Rio Tinto

RIO

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RIO Snapshot +

Part collecting on a great price run

Since early 2016, Rio Tinto's share price has climbed out of the basement, to recently challenge its record share price highs. There is no doubt that in the near-term the second Vale tailings dam failure in early 2019 had a significant and lingering positive impact on the iron ore price and propelled Rio Tinto's share price to, again, touch record highs.

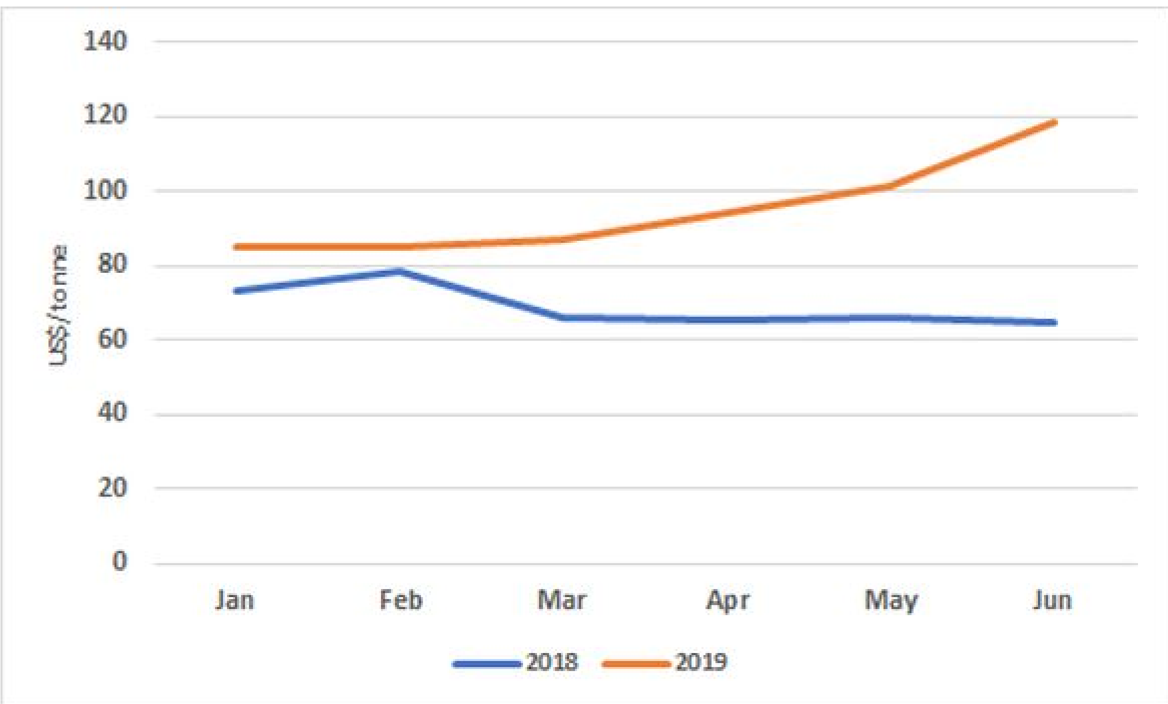
With the global economy displaying signs of potential fatigue on trade war entanglements, geopolitical pressures from Brexit to Middle East tensions and growing currency tensions, we are taking some profits off the table in Rio Tinto.

A 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 first half of 2019 has traded higher compared to the first half 2018, with the comparison shown in the following chart:



Source: UBS

As a result of the positive comparative difference, we expect the company will report a significant improvement in its financial performance, with the first half result to 30 June 2019 to be the first beneficiary (to be released on 1 August 2019). **As we also expect the iron ore price to remain elevated over the remainder of 2019, the company's 2019 financial result will also show a significant improvement over its 2018 result. <u>We are cognisant of the pending earnings up lift in 2019 and believe that the good news is now primarily factored into the current share price.</u>**

On the operational front, the company recently announced a downgrade in iron ore production for 2019. **The company downgraded 2019 iron ore production which it is now forecast to be in the range of 320 million to 330 million tonnes on a 100% basis.** The previous forecast was in the range of 333 million to 343 million tonnes (100% basis). The company delivered 338.2 million tonnes of iron ore on a 100% basis.

We were disappointed in the 2019 downgrade to the company's key product offering. When the share price was last at these levels, Rio was forecasting higher production and was delivering into a rising iron ore price. In 2019 we have the latter but not the former.

Turning to the daily chart, Rio Tinto has pushed above support at the 200 day (green line) and 50 day (red line) moving averages being $88.48 and $101.21 respectively. A move back above previous resistance levels around $90 and beyond the February high of $97.29 also shows that momentum has been strong. A period of consolidation would not however surprise, and a test of the February highs on the downside may be in the offing.

We also question 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.

Rio Tinto Ltd - RIO (ASX) - 1 Month CandleStick Chart - AUD

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 proving a test. A failure to breach this marker may see a move back down towards $90.

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.**

Due to Rio Tinto's strong share price performance, to see it again approach records 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 Rio Tinto at the current price.**

Disclosure: Interests associated with Fat Prophets declare an interest in Rio Tinto.