Platinum rings

Platinum and the environmental terrorist

René Hochreiter | Wed, 31 Aug 2011 21:45

[miningmx.com] -- ARGUING that the platinum sector has landed in a serious hole and should therefore be left “in the ground”, Vic de Klerk essentially got only one fact right: the JSE platinum index has risen to 66,000 and the gold index rose to 2,585 since the year 1960, when all the JSE indices were originally started.

This performance has been remarkable for a number of reasons which De Klerk failed to address in a balanced way.

• He alludes to the platinum index breaching the 200-day moving average. One should remember platinum group metals (PGMs) have mostly industrial demand. The whole world is in a bear phase at the moment; the PGMs reflect that fact and should not be singled out as being more or less negative than any other market.

• Diesel-powered vehicles do account for much platinum demand. However, in petrol-powered vehicles platinum, palladium and rhodium are needed as each metal works most efficiently on particular emissions gases; platinum on NO2, palladium on HCs, rhodium on CO2. True, palladium can be used on its own – but you need at least twice the amount. Multiply the palladium price by two and you have almost the platinum price. Advantage in using palladium? Zero.

• The surplus in 2009, according to Johnson Matthey (which has the longest experience in the platinum market and is one of the biggest autocatalyst manufacturers in the world, where most PGM demand actually arises) was 635,000oz. Last year the market had a 20,000oz surplus in an 8 million oz/year market: essentially balanced. It’s extremely unlikely a surplus of 2 million oz will occur in 2011/2012, as the writer suggests. SA’s production continues to lag forecasts for reasons we all know well. It’s unlikely SA’s producers will over-produce – they simply can’t.

Furthermore, Amplats and Implats are so well connected to the PGM market they’ll always find a way of keeping the market balanced.

• Yes, the US has fallen in love with palladium in catalysts – while it suits its bottom line. I very much doubt the US is making money on palladium catalysts at $800. Also, De Klerk is correct in his statement that once they switch to palladium they dare not change, as a recall for failing to meet emissions standards can destroy a company – as it almost did to Ford a few years ago. That's why Ford is known to overload its catalysts to avoid a repetition.

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The converse is also true. Once the companies decide to go back to platinum-based catalysts as the palladium price becomes prohibitive (the Russian stockpile is depleted and the palladium price will likely not soften significantly in future) the demand for platinum will soar. ETFs are a fact of the market: they can ramp the price at times; they can collapse the price at other times. As the ETF market becomes more sophisticated, so derivatives will be applied (probably by producers) that will negate their effect on the market.

• The reason it looks "as if a few things are becoming bogged down" in terms of the "big guns' " share prices is that SA is now 67th out of 76 mining investment destinations in the world (the Fraser rating scale), mainly because of vacillating SA Government policy regarding nationalisation, DMR irregularities in granting prospecting and mining rights, shutting down whole mines in the event of a fatal accident, Eskom power shortages and HIV/Aids prevalence among miners – essentially, the loss of confidence in SA as a mining investment destination due to maladministration by the State. If Amplats and Implats were in Canada or Chile or Australia, the platinum index would be at around 500,000 by now (in 1960 terms) in my opinion.

TAKE YOUR PICK

• In my experience, share price data can be tortured to confess anything a writer wants the data to say. So moving down through the 200-day moving average (DMA) is negative, yes, but is backward looking. From my point of view the next move for share prices is up through the 200-DMA, which I suggest may be a very positive outlook for those share prices.

Take your pick to suit your story.

• From my experience, fund managers like to use total rate of return (TRRs) not return on RoEs. Again, De Klerk has chosen his RoE and dividend yield to suit the bearish story and hasn't compared that to average historical RoEs or TRRs and makes no mention of forward TRRs or RoEs that most investors look for.

• I'd also suggest RoEs on gold shares currently aren't that different, given that cash costs on gold mines are almost twice that of platinum mines with similar revenues. Again, the writer chooses to ignore that comparison.

• Gold and platinum are very different markets. Although at times they seem to follow each other, the relationship doesn't hold over long periods. Gold is essentially driven up by weakness in the US dollar. Platinum as well as the other PGMs are essentially driven by legislated demand and environmental considerations. They are theoretically countercyclical.

If that’s true and the platinum price is holding above the gold price even in these (the worst of) times, then the performance of the platinum price, when the world’s economies recover, will likely be spectacular. Divergences in the prices of gold and platinum occur at times for good reasons. Sometimes gold prices are above platinum prices, and vice versa.

"The short term is for losers who can’t think past next Friday."

It appears from the chart the platinum price actually drags the gold price along over the longer term. At the risk of upsetting De Klerk even more, I suggest that for him to advocate switching out of platinum and into BAT shares on top of such an exceedingly bearish report against platinum smacks of environmental terrorism. Or does profit mean everything in these dark times?

The very strong demand for palladium will push up the price on par with platinum in due course. The demand for both won’t decline: their demand is essentially legislated (40% of demand). The PGMs remain the best and most efficient catalysts (20% of demand); otherwise the chemists would have found an alternative by now.

That leaves jewellery (25% of demand), which is now the same price as gold, but far more desirable to the sophisticated high net worth individual than gold. (Have a look at the top jewellery shops at the world’s major airports and cities. My estimate of the proportion of platinum metal versus gold in settings is almost three to one.)

ETFs or investment demand could flood the market – but could just as easily ramp the market, as we’ve seen time and again.

My opinion is that the short term is for losers who can’t think past next Friday. For those with longer investment outlooks – such as the legendary Allan Gray himself, Mark Mobius, Louis Stassen and Tim Alsop – an investment in platinum and PGMs will see another three zeros added to the 66 000 platinum index over the years to come.

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