Materials

Scotiabank GBM Commodity Outlook Conference Highlights

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Event

- Scotiabank hosted its annual Commodity Outlook conference in Toronto.

Implications

- China: Economic growth slows but remains healthy, while self-correcting supply should gradually help the market regain its footing.
- Diamonds: Looking for market stabilization in 6-12 months.
- Gold: CPM expects rising investment demand and declining mine production to drive bullion to new highs beyond 2017.
- Copper, Zinc and Nickel: Zn appears to have the best fundamentals near term. Cu to remain under pressure, but surpluses remain relatively small.
- Oil & Gas: Crude oil in danger of breaking lower, while a recovery in the barrel is likely on the horizon, the extent of which will likely not last.
- Fertilizers: CRU sees stronger potash capacity growth than demand growth, with potential marginal cost pricing by 2020. NA to remain a net import market in nitrogen.
- Bulks: AME is more bullish than consensus on iron ore and coking coal.
- Uranium: Market is well supplied near term.

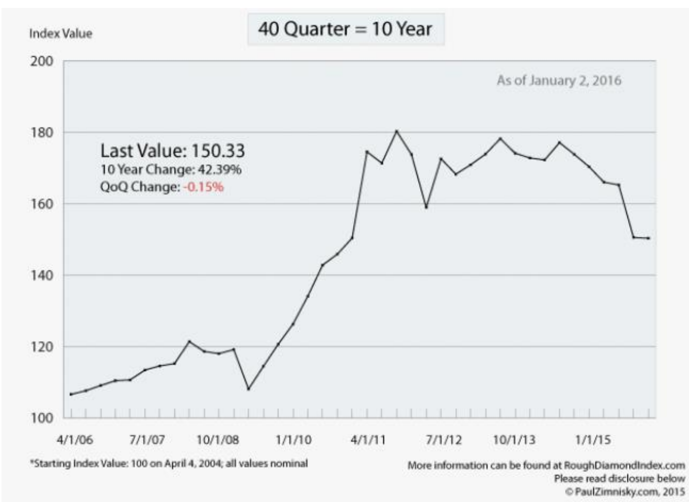
Recommendation

- Overcapacity and weak economic growth, particularly in China, continue to pose a challenge to a nascent price recovery for many commodities. However, many of our expert speakers expect a larger supply response in the form of production curtailments or closures, leading us to believe 2016 could be a transition year for many metals. Energy remains challenged.

State of the Global Diamond Industry, Paul Zimnisky – Paul Zimnisky Diamond Analytics

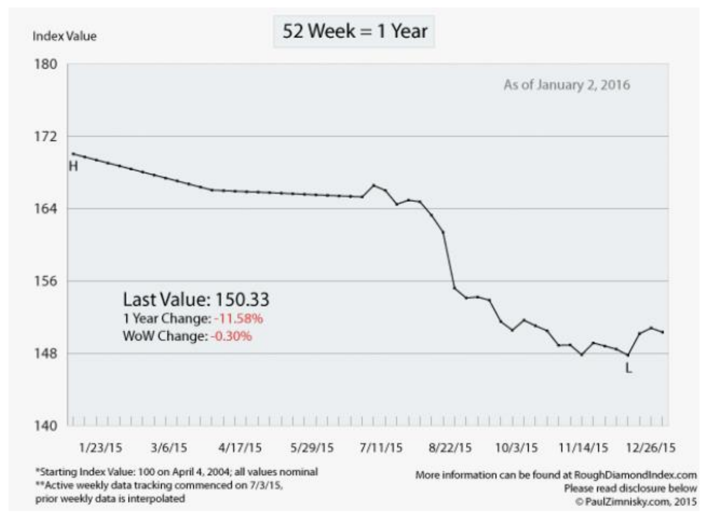
- Mr. Zimnisky began his presentation by discussing the opaqueness of the global diamond market; itself dominated by a few, large, producing firms. In his view, the opaqueness is due to, amongst other things, a lack of a transparent and widely-accepted "diamond price" as diamonds are non-homogenous in nature. For this reason, Mr. Zimnisky believes diamond equities have historically traded at a discount.
- Mr. Zimnisky provided a historical account of diamond prices which were characterized by a significant increase in the late 2000's, driven by the higher demand from China and India which had begun purchasing diamond engagement rings in material quantities for the first time. However, over the past year, Mr Zimnisky's Global Rough Diamond Price Index illustrates a 12% decrease in prices, as the industry has had to cope with slowing global growth, high inventory levels and on-going liquidity issues in the midstream.
- Mr. Zimnisky noted he believes there is currently about 6 months in excess inventory levels in the mid-stream which will be worked through as the market begins to balance and show signs of stabilization in mid-2016. However, he does not expect a meaningful recovery in diamond prices in the near-term unless demand levels in China, where demand has currently been weak due to several reasons (including domestic capital markets), rebound. He noted that diamonds remain a luxury and discretionary item for Chinese purchasers.

Exhibit 2 - Zimnisky Global Rough Diamond Price Index – 10 Year



Source: Paul Zimnisky Diamond Analytics

Exhibit 3 - Zimnisky Global Rough Diamond Price Index - 1 Year



Source: Paul Zimnisky Diamond Analytics

- That said, Mr. Zimnisky pointed to the fact that the industry remains very concentrated, with the top 5 producers controlling over 70% of the market. In order for prices to rebound substantially, in the absence of a rebound in demand, Mr. Zimnisky thinks industry leaders De Beers (which has a history of producing to demand) and ALROSA could reduce production levels which will likely benefit independent diamond producers (or near-producers) such as DDC, LUC, MPV and SWY. Mr. Zimnisky noted he intends to watch for the results from De Beers' first diamond sight of 2016 where he believes it is possible prices could be reduced from between 5-8% on a like-for-like basis.
- Lastly, on synthetics, Mr. Zimnisky noted that while technology has progressed, synthetic diamonds have not yet been adopted as an appealing substitute for authentic diamonds as the costs to produce a synthetic diamond, on average, remains higher than the cost of mining. That said, he expects that as the technology advances over the next few years, costs could reduce and perhaps provide enough price incentive for consumers to substitute. That said, in the medium term, he believes synthetic diamonds will remain a niche market.