

# BHP Group

BHP

July 9, 2019 FAT-AUS-929

AUD\$41.03

Core



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BHP Snapshot

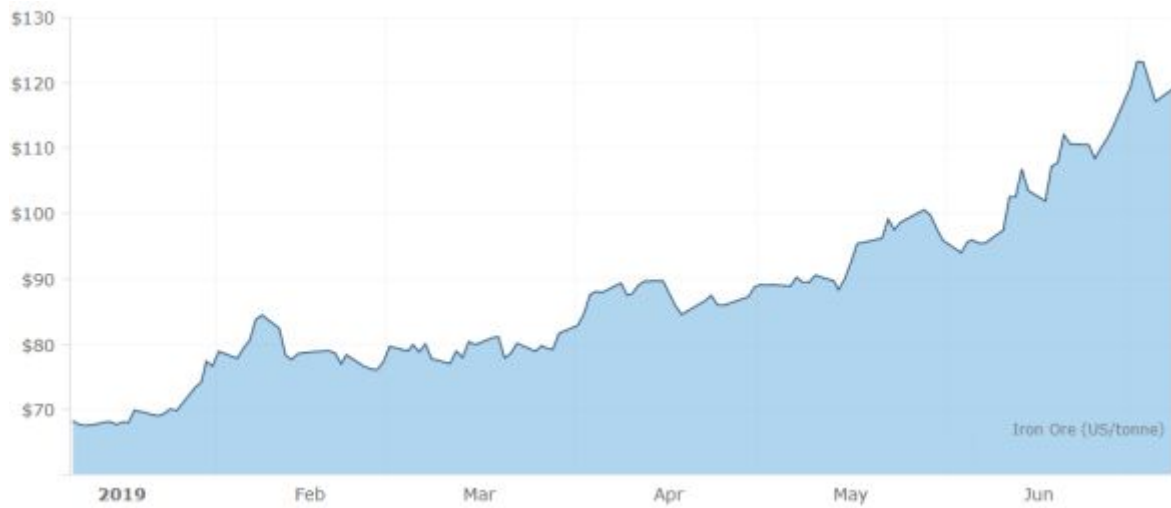


## Nearing a price record so cashing in some chips

BHP Group's share price has been on a well established uptrend since early 2016, when the share price touched lows of A\$15.35 and is now trading around A\$40.99, and is again approach its record highs of A\$43.00. BHP in the near-term has been impacted by the second Vale tailings dam failure in early 2019 and the assertion of pressure on oil supply by the Organisation of the Petroleum Exporting Countries (OPEC). Both factors that have propelled BHP's share price to, again, touch record highs.

**With the global economy displaying signs of potential fatigue on trade war entanglements, geopolitical pressures from Brexit to Middle East tensions and growing currency tensions, we are taking some profits off the table in BHP Group.**

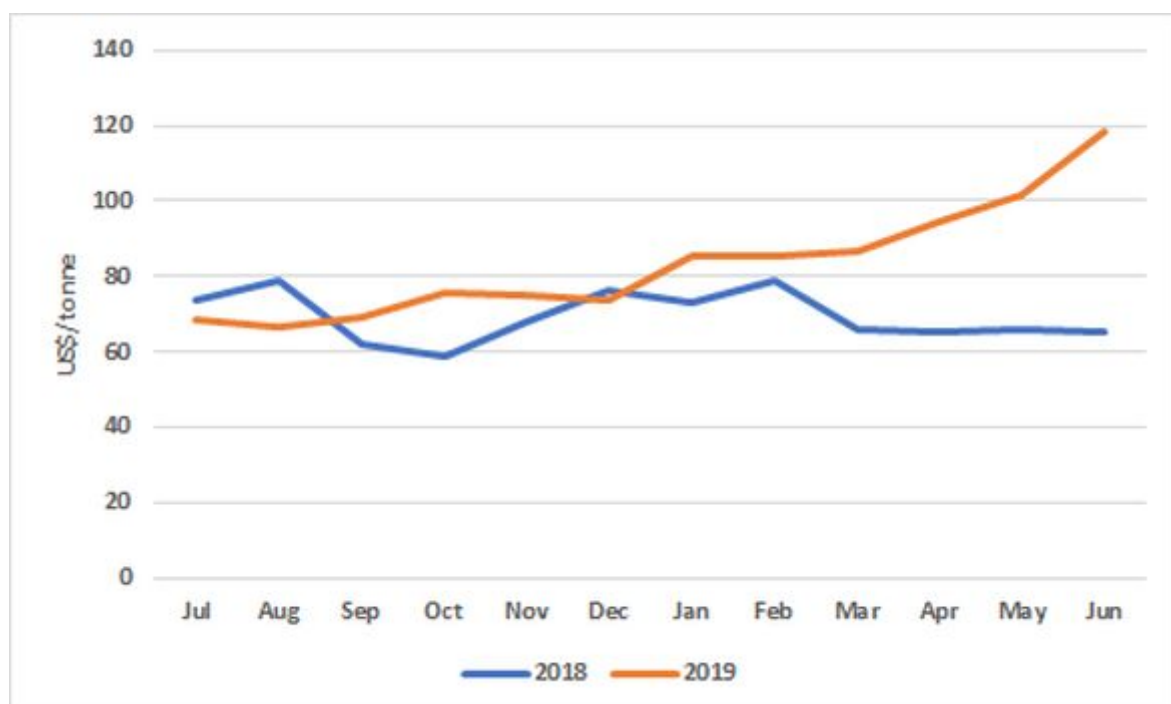
One key driver in the company's share price performance over 2019 was the misfortune that befell Brazilian iron ore producer Vale, following its second tailings dam failure (January 2019). The event had an immediate impact on the iron ore price in 2019. The following chart shows the year to date iron ore price:



Source: MarketIndex.com.au

The event did cause Vale to suspend production of iron ore pellets, with some 28 million tonnes of production likely to be lost in calendar 2019. Vale is guiding 2019 total production of iron ore to be in the range of 307 million to 332 million tonnes. **The return of the impacted production remains under a cloud and will likely not occur until well beyond 2019.** Vale's first tailings dam disaster occurred in November 2015, in the Samarco disaster (Vale's interest 50%); **that facility has yet to recommence production.**

The iron ore price over the company 2019 fiscal year has traded higher compared to 2018, with the comparison shown in the following chart:



Source: UBS

As a result of the positive comparative difference, we expect the company's iron ore operations will report a significant improvement in its financial performance.

We are now questioning whether the surge in iron ore prices can be sustained. While supply is tight, demand on the other side is vulnerable to a reaction from consumers at some point.

Indeed, Chinese steel mills are becoming more vocal it seems, and are complaining that rampant iron prices have been stoked by market manipulation by futures traders. According to reports, a top official representing China's steel industry said Beijing was preparing to crackdown on pricing 'irregularities' for imported ore. Chinese steelmakers, representing 40% of industry output, have also set up a working group to find ways to tackle the 'distortion' between the price of steel and iron ore.



Turning to the charts, on the daily view, the technical outlook has improved significantly since early 2019, although prices have pulled back from their peak levels of this month. An upward rotation in the share price towards resistance sighted at \$36.43, has been successful. Prices have also pushed up and away from dynamic support at \$35.80 (being the 200-day moving average) and the 50-day moving average at \$39.47. Support at \$40.13 will need to hold to ensure the outlook remains firm.

The reaction is probably not surprising, and with iron ore prices having notched up a 5-year high last week of more than US\$126 a tonne. The robust gains in pricing have also been during a period when many have been fretting over the impact of the trade war on China's economic growth story. However, demand has been underpinned by the country's own stimulus initiatives to ensure domestic construction remains robust, alongside demand from China's Belt and Road initiative. **Arguably however we have seen an interim peak in iron ore prices.**

The company's petroleum operations have also played a key role in driving the share price back to near-record highs this year. The following chart shows the oil price comparative between 2018 and 2019:



Source: UBS

As with the company's iron ore operations, the positive comparative price difference between 2019 and 2018 for oil, although not clear cut, will add to the tailwind on earnings for the petroleum segment.

OPEC have been diligent in curbing oil production over 2019, having started the year at 30.5 million barrels, and at its June reading has pulled production back to 29.9 million barrels. US domestic production has, on the other hand, risen from a weekly read of 11.7 million barrels at the beginning of the year to 12.2 million barrels at 29 June 2019. Oil price rallies have capped especially as US domestic production has shifted to the higher side over the year. **It is this continued pressure coming from US domestic oil production that places some uncertainty the energy sector pricing going forward and warrants caution.**



With reference to the monthly chart, resistance at the 61.8% Fibonacci retracement of \$68.98 has been eclipsed, as has that at the 78.6% Fibonacci retracement at \$77.80. This allowed a decisive move above a band of resistance between \$85.76 and \$89.04. This is made up of the long-term 61.8% Fibonacci retracement and the February 2011 resistance level

respectively. The 127.2% Fib retracement at \$103.32 is currently being probed, but is probably a test. A failure to breach this marker may see a move back down towards \$90.

The company will report its 2019 full year results to 30 June 2019 on 20 August 2019. **We are cognisant of the pending uplift in the company's total earnings from both its iron ore and petroleum segments in 2019, but we believe that the good news is now primarily factored into the current share price.**

Due to BHP's strong share price performance, to see it again approach record highs and prices not seen since late 2007 early 2008, we consider it prudent to take some exposure off the table. **This is also as our view of economic global growth is in the balance over the remainder of 2019. Consequently, we recommend Members sell half their exposure in BHP Group at the current price.**

Disclosure: Interests associated with Fat Prophets declare an interest in BHP Group.

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