BREAKWAVE ADVISORS

www.drybulkETF.com

Dry Bulk Shipping

February 4, 2020

Breakwave Dry Futures Index: 767	Baltic Dry Index (spot): 466	Short-term Indicators:	
30D: -14.1%	*30D: -48.6%*	*Momentum:*	**Negative**
YTD: -25.8%	*YTD: -57.2%*	*Sentiment:*	**Negative**
YOY: -13.4%	*YOY: -27.8%*	*Fundamentals:*	**Negative**

Bi-Weekly Report

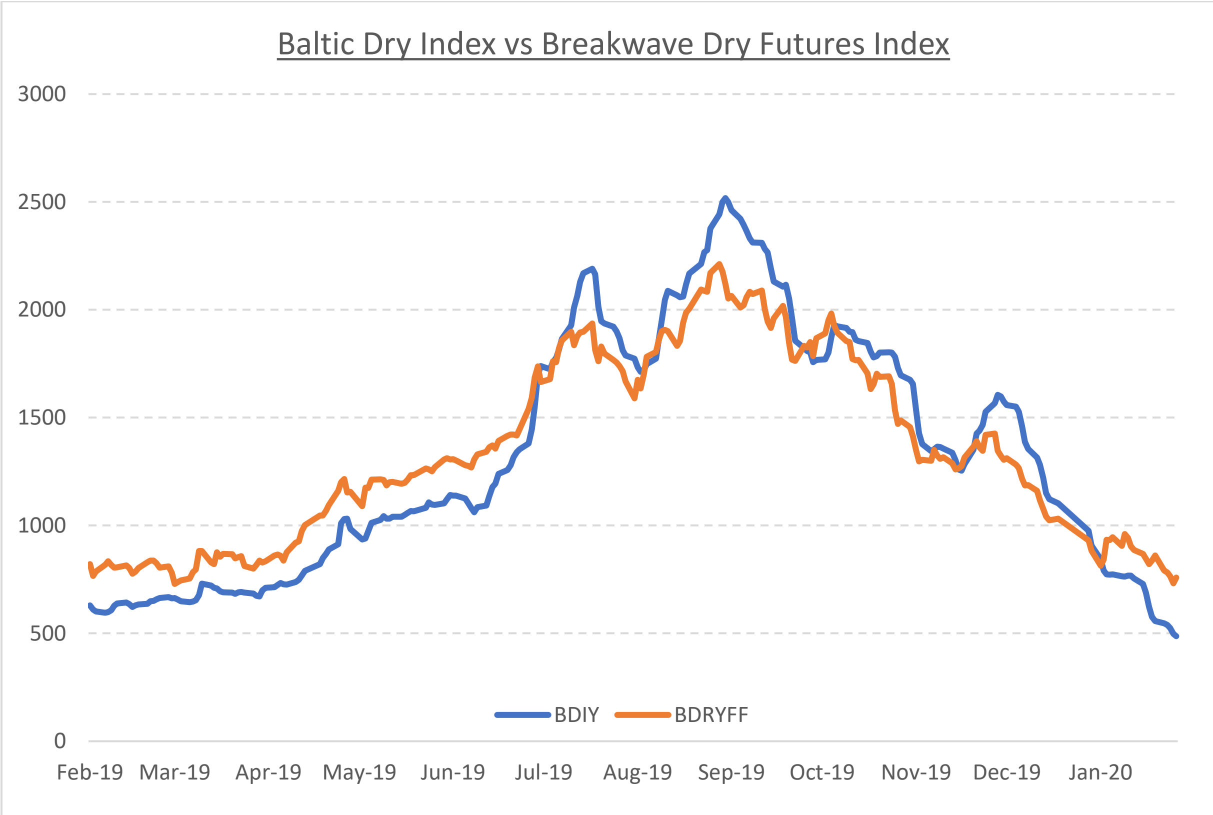
- **Majority of industrial business in China basically shut down –** Whatever the severity of the Coronavirus ends up being, for all indents and purposes, China industrial activity is severely impacted and operating at reduced rates to say the least. Construction activity, steel production, logistical chains and imports are suffering, and this is evident in freight rates that are hovering at record lows across asset classes and geographies. Industrial commodities have been hit hard as well. Although one can argue that rates have been even lower in 2016, the differences are minimal and highly sensitive to calculations. On top of the current virus crisis, weather in Brazil has also had a negative impact on freight, with a major exporting region reporting the heaviest rainfall in 110 years. Combining the above with seasonally slow freight markets and the Chinese New Year break, and dry bulk has basically been hit by a perfect storm with no positive spin other than the extreme bearishness of the situation. Capesize spot rates are currently around 3,500/day while Panamax rates are approximately 4,000/day.

- **Is this an opportunity? –** When it comes to investing, every dramatic decline brings up the natural question of opportunity. The easy answer is yes, as rates currently stand well below historical averages, let alone below operating expenses, something that by itself is unsustainable. Timing is always as important as price level, and although seasonality is definitely a tailwind for freight rates (Chinese New Year behind us and spring restocking upon us) the Coronavirus crisis is becoming a major headwind for Chinese economic activity. The unknowns are significant and given the dry bulk is extremely levered to Chinese economic growth, the extend of the damage combined with the future development of the ongoing epidemic makes any investment decision highly dependent on factors impossible to model.

- **Market balance does not point to current price levels, but we are not in a normal environment –** Although rates are well below the supply/demand equilibrium according to our models, the virus epidemic should be the focus of investors in the near term. Any indication of a slower virus spread that can eventually lead to a restart of the Chinese logistics and transportation chain, and dry bulk will experience a sharp recovery from the extremely low levels it is currently trading. As with most investors out there, we have no idea if and when that happens, but we believe the normal market balance is for rates at multiples of current levels. The futures market is already pricing some recovery into the second quarter, but we think this is highly dependent on the above factors.

- **Environmental concerns front and center for shipping –** For shipping, developments as it relates to carbon emissions are rapidly becoming a very important matter. Although for years such concerns would be just a topic for a longer-term discussion, major charterers are pushing the environmental agenda much faster than the industry can absorb. Such issues will continue to limit new ship ordering as the combustion engine technologies of the future are still debatable and highly uncertain.

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	4.5mt	23.6%
China Iron Ore Imports	1069mt	0.4%
China Iron Ore Inventories	127mt	-9.6%
China Coal Imports	300mt	6.8%
China Soybean Imports	89mt	0.6%
Brazil Iron Ore Exports	336mt	-14.7%
Australia Iron Ore Exports	760mt	-0.2%

Supply

Dry Bulk Fleet	883dwt	0.5%

Freight Rates

Baltic Dry Index, Average	691	-33.9%
Capesize Spot Rates, Average	7,393	-46.8%
Panamax Spot rates, Average	5,569	-30.8%

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

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