



Dawes Points It's all happening now in this Bull Market!!

Key Points

- The Dark Side throwing in the towel?
- Shanghai finally joins the Global Bull Market
- All Ords breaks 5500 and joins in too!
- BHP is a Paradigm SUPER stock on oil and copper
- Expansion continuing with ASX XSR small resources up 8% in July
- Dawes Points 2014 resources portfolio up 64% for 1 January - 30 July
- Gold in super bull market with demand rising from India and China
- Oil and gas exploration activity in Australia stepping up

The Dark Side of Pessimism, Commodity Price Terrorism and China Envy appears to be finally throwing in the towel to surrender to the massive tide of global economic expansion as the aspirations of the world's rising middle classes prevail. Expansion with record levels of global cash to fuel it.

And what an event this is. It is one to savour and to pass on to your grandchildren. I have said that before but it is and it is all happening according to the Dawes Points script. It is crystal clear in the markets now that China is not collapsing, the European banking system is not melting down and the US economy is not falling into the Greater Depression.

If the world has done this well despite the pessimism, what will now happen as the Dark Side

changes its view? Are you ready for it? What will happen with the extraordinary high levels of cash on the sidelines flow back to markets? And from the bond markets? You have been forewarned so are you fore-armed?

The Dark Side has for years churned out a never ending torrent of warnings based on China slowing or Europe collapsing and the ensuing oversupply of commodities that was going to push down iron ore, copper, coal, LME metals, silver and, of course, gold. The Super Cycle Bull Market in commodities was over and also was the strength in the A\$. Oh yes, also buy US T bonds! And build up cash!

And all this has proven to be false prophesy. What can you say about their professionalism?

But the false prophesies have been enough to all but destroy the capital markets for resources stocks along with careers, opportunities, livelihoods and wealth. Yours and mine. FOR NO REAL REASON!

And we still hear it. Investors should build up cash and chase yield. Not capital growth. So why then have the Russell 2000 Small Caps and the S&P600 Small Caps done so well and have led this market up since the March 2009 lows?

The market facts tell it clearly.

	Mar 2009 Low	30 July 2014	% change
S&P 600 Small Caps	131.54	475.25	360
Russell 2000 Small Caps	355.91	1146.57	321
S&P500	695.27	1970.07	282
Dow Jones 30	6709.61	16880.36	251

And Google, Tesla and Face Book are hardly high dividend yield stocks.

So in great contrast to these strong highs, resources stocks are priced for the end of the world which is clearly not happening. So if not, then there should be some 'normalisation' in the terms of Wall Street Wallys. That is, a major upward rerating of resources.

So, where to start with the plethora of positive market signals in July.

We could focus on any of the following:-

Stock Markets

New All time Highs	So Close to All time Highs	Pre 2008 downtrends broken	2011 downtrends broken
US			
Canada			
Germany			
India			
	Sth Korea		
	UK		
		Japan	
		Singapore	
		Taiwan	
			Europe

And how about these for commodities

New All time Highs	So Close to All time Highs	Pre 2008 downtrends broken	2011 downtrends broken	Waiting
	Palladium			Silver
	Bauxite	Moly		Platinum
		Cobalt	Copper	
		Oil	Zinc	
		Nickel	Lead	
		Tin	Gold	
		Uranium	Aluminium	

Resources stocks are not reflecting these conditions at all.

And then there is gold. It was covered in the last Dawes Points and gold stocks are performing well.

Just note the basing and reversal in the GDX ETF of the XAU (Philadelphia Gold Index).



Note that gold stocks in North America are still about just 30% of their 'normal' rating against the general market and are turning up again. Big % gains to come.



But the clearest signal is the economic data coming out of China.

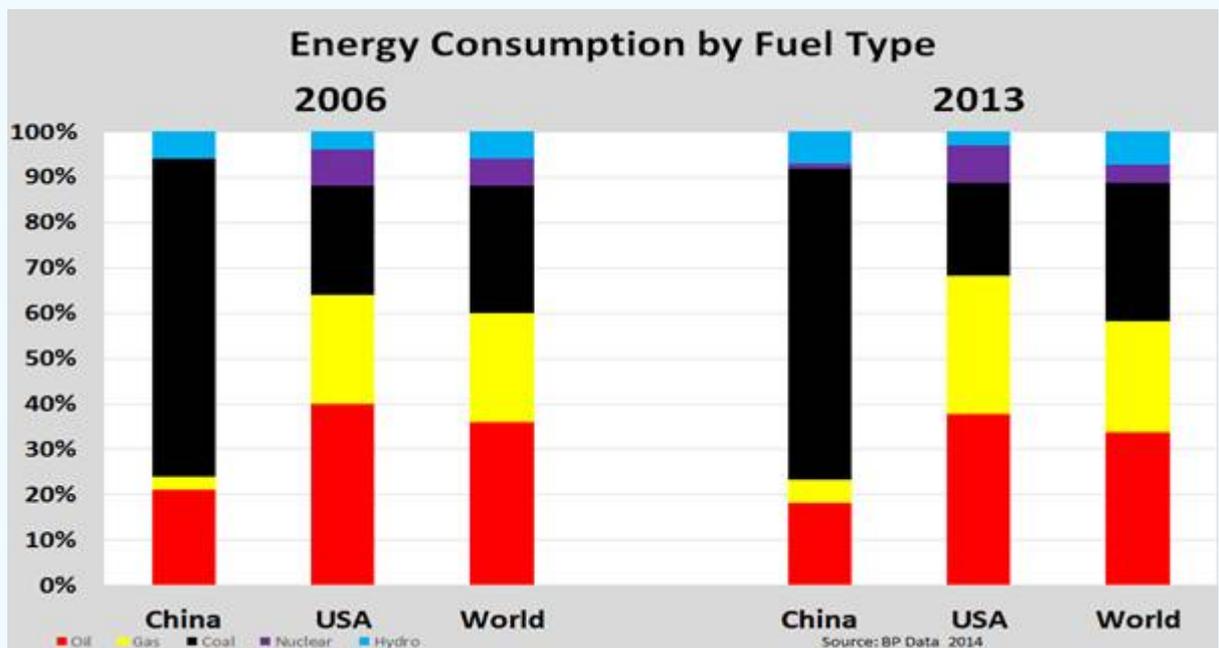
The 7.5% pa GDP growth rate is being maintained and the various Purchasing Managers Indices (PMIs) are now all pointing up. Expect an acceleration from here. Overall, China never really slowed overall and never as much in most sectors as the commentators expected, as we saw through the crude steel production data. And the US had 4% growth for June Qtr!

My four visits to China from Sept last year gave no obvious indication of a real slowdown and in fact reinforced my views of an increasingly sophisticated and complex society so keen to improve living standards. And the infrastructure and technology standards are so high that Australia is not

keeping up.

With economic expansion in China comes an increase in everything but particularly the demand for energy. In a slower 2013, BP Datashows energy demand only grew 4.4% and took China to 23% of total global energy consumption and 25% higher than the US.

Importantly, gas consumption in China increased 10.6% in 2013 but it is still only 5.1% of total energy consumption in China whereas the total global average is 23.7%. Coal is still around 68% in China and 30% globally. The demand for gas in China has so far to go from this 5.1% to at least 20% to get anywhere near the world's 24% and 30% in the US. This graphic tells us a lot about the economies of China and the USA and the changes since 2006.



Focus on the gas numbers because China will be a major importer of gas via pipeline from Iran and from Russia and can be also expected to greatly increase LNG imports as well as develop its own shale gas resources. China needs to increase gas share from 5 to at least 20% in a growing energy consumption profile over the next 20 years.

See how the US has increased gas by 25% to a level of 30% from just 24% in 2006 and reduced its coal consumption by 20% from 24% to 20%. All from that shameful fracking!! So much more garbage from the Greens.

Now just look at the markets.

My last visit to China provided strong signals that share ownership in China is not highly

regarded. It seems much money was lost after 2007 with a steep index fall of 70%, a rally, then a grinding 45% decline over five years and a retreat to the levels of 2001. No one owns shares anymore. Its all in property and shadow banking high interest loans. Unfortunately the property developers can't quite make the payments on the 25-35% loans so the cash will likely go elsewhere. Shares maybe?



The markets are showing that the bearishness is now turning.

The US\$15,600bn market cap Shanghai SEC Index is up 13% in the past year and is on a PER of 10.1x.

The 2007 downtrend is broken after the Index bounced off the 22 year uptrend.

This FTSE China 25 Index ETF is also pushing against the 2011 highs which are also post 2008 highs.



China had been holding back Australia but we are now leading Shanghai and with the break through 5500 the All Ords will now try to catch up the world.



These improvements have been anticipated by some of the better opportunities in the market and are reflected in the 30 stocks Dawes Points Nov 2013 Non-trading Portfolio which is now up 64% since the beginning of 2014. Big gains by LNG (4% of initial book value), LMB (0.8% ibv), AQA(4.3% ibv) and WSA(4.3%ibv) have helped significantly.

Here is the portfolio. Big caps have finally started to move but stock picking in the smaller end has produced stellar results. Much more to come.

Dawes Points Portfolio	End month	2013	2013	2014	2014	2014	2014	2014	2014	2014	2014
	Weighting	base	Nov	Dec	Jan	Feb	Mar	April	May	June	July
Large caps	40%	100	97	100	94	97	97	102	102	101	105
Mid caps	30%	100	95	96	97	111	107	114	118	114	122
Small caps	20%	100	102	100	106	119	136	138	160	226	345
Micro caps	10%	100	95	88	101	107	125	113	121	123	130
Total	100%	100	97	98	98	107	110	114	120	132	161
Indexed to 1 Jan 2014				100	101	109	113	116	123	135	164
XMM		3330	3266	3339	3255	3411	3238	3294	3194	3135	3416
Base: 11 November 2013		100	98	100	98	102	97	99	96	94	103

Now one of the things that has been embedded in my brain since entering the financial markets is that the market in Australia can only go where the market leader goes. And this is BHP.

So if the market leader is not going higher then the market will find it difficult to move higher.

We all have been bombarded by the iron ore bears who equate the iron ore price with the future of the Western and Eastern Worlds. It affects BHP of course and RIO and then we have the numerous experts who have shorted FMG.

But the operational and production responses and the market action of BHP are not of the character of a company, and hence a market, going nowhere.

Note this extraordinary comment from a local fund manager who told Reuters:-

"At the end of the day, BHP's fortunes are tied to the iron-ore market," said, chief investment officer at Asset Management, which recently sold its shares in the miner after holding the stock for close to 15 years.

"The stated strategy of the majors is to squeeze higher cost production out of the market," he said. "We're just not sure that maximizing production is as sensible as they think it is."

So he is sold out. Yet the stock is at 12 month highs so something else is happening.

This is the 'Generals and the Maginot Line' concept referred to in the February Dawes Points.

If the market for BHP is holding up and the iron ore price isn't that bad maybe this something else

is happening. How about the something else being copper?

Copper prices have broken the 2011 downtrend and LME inventories are just 144kt for a 21mtpa market and are at 6 year lows.



The Dark Side has tried to tell us that the inventory has just been moved from LME warehouses to others in China and that financing of this inventory will bring us all unstuck. Garbage!

BHP will produce a net 1.8mt of copper in FY15 and at US\$7000/t this is US\$12.6bn in gross revenue. At US\$7700/t this is US\$1.26bn more. Escondida and Olympic Dam, each growing.

Now to another something else.

The 2011 acquisition of Petrohawk's Eagle-Ford and Permian oil and gas acreage and Chesapeake Energy's gas at Haynesville by BHP was derided by the *cognescenti* at the time as an over-priced and strategically dumb acquisition. Gas prices fell after the acquisition so it was a big joke with writedowns on Cheaspeake's Haynesville assets. Another Magma Copper. HBI. Ravensthorpe. Failure.

But wait a moment.

Look at these numbers for gas which show a doubling for BHPP since the acquisition.

Year end June (BCF)	2011	2012	2013	2014
Bass Strait	107	112	124	109

North West Shelf	125	144	131	128
US onshore	36	448	479	449
Other	137	118	140	153
Total	405	822	874	839
US onshore %	9	55	55	54

US Onshore provides almost 55% of BHP Petroleum's gas production but at the current US\$4/mmbtu at Henry Hub its not too exciting.

But more importantly however, the unconventional oil and liquids mostly from Black Hawk and Hawkville in the Eagle-Ford shales provided 26% of BHPP's FY14 net liquids output and 31% in the June Qtr at a rate of 28mmbbloepa (80,000bbloepd).

PRODUCTION AND SALES REPORT	QUARTER ENDED					YEAR TO DATE	
	JUN	SEP	DEC	MAR	JUN	JUN	JUN
	2013	2013	2013	2014	2014	2014	2013
Petroleum							
Crude oil, condensate and NGL (Mboe)							
Crude oil and condensate							
Bass Strait	2,229	2,247	1,958	2,095	2,355	8,655	8,813
North West Shelf	1,646	1,865	1,497	1,504	1,408	6,274	6,868
Stylarow	401	348	317	282	255	1,202	1,722
Pyrenees	1,817	1,707	1,295	2,386	2,075	7,463	8,480
Other Australia ⁽¹⁾	12	14	12	11	14	51	59
Atlantis ⁽²⁾	2,594	2,953	3,988	3,734	4,114	14,789	7,995
Mad Dog ⁽³⁾	649	732	496	704	187	2,119	2,715
Shenzi ⁽²⁾	3,378	3,467	3,201	3,467	3,530	13,665	14,749
Onshore US ⁽⁴⁾	3,614	5,044	4,238	5,585	7,869	21,940	11,701
Trinidad/Tobago	259	320	314	279	248	1,161	1,328
Other Americas ⁽²⁾⁽⁴⁾	403	378	373	320	371	1,451	1,564
UK ⁽⁵⁾	282	142	305	254	27	728	1,223
Algeria	1,210	1,142	1,156	1,069	996	4,363	5,042
Pakistan	65	62	52	49	37	200	273
Total	18,559	20,421	19,202	21,752	22,686	84,061	72,512

Growing at 1.5mmbbl per Qtr. To get +15mmbbl rate becomes >60mmbblpa by June Qtr15

BHPP has advised a 17mmbbl liquids increase for FY15 and it had spent US\$3.9bn in FY14 to achieve this. So taking a steady growth of +2.5mmbbloep per qtr growth rate to give just 15mmbbloep extra in FY15 then the June Qtr FY15 could be producing at a rate of over 60mmbbloepa (170,000bbloepd). What will FY16 look like? Can't really know today but BHPP has said 200,000bblpd by 2016(>70mmbblpa) so expect higher numbers in FY16.

What may be known is that BHPP is probably getting one year IRRs of over 70% and 60mmbloepa gives annual revenue of US\$6,000m and at a conservative 50% EBITDA margin this adds a lot to BHPP's earnings. Like about US\$2bn in FY15 and US\$3bn in FY16.

The technology changes in drilling are bringing down drilling costs, improving reservoir recoveries

and boosting returns. BHP is testing high-temperature gels for better proppant transportation, different stage spacing to maximize stimulated rock volume, and reservoir modeling to simulate stress capture and optimize well sequencing.' (UOGR April 2014) BHP also reported that field trials achieving are 10-40% higher than production for comparable surrounding wells.

The rapid technology changes in unconventional oil production (now really a 'manufacturing' business rather than exploration) are suggesting increases in oil recovery from about 3% to as much as 6%, with about 50% recoverable in Year 1. Getting 400,000bbls @US\$100/bbl in Year 1 is US\$40m revenue with \$8m op costs for a US\$10m well is over 100% Year 1 IRR. Try 150%. And BHP is spending US\$4bnpa. The above BHP numbers might be low.

So here are two major Divisions of BHP in cashflow growth mode that will offset any earnings weakness from any lower prices there in iron ore with its 10% higher FY15 225mtpa output, costs reduction and revenue of US\$20bn.

It seems that the world has just focussed on BHP's iron ore and ignored Copper and Oil. BHP's share of All Ords market turnover has been at the lowest level for over 10 years suggesting it is very much underowned. Turnover in recent weeks has jumped up sharply suggesting BHP will again lead the market higher.



Other markets are giving BHP a better ranking so have a look at BHP in US\$. More action than in Australia, possibly.



The raison d'être for the establishment of DawesPoints in 2012 was to advise clients and the world in general that the real economy was operating at very different level to the financial economy. And that the real economy was doing far better than the financial community has been giving credit for.

The continual reference to the US markets has been a core activity of DawesPoints because these are far more liquid markets with vast numbers of buyers and sellers with different goals, views, responsibilities, time frames and of course attitudes. The Australia market appears to me to be concentrated with strong convergent groupthink views and guided by a generation of advisors investors with contrasting time frames compared to the real economies' requirements. Risk averse commentators driving investors away from equities and to overweight positions in bonds and cash.

The Australian investment market of course has had the luxury of being able to invest in a vast number of overseas markets with stocks such as Apple, Google and Tesla not available in the local market. So rightly competition for capital is substantial. However, it is a pity bank deposits have won this section of the race with their A\$1,606bn balance.

How is it that our Australia prefers to back the banks and mediocrity or overseas companies rather than backing its citizens in their visions and endeavours? Why would you back XYZ Bank Ltd to invest in 4.8% mortgages rather than to invest in Ken Everyman who has uncommon drive and a great idea about how to produce and sell a better front door lock? What about Dr Phil Brown and his biotech innovation in a field that Australia is an acknowledged leader (did you know that the local George Institute is THE leading medical research unit of the world!!). Why

indeed would you not invest in Bill Brilliant who has a copper deposit that he has assessed as worthy of further development? Or John with his iron ore opportunity? Or Frank with the acquisition of a major exploration target from large international mining company for whom the target no longer met corporate goals. Real ideas, real drive and real assets from real people.

Australia does have the world's largest listed mining company in BHP and a range of other and its banks are world class with all the big 4 with AA ratings

The scope of this is vast and extraordinary. From gold to iron ore from new mining technologies to unconventional oil and gas. Opportunities everywhere.

And yet still the large investment banks are still vying for the title of the most bearish. How many of them have even been beyond Hong Kong into China. Not many, it would seem.

And the fixation with a lower iron ore price and the collapse in the steel industry in China as it goes to yet another new record high (yes, new record of 843mtpa in June!!). Oh, please.

So what **is** really happening now? The Bear Case of overwhelming debt leading to a US Depression with European banking collapse and China falling over has very simply failed to eventuate. You can say QE and other injections of liquidity have prevented the collapse and that unless we get more then it will still happen. Maybe.

The much proclaimed collapse in commodities hasn't arrived yet and apart from the ridiculous preoccupation with the iron ore price it appears it won't.

What is going to happen to these people who have been preaching Armageddon and worse? And to those who have listened?

I saw some 'unverifiable' data from a US columnist that showed that ten major global economies (including US, UK and Australia) had current savings rates in excess of 40%. No wonder global growth has been slightly anaemic.

But what does A\$1,606bn in bank deposits suggest to you? How could Treasury, most banks, the disgraceful 'asset allocators', a growing army of risk averse financial planners and scared ordinary people with the conventional wisdom of Cash is King be on the right side of the market? A thirty year bull market in bonds has certainly sucked in everyone, especially governments who think that the markets will always be there to take over priced paper.

But note that the tide has already turned with major US bond funds reporting a full year of

redemptions as the risk of holding low yield, balance sheet-challenged government paper just keeps growing.

And here, the latest RBA data shows that although total bank deposits are still rising (up 0.7% to a new record A\$1,606bn) in June the Term Deposits category had the biggest ever monthly fall (A\$7.9bn) to just A\$529bn and at -1.5%, the largest % fall since deposits began to rise sharply in 2007.

Funds flowing from bonds and term deposits is now well underway. Into investments, property and soon into retail consumption. For us that is into equities and commodities and into resources equities (read small cap resources stocks!).

Well if you are reading these DawesPoints you know these have been my views and you have had it consistently straight and true.

Bull market for resources and commodities.

And these views haven't changed in the past two years.

Now some more facts for you to consider.

Resources sector bottomed in the GFC in Nov 2008 and the broad markets Dow, S&P, All Ords, FTSE and DAX bottomed almost 4 months later in Mar Qtr 2009.

Say that again. The Resource Sector (XMM.ASX) bottomed in Dec Qtr 2008 and the broader market bottomed in March 2009.



So technically we have been in a bull market uptrend in resources for almost six years now! Hasn't felt like it has it?

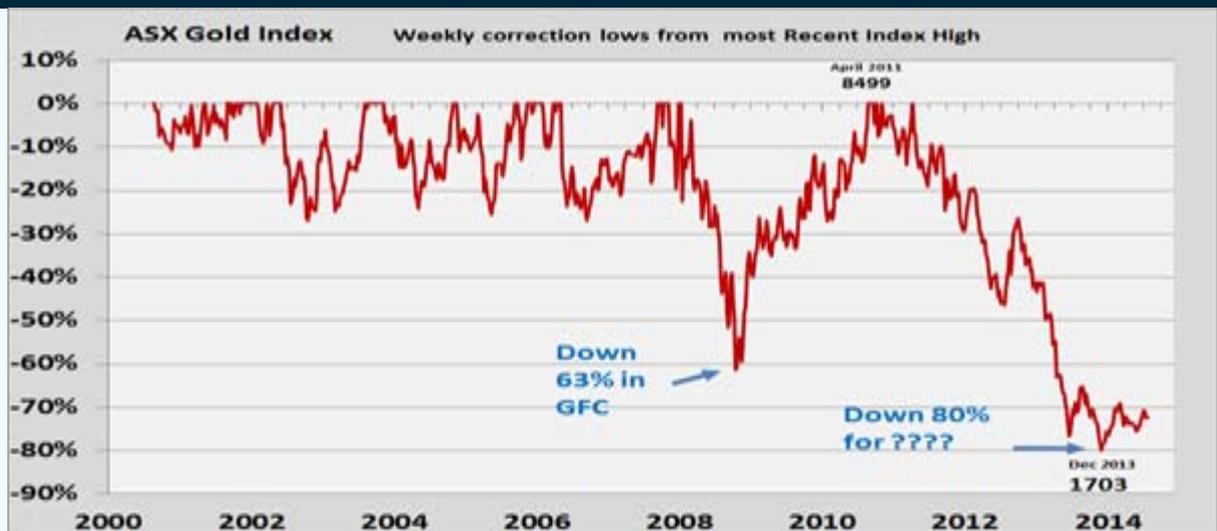
The resources market rallied into April 2011 then weakened into June 2013 for the first major pull back. A 53% fall was some pullback. Ouch.

And 71% for Small Resources was ,.. er,..er,.. um,.. some pull back. But it is bottoming!



The poor old gold sector after making a magnificent 230% rally from the GFC into 2011 then fell 80.0% to Dec 2013. Mere details! And of course the small caps became microcaps and then nanocaps and worse. Quite few 95% falls here. More than OUCH.





All these share price collapses for no real macro economic reason. Just misinformation, groupthink and fear.

But what value has been created!!

And strong stock and portfolio performances in 2014 reflect that. So much more to come.

I have referred to the 'stealth' bull market in Australian oil and gas exploration that is well underway now. The new LNG projects in Australia will be export conduits for many new gas fields in Australia and will change the entire industry.

I particularly like the key Cooper Basin stocks (BPT, DLS and SXY) and also those in the NT and parts of WA. Hopefully a full report might be available very soon. The implications are very great and the opportunities will be very rewarding.

There are hundreds of companies with quality projects that need to be financed and I am happy to recommend dozens of them. This is going to be an extraordinary Bull Market for the next decade!

So the opportunities in Australia now start with our preferred leaders.

BHP and FMG (SUPER stocks) with WPL, OSH, STO, WSA, ORG as leaders.

Onshore oil and gas led by BPT, DLS, SXY in the Cooper Basin and then AJQ, CTP and REY.

Gold stocks NCM, NST, ABU, GOR, SLR, SAR, BLK

Copper stocks CDU, PNA

Industrial metals TRO, AMI, IBG,

Technology metals ORE, ALK, LMB, VXL, KNL, CNQ

Metals explorers SIR, CZI, KGL,

Many more as this market moves up, as we discover new opportunities and as relative values warrant switches.

So what happens now for the supporters of the Dark Side?

This is a very important question.

If the end of the world hasn't happened by now what might be the options for them?

- Wonder what to do with A\$1,606bn in bank deposits?
- Get even more bearish?
- Actually go to China and see it first hand rather than pontificating with propaganda of envy?
- Look for undervalued sectors?
- Concluding resources and Australia look very appealing?

All of the above.

And that suits us just fine!

I own shares in BHP and FMG, STO, DLS, AJQ, CTP and REY. NCM, NST, ABU, GOR, SLR, SAR, CDU, TRO, AMI, IBG, ORE, ALK, LMB, VXL, KNL, CNQ and CZI.

7 August 2014

Sydney

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Barry Dawes' expertise in the Australian resources sector is based on his knowledge as a geologist combined with over 30 years' experience in the resources investment sector. Prior to founding Boutique Investment Firm "Martin Place Securities" in 2000, Barry had worked in senior executive roles of investment management with BT Australia, equities research for Bain Deutsche Bank and equities research and corporate finance for Macquarie Bank. He is currently a Director of a number of unlisted public operating companies. Barry has a substantial depth of knowledge and experience in the international resources industry and is well known for his views on the sector.



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Disclaimer: Barry Dawes owns stock in BHP and FMG, STO, DLS, AJQ, CTP and REY. NCM, NST, ABU, GOR, SLR, SAR, CDU, TRO, AMI, IBG, ORE, ALK, LMB, VXL, KNL, CNQ and CZI.

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