BREAKWAVE ADVISORS

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Dry Bulk Shipping

January 7, 2020

Breakwave Dry Futures Index: 886	Baltic Dry Index (spot): 844	Short-term Indicators:	
↓ *30D: -32.5%*	↓ *30D: -45.8%*	*Momentum:*	**Negative**
↓ *YTD: -13.3%*	↓ *YTD: -22.6%*	*Sentiment:*	**Negative**
↓ *YOY: -27.0%*	↓ *YOY: -33.0%*	*Fundamentals:*	**Negative**

Bi-Weekly Report

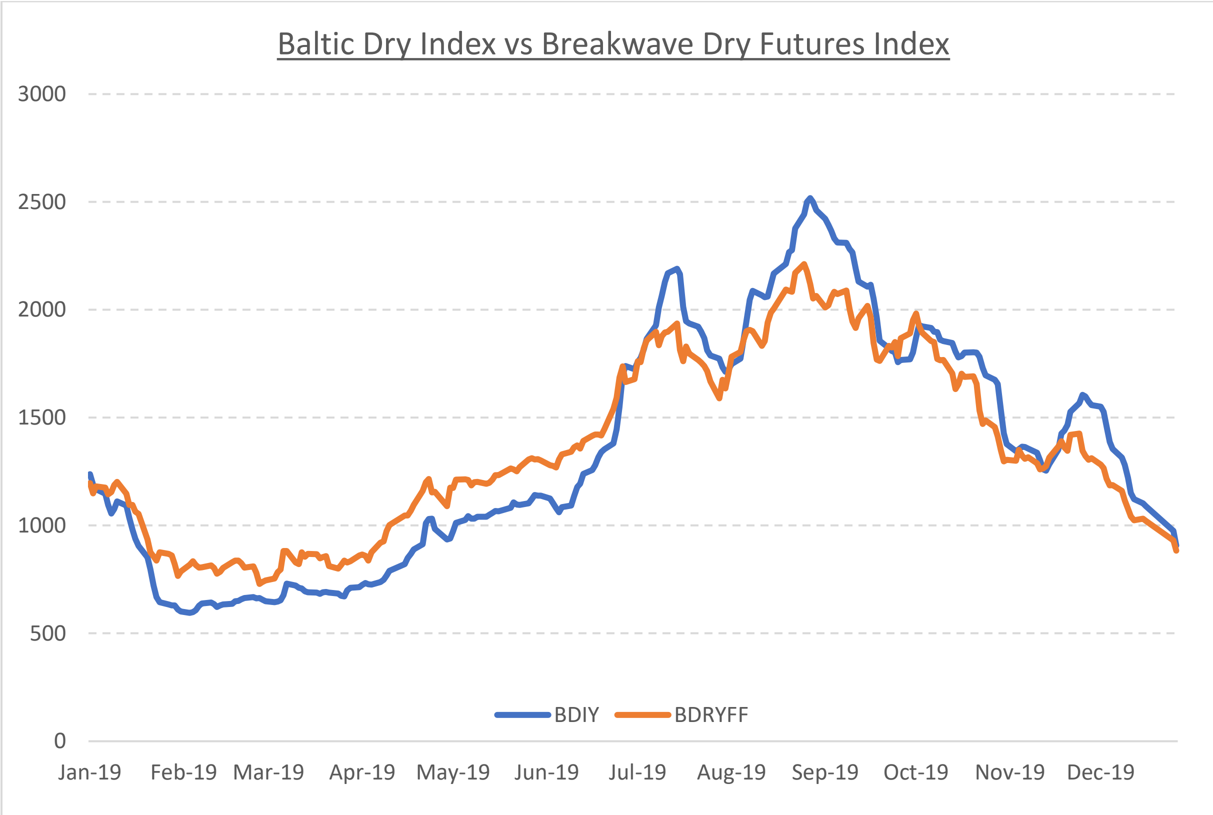
- **Charterers manage to hold voyage levels steady regardless of IMO 2020 –** Despite significantly higher fuel prices as a result of the IMO 2020 transition, voyage rates failed to adjust upwards as a number of market participants anticipated, signifying a major win for the dry bulk charterers (as a reminder, voyage rates include the cost of fuel, while time charter equivalent rates exclude such costs). As of early January, voyage rates are only marginally higher compared to last year, but with fuel costs more than double that of last year's level, time charter equivalent rates are down some 40% year over year (above calculations are for Capesize rates). Such development should come at no surprise, as the Capesize dry bulk market is dominated by 4-5 major charterers, and as such, the pricing power of the hundreds of shipowners diminishes during relatively weak markets. Currently, Capesize rates average below 10,000/day, while Panamax rates are at 10-month lows and below 7,000/day.

- **Now what? –** Dry bulk spot rates should bottom very soon. With the Pacific spot Capesize market below operating expense levels and with volumes remaining healthy at this part of the world, we expect a small recovery in the next few weeks, towards more sustainable levels. For the full first quarter, a lot will depend on how the weather develops in Australia and Brazil however, as this time of the year inclement weather can have a profound impact on iron ore exports. Excluding any unforeseen weather-related impact, spot rates should soon find support.

- **Scrubber-fitted ships sail at highly profitable levels –** Given their ability to burn the cheaper, yet higher-sulphur fuel, scrubber-fitted vessels are currently enjoying strong profits. We expect most of such ships to be employed in the Brazil to China route, as it is a longer route that requires more fuel, and thus the cost benefits are higher. A two-tier market will soon develop, in our view, where scrubber-fitted ships will dominate the long-haul Brazil-China route, while non-scrubber-fitted ships will remain in the Pacific basin where sailing days are generally lower. Such a development will have a meaningful impact on the Capesize index (an average rate index across various routes), as lower implied TC rates in the Atlantic basin will drag the average down, while the Atlantic-Pacific TCE differential will remain elevated and strongly correlated to the fuel price differential (high sulphur-low sulphur). Under such a scenario and given that almost half of the Capesize spot index is weighted towards long-haul Atlantic basin routes, the impact on the Capesize spot index can be significant (estimated at ~6,000/day, based on today's fuel price spread).

- **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	904mt	7.0%
China Steel Inventories	3.1mt	5.0%
China Iron Ore Imports	968mt	-1.0%
China Iron Ore Inventories	130mt	-7.7%
China Coal Imports	297mt	9.8%
China Soybean Imports	79mt	-4.0%
Brazil Iron Ore Exports	336mt	-14.7%
Australia Iron Ore Exports	688mt	-1.3%

Supply

Dry Bulk Fleet	841dwt	0.0%

Freight Rates

Baltic Dry Index, Average	909	-28.4%
Capesize Spot Rates, Average	10,861	-29.0%
Panamax Spot rates, Average	7,191	-34.1%

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

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