Dry Bulk Shipping

February 18, 2020

Breakwave Dry Futures Index: 799	Baltic Dry Index (spot): 425	Short-term Indicators:
↓ *30D: -16.7%*	↓ *30D: -44.3%*	*Momentum:* **Negative**
↓ *YTD: -21.8%*	↓ *YTD: -61.0%*	*Sentiment:* **Negative**
↓ *YOY: -0.7%*	↓ *YOY: -32.3%*	*Fundamentals:* **Positive**

Bi-Weekly Report

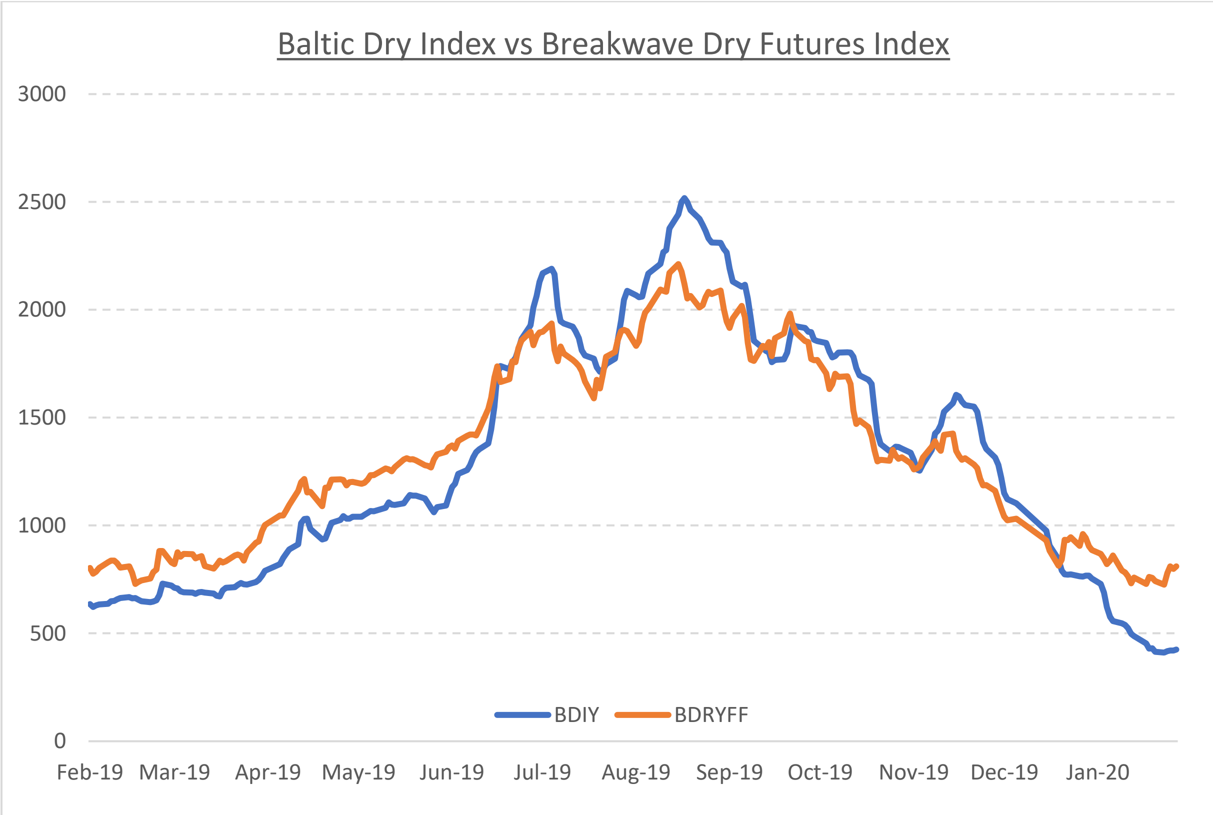
- **Will dry bulk be the coronavirus epidemic recovery trade? -** Dry bulk shipping remains in the doldrums, with Capesize rates almost at zero and Panamax rates hovering around operating expense levels. The coronavirus epidemic is the primary reason for such weakness, in our view. Industrial activity in China has been severely impacted, from transportation and logistics systems, to construction and steelmaking processes. The timing of a recovery, if any, is anybody's guess, and it will restart not only shipping, but a wide variety of economic activity and the heart of China's economy. However, what is unique about shipping is that such a decline in demand won't have long lasting effects, if demand returns. There is no "inventory" adjustment in shipping, unlike other commodity sectors. Once demand returns, shipping capacity will once again begin to tighten, and rates will gradually recover.

- **If history is a guide expect an impressive rally later in the year -** Given the severity of the decline in dry bulk shipping, such a potential upturn can be significant. One has only to go back a year and see the impressive recovery resulting from the resumption of Brazilian iron ore exports that led to Capesize rates moving from ~3,000/d in March all the way to more than 30,000/d by late summer. It is impossible to predict or model such extraordinary events, whether it is the dam disaster last year or the coronavirus epidemic this year. However, dry bulk remains one of the very few investable assets that are severely affected once again by unforeseen events and will most likely see an impressive recovery once conditions begin to improve in China.

- **Futures are pricing some recovery, but not meaningful -** The dry bulk futures market is currently in contango, with prices progressively higher in the outer months. However, spot rates are virtually at zero, so one would expect market participants to price-in a recovery down the road. Still, we believe the futures market is predicting a meaningful recovery, as futures remain closely related to the abysmal spot market. Such an environment reminds us a lot of last year, when Vale's dam disaster led to such a bearish sentiment in the industry, with futures discounting a long period of depressed rates, only to see rates reaching new multi-year highs a few months later.

- **It is the demand side this time around -** The industry is facing a much different challenge this time around compared to last year, as Chinese commodities demand that always been and continues to be by far the most important aspect of the shipping market has been severely affected. We believe the risk/reward remains on the upside, especially given the fact that a number of other markets around the world (energy, grains, commodities, equities, etc.) are not priced against a prolonged period of a particularly weak Chinese economic activity. To the contrary, the economic stimulus discussion and associated signals out of China have been particularly strong, and we expect the bounce to be quite significant once that happens. In addition, with Brazil's iron ore exports back in full swing, and expectations for a sizable increase in the run rate following the seasonally weak first quarter period, demand for transportation will increase, still always subject to a normalization on the receiving end, i.e. China.

The Baltic Dry Index (BDI) measures the average spot rates for dry bulk freight with a sector weighting of 40% Capesize, 30% Panamax and 30% Supramax. The Breakwave Dry Futures Index (BDRYFF) is designed to track freight futures contracts with a sector weighting of 50% Capesize, 40% Panamax and 10% Supramax and a weighted average maturity of approximately 50-70 days.



Dry Bulk Fundamentals

Demand	YTD	YOY
China Steel Production	996mt	8.3%
China Steel Inventories	9.2mt	24.4%
China Iron Ore Imports	1069mt	0.4%
China Iron Ore Inventories	131mt	-9.0%
China Coal Imports	300mt	6.8%
China Soybean Imports	89mt	0.6%
Brazil Iron Ore Exports	27mt	-19.4%
Australia Iron Ore Exports	838mt	10.1%

Supply

Dry Bulk Fleet	886dwt	0.8%

Freight Rates

Baltic Dry Index, Average	616	-33.3%
Capesize Spot Rates, Average	6,103	-50.1%
Panamax Spot rates, Average	5,047	-28.8%

Note: All numbers as of latest available; Demand figures are 2019 except Brazil; Sources: Bloomberg and Breakwave Advisors

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