of life.

The looming convergence of lifestyles between the emerging world and the developed world is a fact we must all understand and accept in order to chart a sustainable path forward for humanity.

The Disruptive Discoveries Journal is a free weekly newsletter we write focused uncovering and interpreting both the opportunities and challenges in the natural resources, nanotech, and clean tech sectors resulting from the belief mentioned above.

### More Information:

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The vision of Rockstone is to provide a contribution to the continuing education of private, professional and institutional stock market investors with focus on exploration and mining. Especially in the stock market segment resource stocks, the knowledge of all market participants is not even approximately the same, since not only the published company reports typically require at least a substantiated basis to expert knowledge about geology, exploration, geophysics, geochemistry and engineering to appraise correctly by trend the future of a exploration and/or mining project. Additionally, the trained part of professional market participants are typically specialized on micro- and macro-economic analysis as per their degrees in business administration and economics.

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