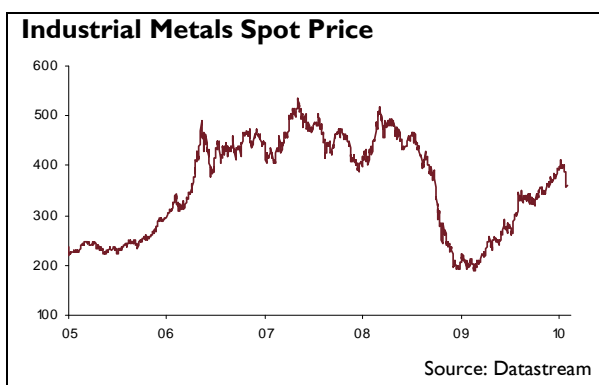


Outlook for industrial metals is tarnished but intact

After last year's fantastic performance by industrial metals prices, January recorded the worst monthly returns since December 2008. The doubling of metals spot prices last year has inevitably prompted investors to take profits and review the outlook, especially amid uncertainty surrounding the outlook for a sustainable global economic recovery. While these concerns are valid and likely to produce greater volatility and risk to investing in industrial metals, we believe that the positive trend will continue and forecast that prices will record new post-recession highs, even if gains are more modest than last year's dramatic bounce-back.

After falling by nearly two-thirds in 2008, industrial metals doubled in 2009 as fears of a global depression were replaced by economic recovery. Industrial metals, copper in particular, are occasionally referred to as the 'commodity with an economics degree' because of a clear link between their prices and the outlook for the global economy.



Many of the concerns that have beset industrial metals at the start of this year are therefore linked to uncertainty over the global economic outlook, though others are more market-specific. The developed world faces significant headwinds to

recovery, with uncertainty over how sustainable growth will be once monetary and fiscal stimulus measures start to unwind over the course of the year. The outlook for emerging markets is more robust. But initial moves by the Chinese and Indian authorities to tighten monetary policy in order to suppress inflation (in part driven by rising commodity prices) have raised concerns that growth might be choked off.

The recent rally in the US dollar has had a negative impact on commodity prices, which are priced in dollars. The price reversal has also prompted concerns that the current high levels of 'speculative' investment (speculators here defined as any not directly involved in the production or consumption of the commodity) could unwind and so further depress prices. To this are added the overhang from stocks that China accumulated last year, when its buying provided a major boost to the market.

Against these concerns we highlight again the clear relationship between the prices of industrial metals and the global economic outlook. Our central case is that the recovery continues, even if developed economies will lag behind, driving demand for industrial metals. This will slow and even reverse the accumulation of stockpiles, supporting spot prices and reducing the current premium in the futures market to the benefit of investors. Constraints on supply remain, with high energy and steel prices acting to drive up costs of exploration and production. We also see scope for emerging economies to address their domestic inflationary pressures by allowing their exchange rates to appreciate. This would reduce the domestic price of internationally traded commodities, which not only reduces inflation, but also stimulates demand.

Therefore, while accepting that markets will be more volatile and less rewarding than last year, we conclude that the current outlook for industrial metals prices is favourable.

Carl Astorri
+ 44 20 7753 1612

firstname.lastname@coutts.com

Jean-Maurice Ladure
+ 44 20 7753 1469

Henry Lancaster
+ 44 20 7957 2426

Georgios Tsapouris
+44 20 7753 1888

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