Short-sellers brace for iron ore back at $US100; Commodities

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Body

An army of short-sellers is nervously watching the rebound in iron ore prices this week amid signs Beijing will introduce more measures to stabilise China's property crisis.

The iron ore spot price has climbed for three sessions to trade at $US97.90 a tonne, according to S&P Global Platts. Futures added 0.8 per cent to $US99.25 a tonne yesterday, and have bounced more than 7 per cent from last week's two-year low of $US91.45.

The swift rebound follows a 9 per cent plunge in prices last week, which added fresh momentum to Asian hedge funds targeting Australia's largest mining stocks.

Short positions in Mineral Resources hit record levels this week, and bets against Rio Tinto are at the highest in more than three years.

That trade has paid off, with BHP, Rio Tinto, ***Fortescue*** and MinRes down more than 20 per cent this year, but there are signs of that unwinding after all four miners rallied on Wednesday.

BHP jumped 2.6 per cent from its low, Rio Tinto gained 2.7 per cent, ***Fortescue*** 4.9 per cent and MinRes 7.5 per cent. All four extended those gains yesterday. "Asian hedge funds were still shorting Aussie resource stocks [yesterday morning], but as they saw iron ore still rallying, it looked like they went to the sidelines to see if this is a false recovery, or it keeps going and takes iron ore back above $US100," said Bell Potter strategist Richard Coppleson.

That "would be a disaster for all the shorts and see some trying to cover".

Iron ore's rapid turnaround has been triggered by reports that Beijing is considering a new funding option for local governments to buy unsold homes. It would involve the issue of so-called special bonds, which are currently restructured for use in infrastructure and environmental projects.

The potential support follows a series of rescue packages that have failed to stabilise China's real estate market - a big source of iron ore demand.

That included 500 billion yuan ($104 billion) of funding to purchase excess housing inventory for conversion to affordable homes. But with market estimates indicating that between 2.5 trillion yuan and 7 trillion yuan is needed to absorb the excess housing in China's property sector, traders have been left disappointed.

Analysts remain divided on the direction of iron ore prices and mining stocks from here.

Morgan Stanley strategists told clients yesterday they did not expect iron ore to stay under $US100 a tonne for longer than one to two months because lower prices would force higher-cost producers to curtail supply.

The broker estimated that about 80 million tonnes of production was making losses at current prices, with about 93 per cent of that coming from Chinese supply.

Morgan Stanley also said the increase in supply from Australia and Brazil in the first half, which weighed on prices, looks to have passed.

"Although a rebound in iron ore prices will benefit all iron ore miners, it is likely to benefit higher-cost miners more," noted its equity analyst Rahul Anand.

For that reason, the broker prefers Minerals Resources followed by Rio Tinto. It has an "overweight" rating on both stocks.

It is "equal weight" BHP and remains "underweight" ***Fortescue*** given the company's continued spending on green energy, which threatens its free cash flow generation and future dividend payouts.

That stands in contrast to some fund managers - including Ellerston Capital's Chris Kourtis, who sold his fund's BHP stake to buy ***Fortescue***, and other brokers who have upgraded the stock to a buy.

Morningstar also warned investors this week it was too early to jump back into beaten-up mining stocks, given Beijing had offered little hope of stabilising China's property sector.

And Westpac, which has been one of the most vocal iron ore bears, is sticking with its view that prices of the commodity will drop below $US90 a tonne this year.

"If we do see iron ore back into the late $US90s, we want to sell it again for that coming drop into the $US80s," said Westpac's head of commodity and carbon strategy Robert Rennie.

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