Specialty Metals: There is a Season – Turn, Turn, Turn

With the blizzard of noise in the Lithium space and the generalized feel-good in the mining space in general, it is easy to fall into the trap of thinking that all is well in the world. As we all know Uranium remains in the dog house but quite a lot of specialty metals are not exactly in the rudest of health either.

A key factor missing from the specialty metals scene, that would give it an upward boost, is a generalized economic recovery. Sure the US is doing OK and Europe is struggling out of its mire but many emerging economies (e.g. Brazil) have been going backwards and China is still in its swoon.

Tin

The price of this key minor metal has moved up by a third from its lows around the start of this year. To get back to its average price over the last five years it would need to rise another 20%. Therefore it looks like there is still good upside potential. The fact that should be overlaid upon this proposition is that the supply situation has considerably weakened over the last five years with the still-dominant Indonesian and Malaysian alluvial deposits in terminal decline and with the former country particularly intent upon squeezing the supply situation by insisting that concentrates be processed and upgraded within the country rather than in China.

The best upcoming Tin deposits are in Africa, most particularly in the DRC and Burundi, neither of which inspire massive confidence in investors. Some underground mines are on the drawing boards (or are old mines that might be reactivated) but they will inevitability skew the average cash cost of production higher. Tin is destined to be a tighter market with higher prices.

Tungsten

It is simplistic to link Tungsten's fate solely to machine tools and thus to activity or lack thereof in the Chinese economy. More countries' economies use machine tools than just China's. Additionally the use in drill-bits etc. took a double blow in 2015 with miners virtually ceasing to do exploration while the oil industry's long boom came to an end with the steep falls in oil and natgas prices. While oil remains in the dog house, mining is stirring to life and while the drilling is not as frenzied as before it is reviving and there is money to fund it. That alone gives encouragement to those keen on this tough metal.

The chart below shows the Ferro-Tungsten price and it's clear that this is far from being in boom mode with a rise of only 10% off its bottom and half the level of four years ago.

Antimony

This metal largely has its application in alloys (with Lead amongst others) and in fire retardants. The plunge from early last year to its nadir in early 2016 was brutal and I believe prompted by the FANYA debacle. The applications that Antimony is used for are not in any sort of swoon and indeed the auto industry (a major fire retardant user) is booming all around the world. Therefore the blame can most probably be laid at the door of FANYA. The problem with that issue is that the market place never really knew the extent of the FANYA overhang and probably never will. The fact that prices have rebounded nearly 30% in recent months probably means that the overhang is gone.

Supplies are reputedly tight and therefore the chances of the price returning to early 2015 levels is good, not that $8,000 per tonne is all that ritzy a price for this commodity.

Rare Earths

This group is down and out purely at the discretion of the Chinese who have decided to bankrupt and drive out the Western players. The turn in this group of metals could be as basic as some Beijing official getting out of the bed one morning and thinking it’s time to lift prices. It has very little to do with supply/demand and almost everything to do with an industrial policy. However the policy has now gone beyond beggaring the *Gweilo* and China is now beggaring itself in a scarce resource.

The scene is ripe for this bedside conversion as the Chinese could easily hike prices by 50% in the entire Lanthanide group (excepting Cerium and Lanthanum) and there would be no negative effect on demand and only one non-Chinese company would benefit (Lynas) while all the Chinese producers would be banking significantly higher incomes. There is no chance that even such a hefty rise would bring another Western player into contention for 3-4 years and even then whatever new source of production appeared would not be disruptive in terms of volumes added to the global supply.

Therefore, with timing unknown, we would still sustain that a REE breakout is more likely to happen than not with the decision not in the “lap of the gods” but within the purview of a Chinese apparatchik.

Niobium

This metal is joined at the hip with the steel complex and frankly it’s hard to see why there should be an upsurge in demand for the foreseeable future. Added to that is that the biggest player in the metal keeps a tight rein on prices and operates on a Goldilocks principle of “Not too cold, not too hot, just right”.

One matter that is rarely mentioned is that CBMM is like a one-company cartel (somewhat like Materion in Beryllium) and that it tolerates Niobec and the other small players in the interests of an “orderly market” and not appearing to be a total monopoly. That said, one should not discount that CBMM controls the levers of the Niobium price and if it sees a threat to its dominance from too many players appearing on the scene then it may well (and certainly could afford to) lower the price 20-30% to throw wannabe producers into confusion. Thus any new Niobium player that appears and talks about their massive potential production then that wannabe and its shareholders should watch out that the Brazilians don’t decide to play Whackamole with their project via the pricing mechanism.

Conclusion

One should not discount that the FANYA Exchange debacle is still having some lingering effects on specialty metals and it has definitely sidelined a lot of the speculative players in China who lost their shirts and ended, metaphorically, up to their eyeballs in Bismuth and Indium (and Antimony). The overhangs may have been cleared away but the creative destruction of “locals” in the marketplace for specialty metals has returned trading to the producers and end-users who have failed to provide liquidity to specialty metals in the past and who indeed seem to prefer prices that are set by a combination of smoke signals, nods & winks and Masonic handshakes.

Despite this the signs are there that specialty metals were oversold at their worst and are now in recuperation mode even though the words “boom” or “surge” could not be employed. And that is probably all to the best after past “pump and dumps” in thinly traded commodities.

The lack of pure plays continues to be a problem in some spaces and we continue to admire the consolidation strategy pursued by the likes of Almonty which should be a model for those companies operating in all the specialty metal sub-spaces.

The tide has lifted (almost) all boats in the precious metals space and specialty metals now await their turn. The lack of investment in recent years and the exhaustion of some traditional sources of supply means that any resurgence in prices will need to be fed with new projects to ensure that supply crises do not eventuate again sending prices to the levels seen late last decade. Its up to the hardy survivors to re-emerge from the bunkers and set to work providing this new supply.

China’s CHX foothold in US capital markets?

It is 30 years since the last “Asians are Coming” scare washed across the US. At that time it was the Japanese newly minted with the title of Global Economic Dominator and having the World’s Largest Bank that were feared for their purchase of the iconic Rockefeller Center and various golf courses around the US. The rest is of course history with the Japanese economy only having a very brief day in the sun before tumbling into deflation and disdain (though bumbling along quite nicely ever since). Now it is the Chinese who are the feared economic invaders.

With the current distraction being the Muslim “threat”, the Chinese have competition for the title as the Great Satan of xenophobes. As a result their latest deal has not attracted the nativist outbursts one might have expected a couple of years ago when the US was perceived to be on a back-foot *via a vis* China. Even more poignant is the lack of a counterattack from those who capital markets, as we suspect many would like to see more competition for entrenched quasi-monopolies in the equities trading world.

The Deal

Late last week the Chicago Stock Exchange, Inc. announced that it had entered into a definitive agreement to be acquired by an investor group led by Chongqing Casin Enterprise Group. However no details were offered of price or conditions, although Bloomberg claimed to have a source close to the deal saying the price did not exceed $100mn. The deal was unanimously approved by the Exchange’s Board, but the sale remains subject to regulatory approvals. The acquisition is expected to close in the second half of 2016.

Founded in 1882, the Chicago Stock Exchange, more jazzily referred to as the CHX, is one of the nation’s oldest full-service national securities exchanges with strength in high-performance technology trading. CHX offers a compact set of order types and trading functionalities, such as CHX|snap, designed to provide a level playing field for all market participants.

Chonqing Casin Group is a privately-held diversified holding group founded in 1997 with headquarters in Chongqing, China. The group’s founder and chairman is Shengju Lu, who reputedly was a torch bearer during the Beijing Olympic Games in 2008. The company is focused on real estate development, environmental protection industry investment and operation, financial holdings and municipal infrastructure investment and construction. By Chinese standards it is relatively small with only 821 employees, though it has operations across China and abroad, including Beijing, Hong Kong, Sydney and other locations.

Casin has a fairly low profile up until now. We found a record of a deal in November 2015 when it acquired Sino-Australian International Trust Co., Ltd., based in Shanghai, which provides non-banking financial services, including arranging finances for companies and local government bodies. Bloomberg reported that in 2012, the firm increased its stake in Shenzhen-listed Guoxing Property to 30%, becoming the biggest shareholder. Guoxing is now 60% owned by Casin Group. Casin also bought a 25% stake in Singapore-based Great Eastern Life Assurance in 2013.

In light of this, it looks like the move into big-time exchange and settlement management is a move way out of left-field. The fact that the current CEO & President of the CHX, John Kerin, will continue to hold those positions under the new onership and that the rest of the CHX's management team is to remain in place means, in theory, little change. But that is just the theory…

Shengju Lu, speaking for Casin, said. "We have reviewed CHX's plans to improve market share through new growth initiatives and fully support them. Together, we have a unique opportunity to help develop financial markets in China over the longer term and to bring exciting Chinese growth companies to U.S. investors."

Casin was also reported as committed to preserving CHX's current business operations and proprietary trading platform, which has "demonstrated state-of-the-art capacity, speed and system reliability". But that of course is standard M&A-speak to not "scare the horses" in the run-up to the transition and particularly with regulator’s approval still pending. The SEC certainly does not want a FANYA on its hands.

Some Background

The Chicago Stock Exchange officially became public and opened its offices in 1882. The exchange began to flourish significantly in the late 1880s, with the rate of transactions of stocks and bonds increasing. In 1894, the Chicago Stock Exchange moved its trading floor to the old Chicago Stock Exchange building, located at corner of Washington and LaSalle streets. The old Chicago Stock Exchange building was demolished in 1972.

In 1920, the Chicago Stock Exchange Stock Clearing Corporation was established. Then the Exchnage bulked up in 1949, when the CHX merged with the exchanges of St. Louis, Cleveland and Minneapolis/St. Paul to form the Midwest Stock Exchange. In 1959, the New Orleans Stock Exchange became part of the Midwest Stock Exchange, and in the early 1960s the Midwest Stock Exchange Service Corporation was established to provide centralized accounting for member firms.

In 1993 a rebranding was embarked upon and the exchange changed its name back to the Chicago Stock Exchange. In 2005, the SEC approved a change to a demutualised ownership and now the CHX operates as a direct and wholly owned subsidiary of CHX Holdings, Inc., a Delaware corporation. In 2006, the Exchange announced regulatory and shareholder approval of an investment in CHX by Bank of America Corporation, Bear Stearns (acquired by JP Morgan Chase in 2008), E*TRADE FINANCIAL Corporation, and Goldman, Sachs & Co.

Technology

The Chicago Stock Exchange has long been at the forefront of technological advances to try and rebalance the playing field between itself and the NYSE, the AMEX and the NASDAQ. In 1978 it launched an Intermarket Trading System, a system that allowed orders to be sent from one exchange to another to ensure that customers received the best execution available. In 1982, the CHX launched the MAX system, which allowed CHX to be one of the first stock exchanges to provide fully automated order execution. In 1987, the CHX implemented programs to trade Nasdaq securities.

In 2005, the CHX implemented the Electronic Book trading platform; the predecessor technology of the New Trading Model's Matching System. This Matching System was designed for full electronic trade matching. Publicly traded companies do not need to be listed on the CHX to be traded at CHX and SEC rules allow the CHX to trade stocks listed on other exchanges.

In the near future, CHX anticipates rolling out its new on-demand auction product, CHX SNAP (Sub-second Non-displayed Auction Process), which is designed to facilitate bulk trading of securities on a lit market and to minimize speed and information advantages enjoyed by only a few market participants. The new system received regulatory approval from the SEC in October 2015. CHX SNAP

John Kerin was reported as saying of the Casin deal "..we will have significant additional resources to pursue our new business initiatives, including the launch of our on-demand auction product, CHX|snap, in the spring of 2016".

What It All Means

It's probably unfair, but almost inevitable, that FANYA might be mentioned in relationship to such a transaction as this. This is why we have lashed the Chinese authorities for letting the carpetbagging crooks at FANYA besmirch the reputation of other Chinese businesses by being given such free rein to create such damage. Indeed the latest transaction might be the fast-track to redeeming the damaged reputation if Casin can't ramp up CHX's operations without any pitfalls. We would expect that there will be a grab for extra business. Some have speculated that this may include adding Chinese listings and we might expect them to pitch for Chinese (of China-related) stocks listed on other US exchanges to make the switch. Beyond that there is the enormous frustrated pile of Chinese savings back in the motherland that could be channeled towards the US equities markets in general. How this might evolve is anyone's guess, but up until now the Chinese investor in the street has had scant access to foreign markets and so the potential to funnel flow into US stocks for those investors at home tired of the "two booms and busts per annum" cycle in China is enormous in theory. Again.. in theory.

Conclusion

While the temptation is to reel in horror at the idea of the foreigners buying a US institution (Remember the Rockefeller Center!) one can equally find home grown buyers for securities exchanges that have been of less tender mercies than Attila the Hun. We need look no further than the TMX brutalization of the Vancouver and Montreal Stock Exchanges to see that devil one knows is infinitely less desirable (and usually leads to less competition).

Indeed, a wicked thought even passed through our minds that once the Chinese get a grasp of what they have taken on in Chicago they might indeed turn their attention to the orphan children of the loveless marriage of the TSX with the other Canadian exchanges. While in normal circumstances we would be the first to decry a sell-out to the Chinese frankly they could not make more of a hash out of the TSX-V than the TMX Group did. Investors in junior miners would (and should) probably welcome a change of control of the venture exchange because it could certainly provide a massive jolt of electricity into what is a very forlorn institution. We can only hope!

2015 – China's Annus Horribilis

For the Japanese, their *anni horribili* at the end of the 1980s are chiefly remembered for overpaying for the Rockefeller Center and golf club acreage. When the Brazilians come a cropper, it's a case of party like its 1959, and return to the basics of fresh air, coconuts and sunshine. But when it comes to *hubris* the Chinese, as in everything, outdo everyone. The new self-proclaimed *Masters of the Universe* have managed to end the year choking themselves, and their economy, to death in a cloud of Purple Fumes (cue the Performer once known as Prince) and shown that as for regulation (and development) of financial markets the Chinese, to put it more politely, could not run a booze-up in a brewery.

The last weeks of 2016 saw several prominent financial market figures disappear and then reappear (including the reputed Chinese version of Warren Buffett), the aforementioned pollution disaster and the start of criminal investigations relating to the FANYA schemozzle. There is an innate tendency for institutions in the capitalist side of the Chinese economy to deteriorate into illegality and irregularity with remarkable speed. In this aspect the Chinese system appears most akin to the rip-roaring US markets of the late 19th century when Robber Barons ruled the roost on Wall Street and established suffocating and anti-competitive cartels/trusts.

FANYA

For the mining community the most important thing about China is the demand aspect as this has driven so much of the global mining industry's thought process over the past 20 years, however for the

The establishment of the FANYA Exchange with its focus on specialty metals seemed like a logical and inevitable evolution of the Chinese dominance of the production of (many) specialty metals and the substantial position it also held as a processor and end-user. FANYA initially started out with specialty metals and then diversified into fixed income products. The problems in the Bismuth, Indium and Antimony trading by the exchange's investor base are well documented now.

In mid-July Metal Bulletin reported that the Fanya Metal Exchange had suspended accepting applications from companies to sell Indium, Germanium and Bismuth on the exchange between June 23 and August 31. An official from Fanya, who refused to be named, cited "Liquidity-related problems" were the major reason for the decision. That there should be "liquidity problems" in trading notoriously illiquid metals in the pre-FANYA era, comes as no surprise to participants in the global market for specialty metals.

While FANYA has been most (in)famous its metals trading, it has also had a fixed-income element, which not unsurprisingly has reputedly also gone bad. The Financial Times reported in September that "hundreds of well-heeled urban professionals who had purchased high-interest rate products from the Fanya Metal Exchange united with distribution agents who sold them in an unusual protest….in the financial heart of Beijing".

The FT captured the moment at which the head of FANYA, Shan Juiliang was manhandled by a crowd in Shanghai. They dragged him off to the police to have him arrested. Whether his potential fate at the hands of the crowd or in the Chinese legal system will be a better one will remain to be seen.

The big question, as everyone knew six months ago that FANYA was going down in a welter of financial irregularities, is why did it take so long to look into the matter? Obviously people in high places wanted to cover their behinds (and unwind positions) before the Great Unwashed cottoned on. However, the public are now so far ahead of the authorities in catching a whiff of scandal that the Powers that Be are last to know.

Chinese “Statistics”

Time and again we have seen the Chinese “issue” with deceptive practices on bonded warehouses and the collateralization and double-counting of fictitious or “massaged” inventories. It is very easy to create theoretical liquidity by miscounting (read exaggerating) warehouse numbers then creating paper instruments based on the bogus holdings, trade them fast and furiously and voila, liquidity. The whole scheme (never let the word “Ponzi” cross our lips) comes apart at the seams when someone wants physical delivery and then the game is over. In China of course the small and medium sized investor can be stalled for a while, while the big fish exit their positions and when the curtain is eventually pulled back to reveal that the “cupboard is bare” then the recriminations start flying. A few random death sentences may be meted out (involuntary organ donations, anyone?) and the matter is regarded as swept under the rug until the next time.

The result though is that China has blown up chances of being taken seriously as a locale for trading of commodities due to this repeated flaunting of warehouse statistics which are at the root of the credibility of any market in the metals trading world.

Bubbles

The Chinese cannot be criticized for having “bubbles” in their stock exchange(s) for the US is a repeat offender in this regard, with Alan Greenspan being a notorious bubble-blower with a goodly part of the US economy and the High Net Worth sector regularly refilling their coffers through repeated pump and dumps on a truly grand scale. However in the case of China a casino-ish atmosphere has not only existed, but been encouraged. The closest that the US has come to this was the dot-com era market of 1998-2000, which was mainly tech/media/telecoms (rather than a whole market) and 1929, which was a very long time ago and before hardly any legislation governed markets.

While regulators in the West, in the wake of a market bust, go into a frenzy of reregulating and attempting to close the gate after the horse has bolted, the Chinese on the other hand are quite shameless with the goal being to reinflate the bubble as fast as possible. Investors in the West go into soul-searching wondering why they were suckered or why they suckered themselves, whilst in China introspection seemingly has no place and mass amnesia is seen as the cure for all ills.

Robber Barons

China looks like the US in the Age of the Robber Barons in the late 1800s. The trouble for China is that we are talking about 130 years ago. It is not that hard in this day and age to be up to date in regulatory and supervisory matters and systems. If you can have stock tickers wrapped around office blocks then why can’t you buy in some skillsets on market regulation? The answer is largely because the authorities don’t want to appear to be taking advice from the *Gwai Lo*. Frankly they could save themselves (and everyone else) a lot of grief is they forsook the financial Wild West (East?) and got their house in order in 2016.

Riding the S-Curve

Or we could less charitably say going down the S-bend! We found an interesting thesis, posited by a Charles Hugh Smith, that tallied with our own view that China is following a well-trodden path down which Japan, Taiwan and South Korea have already travelled. China would like to think it is different and heading down some Middle Kingdom version of the Thousand Year Reich (oops!) when in fact it is just doing what all economies have done since the dawn of time, and that is pursuing an S-shaped trajectory.

We have seen this process described as being somewhat akin to a rocket's trajectory with an ignition phase as the fuel of financialization and untapped productive capacity is ignited. The high growth rate of credit and production overwhelms all other factors, as rising profits and production increases wages which then support further expansion of credit and consumption which then supports more production (or excess-capacity).

After this the thrust that comes from "financialisation" is exhausted, and the previously fast-growing economy moves forward on momentum alone. As the economy weakens, this momentum is to the downside. This is where we find ourselves now in the China cycle as everything that worked in the boost phase reverses, as nothing works any more. Investors in China's "markets" lose every bet and officialdom's efforts to reverse the decline end in repeated failure.

Conclusion

While many in Western markets (and particularly in the US) are used to complaints that the system is rigged against the investor class by the Powers that Be, the complaints are usually just hyperbole and blame-searching after the one a decade meltdowns that we have become inured to. In China though, like all casinos, the House always ends up winning and the punters, by and large, end up going home without their shirts. The markets in the West may end up occasionally ripping off investors whereas in China they seem to be set up with the explicit purpose of fleecing the lambs. The results is that the middle and lower middle classes keep having their savings confiscated for the greater good of those higher up the totem pole that mastermind, tolerate, encourage and then cover-up the scams. It is like China is in the grip of a horde of Bernie Madoff clones.

If 2015 was bad then 2016 has got off to an even worse start with two suspensions of trading on the Stock Exchange in the first few days of the New Year. This was followed by the same old intervention which obviously failed in the first instance because it had to be applied again a few days later. The "Street cred" of the Chinese "powers that be" that pull the financial levers is totally shot. Major figures on the financial stage appear and disappear like characters in a Feydeau farce. Re-education used to involve years in the paddy-fields and now consists of a weekend of being brow-beaten in a board room at the Ministry of Finance. Maybe the old ways were better!

Once a soap bubble is burst there is no reinflating it. The Chinese should face the fact and move on. They are now in a new place that the rest of us in the Western economies have been in all too frequently in recent decades and they may care to learn from it… even if it means having to lose a little face.

FANYA – Good Girl Gone Bad

As we have written in the past the Chinese are not as infallible as they would like everyone to believe. Economic booms of the intensity of that which the Chinese have experienced over the last 15 years can bring the tendency to become self-declared Masters of the Universe. Look at the

Japanese in the late 1980s, where pride definitely came before a fall and a long and depressing two lost decades for the Japanese economy. One could also say that the Vietnam War was the Waterloo of the US dominance after twenty years of post-War economic mastery over the global economy. That war saw the baton of net savings/wealth pass to the oil states of the Middle East and to the Japanese.

One of the attributes of these periods of fleeting dominance is an attitude *internally* of superiority over other economic systems (particularly over that of the displaced power). Then the attitude is manifested *externally* with criticisms about how other economies, have become fat or lazy or decadent.

FANYA – Good Girl Gone Bad

The establishment of the FANYA Exchange with its focus on specialty metals would seem a logical and inevitable evolution of the Chinese dominance of the production of (many) specialty metals and the substantial position it also held as a processor and end-user. Alas though there is an innate tendency for institutions in the capitalist side of the Chinese economy to deteriorate into illegality and irregularity with remarkable speed. In this aspect the Chinese system appears most akin to the rip-roaring US markets of the late 19th century when Robber Barons ruled the roost on Wall Street via massive cartels/trusts and rampant stock market manipulation schemes.

FANYA initially started out with specialty metals and then diversified into fixed income products. The problems in the Bismuth, Indium and Antimony trading by the exchange's investor base are well documented now. In mid-July Metal Bulletin reported that the Fanya Metal Exchange had suspended accepting applications from companies to sell Indium, Germanium and Bismuth on the exchange between June 23 and August 31. An official from FANYA, who refused to be named, cited "Liquidity-related problems" were the major reason for the decision. That there should be “liquidity problems” in trading what were regarded as notoriously illiquid metals in the pre-FANYA era, comes as no surprise to participants in the global market for specialty metals.

Once again we have seen the Chinese “issue” with deceptive practices on bonded warehouses and the collateralization and double-counting of fictitious or “massaged” inventories. It is very easy to create theoretical liquidity by miscounting (read exaggerating) warehouse numbers then creating paper instruments based on the bogus holdings, trade them fast and furiously and, voila, liquidity. The whole scheme (never let the word “Ponzi” cross our lips) comes apart at the seams when someone wants physical delivery and then the game is over. In China of course the small and medium sized investor can be stalled for a while, while the big fish exit their positions and when the curtain is eventually pulled back to reveal that the “cupboard is bare” then the recriminations start flying. A few random death sentences may be meted out (involuntary organ donations, anyone?) and the matter is regarded as swept under the rug until the next time.

Not just Metals

Like any good scheme, over-reaching (mission-creep?) sets in. While FANYA has been most famous its metals trading, it has also had a fixed-income element, which not unsurprisingly has reputedly also gone bad. The Financial Times reported this week that earlier this week “hundreds of well-heeled urban professionals who had purchased high-interest rate products from the Fanya Metal Exchange united with distribution agents who sold them in an unusual protest….in the financial heart of Beijing”.

The FT captured the moment at which the head of FANYA, Shan Juiliang was manhandled by a crowd in Shanghai. They dragged him off to the police to have him arrested. Whether his potential fate at the hands of the crowd or in the Chinese legal system will be a better one will remain to be seen.

Conclusion

The collateral damage to the metals markets has been brutal but hopefully short-lived. Antimony and Bismuth have seen large amounts of product tipped out into markets that are illiquid at the best of times with particularly damaging effects for Antimony that has gone from $9,000 per tonne down to $6,000 in a the space of a few months.

While the FANYA bust-up looks like a Chinese Madoff-like moment that will pass quickly, we doubt it. China was well positioned five years ago to have the Shanghai Metals Exchange become the leading global market for metals. Repeated scandals (most notably the copper inventory scam that caught Standard Chartered and Citibank amongst others) mean that the SME's warehouses have zero credibility. The LME has shown through its long existence that credibility is everything and the SME had a chance to grab some of that credibility for itself. It should take at least ten years to rebuild that trust, but maybe the moment has been lost.

As for FANYA, there is no chance of redemption. China's own position as the dominant force in the specialty metals world is slipping away due to over-exploitation and erratic export/import duties and other examples of unreliability. FANYA's arrival meant there was a chance to create a legacy overlordship by creating a financial dominance, even as a role as a leading producer leaked away (much as Britain did with the LME). Instead the sleazy operators at the FANYA put on their suicide vest and blew up any chance of China controlling the "trade" in specialty metals. In a world of increasing "discovery" in both price and volumes in so many products, the Chinese authorities let some cowboys essentially create a noxious fog of misinformation which has choked a large group of investors and justified Western observers' growing belief that there are "lies, damned lies and Chinese inventory statistics".

FANYA – Breaking the Mold on Specialty Metals Trading?

Commodity exchanges have sprung up over time either at the source of the capital in major financial centres (e.g. LME and New York Mercantile Exchange) or at the source of the product traded (e.g. the various spice exchanges in India) or the attempts to launching exchanges in Indonesia and Malaysia dealing in local products such as tin or palm oil.

As is well known the Chinese dominate a number of metals through the production of the raw material and at the same time are important as the end-consumers or processors of the same metals. Thus to some extent it makes sense that the trading of these metals should take place at exchanges within China rather than in some far distant place like Singapore or London. Moreover it would seem the Chinese are also tired of the low value added that the big trading houses bring to the equation. Knowing the end users in a space like Antimony or Rare Earths, for instance, is no rocket science. Everyone knows who they are, so why would one need some slick-suited bankerish type intermediating the transaction when in some cases the product is produced in China and ends up in an industrial application within China?

Bringing Home the Bacon

The issue has been addressed in two ways. Firstly we saw the Hong Kong-backed acquisition of the London Metal Exchange (reminiscent of the old advertisement featuring Victor Kiam saying “I liked the product so much I bought the company”). Secondly the establishment of exchanges within China such as the Shanghai Metals Exchange for bulk products (in competition with the LME and more recently with the appearance of the FANYA Metals Exchange in Yunnan province with a focus upon those specialty metals that China has quite literally “made its own”.

The short-term goal of FANYA Metal Exchange, which started trading in April 2011, was to be the leading global market in rare metals The metals traded include Indium, Germanium, Cobalt, Tungsten (APT), Bismuth, Gallium, Silver, Vanadium, Antimony, Selenium, Tellurium, Rhodium, Dysprosium oxide, and Terbium oxide. Apparently, the volumes of both trading and settlement of Indium, Germanium, Tungsten, Bismuth and Gallium rank in the first place in the world. However to be the largest trading platform in the mentioned metals (excepting cobalt) is not that difficult considering there is no other trading platform.

They cite Indium as an example, claiming that more than 90% of Indium is now traded through the FANYA Metal Exchange, and that warehouse stockpiles amount to more than 2,800 tonnes (six times Chinese annual output and four times world annual output). This warehouse facility is a double edged sword for players in the specialty metals space. It certainly makes the exchange more credible but at the same time gives the formerly opaque business of estimating stocks or supplies an added piquancy. The first reaction is to say it enhances transparency but then thinking about the way stocks in Chinese warehouses have been brutally and cynically exploited to send out “mood” signals on the market for certain metals (copper comes to mind) we wonder whether the statistics on movements into and out of FANYA’s warehouses might indeed be “garbage in, garbage out" to bamboozle the foreigners moving in the specific metals that China dominates.

FANYA also claims to have the largest amount of clients' assets under management on its spot trading platform, though that is a statistic that is not only unverifiable but surely also subject to fluctuation. FANYA's website states that "clients' assets under management increased to more than RMB 42.5 billion, and more than RMB 32.7 billion has been injected into real economy". They also claim that newly added clients' assets are increasing at a rate of RMB2 billion per month.

As for turnover and "membership" the Exchange asserts that, by the end of October 2014, the accumulated turnover had been more than RMB 290.3 billion and there have been more than 160,000 "members" nationwide. The total commodity trading volume has been nearly 350,000 tons of listed commodities.

The Mechanism

Finding out information on the costs of doing business on this new exchange is not as easy as one might imagine for a group that wants to be taken seriously as the "go to" place for trading in the metals mentioned above. What we do know is:

Membership Fees (for brokers we presume): RMB 1,000,000 (US$ 161,290)

Daily Storage Charge of RMB 0.0008 per kg

Warehouse Entry Charges

- RMB150/t Bulk Unloading Fee (including Unloading, Weighing, Sampling, Packaging fees)
- RMB40/t Pallet Uploading Fee (Forklift, Weighing, Sampling, Packaging fees)

Warehouse Out Charges : RMB20/t, Loaded Fare (Including Forklift, Handling Fees)

These numbers were presented to an audience at the Antimony Congress in Madrid which I attended back in March. The presentation cited one market participant who revealed that if antimony price rose by above 6%, then he covered his holding cost at the warehouse.

Critiques

Originally we had heard that this was going to be a market for trade players. However it would appear that in true Chinese fashion it has morphed into a playground for the notorious Chinese penchant for gambling. Chinese retail players seem to be pouring in to "play the ponies" in the form of Indium and Tellurium. While these are certainly exotica, the fact that holding costs are purportedly around 6% meaning that there needs to be a decent move in the price of the commodity to even break even. Indium is scarcely a commodity that is the word on everyone lips and short of a great new application the demand for it should putter along. This is a good thing but scarcely the grounds for a big speculative gain.

Moreover the size of the stockpiles being built up must be worrying. Four years' worth of global consumption is an awful lot of any metal. The Zinc numbers at the LME are measured in weeks of consumption. We wonder how much of the other specialty metals are stashed away here.

Apparently Chinese authorities are concerned about the situation. What seemed like a good way of getting the retail hordes to sterilize their savings in a "useful" commodity besides gold may end up sabotaging the Chinese goal of appearing to control these metals if one of the all-too frequent rushes to the exits by panicked small investors results in masses of product being tipped out into the waiting arms of bargain hunting foreigners or forcing State-owned Enterprises to step in and soak up metals sales in a panic situation.

Conclusion

It is said that an Australian will bet on two flies walking up a wall, however they look like rank amateurs when it comes to gambling when compared with the Chinese.

What started out as a good idea at FANYA with the government probably looking on benevolently has gone from being the crowning statement of China’s dominance of specialty metals to a potential embarrassment. The government could well end up with egg on its face if the retail crowd are allowed to blow up the exchange with their surging mood swings and rapid in and out movements in relatively short periods of time in excessive quantities of metals that are usually traded “by appointment only”. Nothing will break China’s dominance of a particular metal like looking like it doesn’t really have a grasp on the trading of the metal within its own borders and jurisdictions.

That the world needs some transparency in specialty metals is a given (though many resisted the LME launching contracts in cobalt and moly a few years back). FANYA was a step along that road. Being the biggest thing (in terms of churned turnover) is not necessarily as useful to all concerned as being a quality market matching producers and end-users. The structure for potentially achieving this is here, now it just needs some of the *sturm und drang* removed from the equation.