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RESOURCES BULLETIN by Gavin Wendt OCTOBER

Ten Key Points to Bear in Mind Based on Current Resource Volatility

1. ***Let's firstly put Glencore's recent dramatic 30% plunge into perspective*** - what's driven the latest market concerns are the company's high debt levels, however this isn't something new. It was there when the company merged with Xstratra more than two years ago. What's exacerbated the situation however has been the subsequent decline in commodity prices and softer Chinese demand, which have placed enormous strain on the company's balance sheet – and financial viability.

2. ***Glencore is viewed as a more entrepreneurial enterprise*** - many analysts and observers have typically viewed Glencore as a much more 'entrepreneurial' enterprise than its sector rivals BHP Billiton and Rio Tinto - which is to some degree true. This has been based on a belief that Glencore would generate enough earnings via its commodity trading arm to keep its business well afloat, even during a declining commodity price environment. This hasn't been the case.

3. ***Glencore's management aren't financial magicians*** – although many supporters and market observers have believed they are. The downturn in commodity prices has applied the blowtorch to the company's strategy. There has also been greater disclosure as a result of the merged group's full sharemarket listing during mid-2013.

4. ***Glencore is finally forced into tough decision-making*** – the company has now been forced to undertake the tough decisions that heavyweight miners like BHP, RIO and Anglo American undertook four years ago – and which ultimately cost several high-profile CEOs like Tom Albanese and Cynthia Carroll their jobs. This will involve capital raisings, mine closures, asset sales/disposals/ spin-offs in order to reduce debt and get its balance sheet back in order.

5. ***Current negative sentiment driven by four major factors*** – slower Chinese growth, lower IMF growth projections, weaker commodity prices and softer mining equity prices. In reality, none of these factors are particularly new – and the resource sector has been grappling with these challenges for a number of years now. The latest blows are merely part-and-parcel of the resources cycle, which ultimately will see a recovery in commodity prices and demand.

6. ***Double-digit Chinese growth couldn't continue*** – indeed it wasn't necessary or desirable for the Chinese economy to sustain the record levels of growth that we've witnessed for the past two decades. Markets knew that an economic slow-down was inevitable (indeed healthy), as was a restructuring of China's economy away from an infrastructure and export focus, towards a more consumer and service-oriented economy. As is often the case however, markets tend to overreact.

7. ***China is managing the restructuring process well*** – despite what you might read in the mainstream press, China is in fact doing an enviable job in terms of managing the restructuring of its economy, although there will naturally be hiccups along the way. Recent volatility with respect to China's sharemarket is sometimes pointed to as an indicator that the restructuring process is being derailed, but as we've previously highlighted, China's economy and stockmarket are vastly different beasts.

8. ***We don't expect China sharmarket losses to damage its economy*** – as we've previously high-lighted, financial leverage within China's sharemarket remains modest overall. At the same time, equities account for only about 20% of overall household financial wealth, compared with 54% in deposits – and if we throw in property, the equity share goes down to 12-13%. Investors have not typically depended upon equity investment returns as their primary source of income – rather wage growth has provided the vast bulk of incomes.

9. ***`Strong parallels with the Asian Financial Crisis*** – from our perspective there are strong parallels with the Asian Financial Crisis almost two decades ago – as evidenced by strong commodity price falls, Asian turmoil, financial readjustment, declining company profitability, weaker lending and weaker commodity prices. We even have the spectre of junior companies making the leap into the dot-com space – back then it was referred to as the *'New Economy.'* Back then it was the Asian 'tiger' economies, whereas now it's China. At the end of the day, with the world's population set to grow from 7 billion now to 10 billion by 2050, commodity demand will only grow.

10. ***Importantly, the world didn't end (and won't this time)* – ultimately**, the right decisions on restructuring were made by Asian nations and a longer-term and more damaging crisis was avoid-ed. We are confident that China is also making the right decisions that will lead to an orderly transitioning of its economy. The one piece of the jigsaw that is still missing however are the necessary supply-side cuts by the major miners that are inevitable in order to bring commodity markets back into balance and to provide price support, prior to an inevitable recovery.