

Module 9: Macro Overlay — Commodity Cycles & The ASX Small-Cap Resource Cycle

Why this matters

The same project gets a 5x valuation in a bull cycle and a 0.2x valuation in a bear cycle.

Commodity cycles dominate everything else. A great project at the wrong point in the cycle will lose you money. A mediocre project at the right point in the cycle can multi-bag.

Most retail focus only on company-specific factors. The professionals build their thesis around the cycle first, then pick the best vehicles within it.

The two cycles you need to understand

1. The commodity cycle (10–15 years)

The underlying physical commodity moves through long cycles of:

- Underinvestment → supply tightness → price spike → over-investment → oversupply → price crash → underinvestment

These are driven by mine development lead times (5-15 years from discovery to production) and capital allocation that lags price signals by years.

2. The ASX small-cap resource cycle (3-7 years)

Driven by retail capital flows, broker IPO pipelines, and sector sentiment. Tends to lag the commodity cycle by 12-24 months at the start of a bull, then leads at the top by 6-12 months.

When both cycles align bullishly, juniors print money for everyone. When they diverge, only the best projects survive.

Why mining is so cyclical

Demand inelasticity in the short run

Industrial users can't quickly substitute most metals. Copper users need copper. Lithium users need lithium. So short-run demand barely responds to price.

Supply inelasticity in the short run

You can't build a copper mine in 2 years. From discovery to first production: typically 7-15 years for a major. From production decision to first metal: 3-6 years for a development-ready project. Supply responds to price with massive lag.

Result: prices overshoot in both directions

- Tight markets → spike to multiples of long-run average
- Surplus markets → crash below all-in costs of the marginal producer

This is structural, not cyclical noise.

Structural vs narrative-driven supply and demand

This is the single most useful distinction in macro mining analysis. Most commodities are at any moment driven by some mix of structural factors (real, long-cycle) and narrative factors (sentiment, headlines, positioning). Knowing which is which prevents trading the wrong thesis.

Structural drivers

These are the long-cycle forces that determine the actual physics and economics of supply and demand:

- **Mine development lead times** (5–15 years from discovery to production)
- **Mine depletion rates** (existing mines depleting their reserves at known rates)
- **Capex required to bring on new supply** (incentive prices)
- **Geological constraints** (where economic deposits actually exist; how grades have been trending; how much exploration has been funded over the past decade)
- **Long-term demand drivers** (EV adoption, grid build, demographic-driven consumption, urbanisation)
- **Substitution economics** (when does aluminium replace copper; when does sodium-ion replace lithium-ion)

These move slowly. They don't show up in headlines. They drive 5–10 year price trends.

Narrative drivers

These are the short-cycle forces that move prices in the next quarters and shape sentiment:

- **Specific announcements** ("Country X bans exports of commodity Y", "Producer Z guides production lower")
- **Geopolitical events** (sanctions, conflicts, election outcomes)
- **Speculative positioning** (CFTC reports showing extreme long or short concentration)
- **Specific stimulus programs** ("China announces \$X billion infrastructure program")
- **Regulatory shifts** (US Inflation Reduction Act, EU Critical Raw Materials Act)
- **Broker upgrades and downgrades**
- **Investor letters and conferences**

These move fast. They're loud. They drive 1–6 month price action.

Why the distinction matters

A move that's structural is usually durable. A move that's purely narrative is usually mean-reverting.

Consider two cases of a 30% commodity price rise:

Case A — narrative-driven: "Country exports of metal X get banned for 3 months due to political dispute. Spot price rises 30%." Reading: the underlying production capacity exists; once the dispute resolves, supply returns. Mean-reverting move; don't chase juniors at the top of the spike.

Case B — structural: "Major copper mine in Chile faces 5-year permitting delay; Indonesian nickel grades have been declining for 18 quarters; lithium hard rock incentive price is now above spot for sustained periods." Reading: the supply curve has shifted, not just temporarily disrupted. Higher prices are more likely to persist; juniors with fundable projects can re-rate durably.

The mistake is treating a narrative move as if it were structural and piling into late-stage juniors who only work at peak prices. The reverse mistake is treating a structural move as if it were narrative and selling into the early innings of a cycle.

How to read the difference

Three questions clarify which kind of move you're looking at:

1. **Has the supply curve actually shifted, or is supply just temporarily disrupted?** Mine closures vs export bans vs strikes are different. A mine closure that requires 3 years to restart is structural. A strike that resolves in 6 weeks is narrative.
2. **Has demand been re-rated based on durable factors, or based on near-term sentiment?** A change in EV adoption forecasts based on 5-year manufacturing build-out is structural. A change based on this quarter's Tesla sales is narrative.
3. **Are the major producers responding with capex commitments?** Producers don't move on narrative. When they announce major capex programs to expand or open new mines, they're confirming a structural read. When they keep capex flat through a price rise, they're treating the rise as narrative.

The commodities most prone to dangerous narrative-led moves are the ones that get hot on social media and in financial press: rare earths, uranium, lithium during peaks, gold during panics. The commodities most consistently structural in their moves are bulk industrial metals (copper, iron ore) where the supply economics dominate over headlines.

Reading the underlying commodity

You cannot invest in mining without watching the commodity itself. The minimum:

Where to track prices

- **Gold/Silver:** LBMA, COMEX (CME futures)
- **Copper, Aluminium, Zinc, Nickel, Lead, Tin:** LME (London Metal Exchange)
- **Iron Ore:** Singapore Exchange (SGX) 62% Fe futures, Platts IODEX
- **Lithium:** Fastmarkets, Benchmark Mineral Intelligence (subscriber data, but quoted in trade press); spodumene CIF China is the key Australian benchmark
- **Rare Earths:** Shanghai Metal Markets, Argus, Asian Metal — the market is opaque and Chinese-dominated
- **Uranium:** UxC, TradeTech (spot and term prices reported weekly)
- **Coking coal / Thermal coal:** Platts, Argus, IHS

What to watch

- **Spot price vs forward curve** — contango (forwards above spot) suggests storage costs/expected supply growth; backwardation (forwards below spot) suggests tightness
- **Inventory levels** — LME warehouse stocks, SHFE stocks, major producer inventories
- **CFTC Commitment of Traders reports** (for futures) — speculative positioning
- **Major producer guidance** — quarterly updates from the supermajors give early supply signals
- **Chinese demand data** — especially copper, iron ore, steel, lithium — China is 50%+ of most base metal demand

Incentive price

The commodity price required to justify building the next marginal mine. If spot is above incentive price, new supply is coming. If spot is below, supply tightens.

Rough current incentive prices (these change with input costs and grade benchmarks — verify if precision matters):

- Copper: ~\$10,000–12,000/t for new tier-2 projects
- Gold: ~\$1,800–2,200/oz for new mid-tier projects
- Lithium spodumene: ~\$1,500–2,500/t for new hard rock projects
- Nickel: ~\$22,000–28,000/t for new sulphide projects

When spot trades persistently below incentive, the cycle's bottom is forming. When spot trades far above, the top is approaching.

The China commodity manipulation playbook

China has been running variations of the same playbook on multiple commodities for the better part of 40 years. Recognising it is essential for any commodity where China is the dominant producer or consumer. The pattern works because it relies on differential time horizons — China can play decades; Western juniors and even majors can't.

The playbook in stages

Stage 1 — Build dominance. China invests heavily in domestic production capacity (rare earths, lithium chemicals, gallium, germanium, graphite, vanadium, magnesium, tungsten, antimony) or in offshore acquisitions (copper in Africa, lithium in South America, nickel in Indonesia). The investments are often loss-making at the time on a stand-alone basis but build production share.

Stage 2 — Suppress prices to crush competition. Once dominant, China expands supply or tolerates oversupply, pushing prices below the all-in cost of Western producers. Western projects close, mothball, or fail to be financed. The marginal cost curve effectively becomes determined by Chinese producers.

Stage 3 — Wait out the lag. Mining is a slow industry. New projects take 5-15 years to bring online. Once Western capacity is depleted and the next development cycle hasn't started yet, China's dominance becomes structural rather than just market-share-based.

Stage 4 — Tighten supply selectively when leverage is needed. Through export bans, quotas, environmental crackdowns, or "operational issues" at strategic facilities. Prices spike. Western governments and companies panic. Funding flows to Western alternatives, but at a 5-15 year lead time before any meaningful new capacity comes online.

Stage 5 — Allow Western capacity to be partially built, then crush again. Once Western governments have funded some alternatives and incentive prices are high enough that projects look fundable, China can release capacity, allow exports to resume, or expand its own production to undercut the new Western entrants before they reach steady state.

Where you can see this pattern

- **Rare earths:** dominant since the 1990s; periodic export quota cuts; the 2010 export restriction to Japan; the 2024 export controls on certain processing technologies
- **Tungsten, antimony, gallium, germanium, graphite:** dominance + selective export controls in 2023-2024

- **Lithium chemicals:** rapid expansion of Chinese refining capacity 2020–2023, contributing to the 2023–2025 lithium price collapse that killed many Western projects
- **Magnesium, silicon metal:** periodic supply tightening linked to electricity rationing in Chinese provinces
- **Steel-grade iron ore:** China's pricing leverage as the dominant buyer

What this means for ASX investors

A few practical implications:

1. **Be very cautious about the back end of the cycle in any commodity China dominates.** The price spike phase looks great for juniors but Chinese capacity can be released faster than Western projects can come online. The window between Western project FID and Western project commissioning is exactly when China's response can crush the trade.
2. **Distinguish between commodities China can crush and commodities it can't.** China can crush rare earths, lithium chemicals, graphite, antimony — they have or can build the supply. China cannot crush, e.g., Athabasca-grade uranium (geology dominates), Chilean copper (geography dominates), Western Australian iron ore (China is the buyer, not the seller).
3. **Watch Western policy responses.** Critical mineral lists, defence stockpiling, IRA-style subsidies, EU Critical Raw Materials Act — these are the response that creates the next investable cycle. But the policy response leads and the actual incentive prices can take years to translate to project economics.
4. **The "China is going to be cut off" thesis is a real structural change but a slow one.** Western re-shoring of critical minerals supply is a multi-decade project, not a 12-month trade. The juniors that benefit are the ones still standing in 2030, not necessarily the ones up 200% in 2026.

Why the playbook works

China's central planning gives them a longer time horizon than Western capital markets. A Chinese state-owned enterprise can absorb 5–10 years of losses to build dominance; a Western junior cannot. A Western board cannot defend a project that's losing money for three years to a stockholder base looking for quarterly results.

This is the structural reality of the resource sector. The ASX investor who ignores it will repeatedly buy Western critical mineral juniors at the top of supply-driven price spikes and watch them get crushed when the supply dynamic flips.

The thin-thematic premium

Some commodities are so small in dollar terms that even modest capital inflows produce extreme price moves and extreme junior valuations. This phenomenon — the **thin-thematic premium** — is worth understanding because the same projects that look "cheap" can become expensive in a hurry, and the same projects that look "expensive" can crash hard when the thematic capital rotates out.

Examples of thin-thematic markets

- **Tin:** annual market ~\$8-10bn USD; a few hundred million dollars of fund flow can move the entire space. ASX names like MLX (Metals X), ELT (Elementos), SRZ (Stellar Resources) and others have moved 5-10x in tin price spikes.
- **Antimony:** even smaller; <\$3bn annual market. China dominates; supply concerns drive episodic price moves.
- **Tungsten:** small market; defence-driven buying creates premiums.
- **Vanadium, magnesium, germanium, gallium:** very small markets; thematic capital can create dramatic valuation swings.
- **Smaller rare earths:** specific elements like dysprosium, terbium have tiny markets and extreme price volatility.
- **Index inclusion effects:** when a uranium ETF gets bigger or a thematic ETF rebalances, individual junior stocks can see step-function volume changes. DYL (Deep Yellow) is an example where index/ETF flows have driven significant moves alongside the underlying uranium thesis.

How the thin-thematic premium works

When thematic capital decides a particular small commodity is "the next thing":

- A small dollar inflow chases a small number of listed names
- Liquidity-constrained trading drives extreme price moves
- Junior valuations re-rate to multiples of underlying NPV
- Capital raises become easy and oversubscribed
- IPO pipeline floods in to capture the premium

When the thematic capital rotates out:

- Same dynamics in reverse
- Even structurally good projects see their valuations collapse
- Capital raises become impossible or punitively dilutive
- The IPO pipeline dries up overnight

The trade implication

The thin-thematic trade is real, but it's a trading position, not an investment thesis. Treat thin commodities as cyclical thematic plays where:

- Position sizing is smaller than for major commodity exposure
- Entries are during the early thematic phase (before the IPO pipeline floods)
- Exits are when the thematic capital is clearly broad-based and IPOs are pricing at premium multiples
- Position duration is months to a couple of years, not 5+ year holds

The juniors that survive the thematic bust are usually the ones that were going to be built anyway based on the underlying economics. The ones that needed peak-of-cycle pricing to be funded usually don't make it through to the next cycle.

A useful test: at the long-term mean price for the commodity (not the spike price), is the project still economic? If yes, the thin-thematic move is just timing. If no, you're trading the thematic and need an exit plan.

The ASX small-cap resource cycle phases

Phase 1 — Capitulation (after a bust)

- Junior valuations 70–95% off prior peaks
- Capital raises difficult, deeply discounted, often involve free options
- Brokers reduce coverage
- Companies hibernate; no drilling, minimum activity to maintain tenements
- Acquirers pick up assets at distressed prices
- **What to do:** accumulate quality survivors at the bottom; ignore broken companies

Phase 2 — Stealth recovery

- Commodity prices begin rising
- Producers re-rate first (operating leverage to commodity price)
- Junior capital raises easier but still at premium to lows
- Brokers re-introduce coverage

- M&A activity picks up
- **What to do:** focus on near-production developers (Stage 7-8); they convert commodity move directly into equity value

Phase 3 — Broad bull

- Producers fully re-rated; multiples expanding
- Developers re-rated as projects look bankable at higher prices
- Explorers begin to move on hopes of being next discovery
- IPOs accelerate
- **What to do:** sell into developers, rotate into earlier-stage explorers selectively

Phase 4 — Mania

- Anything with the right commodity in its name moves
- Quality differentiation collapses; trash trades alongside good companies
- IPO pipeline floods the market
- Capital raises oversubscribed at premium pricing with no options attached
- **What to do:** reduce exposure across the board; raise cash. This is when the best risk/reward is on selling.

Phase 5 — Bust

- Commodity peak passes; spot starts falling
 - Broker enthusiasm fades
 - Mania-priced IPOs collapse first; then Stage 1-3 explorers; then developers
 - Dilutive raises return; SOIs balloon
 - Capitulation resets the cycle
 - **What to do:** preserve capital; if you're heavy, you've already failed
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Macro factors that drive commodities

USD strength

Most commodities priced in USD. Strong USD = headwind for commodity prices (dollar buys more of the same physical good). Weak USD = tailwind.

Watch DXY (US Dollar Index) — sustained above 105 is generally bearish for commodities; sustained below 95 is bullish.

Real interest rates

Real rates = nominal rates - inflation. Particularly important for **gold**:

- Rising real rates → headwind for gold (it pays no yield, opportunity cost rises)
- Falling real rates → tailwind for gold

Real rate proxy: 10-year US TIPS yield.

Inflation

Generally supportive of commodities — they're real assets. But the relationship is messier than the bumper-sticker version: high inflation can also crush demand, which hurts industrial metals.

Chinese demand

~50%+ of global copper, iron ore, aluminium, nickel demand. Chinese property starts, infrastructure spend, and EV production are direct demand drivers.

China stimulus = bullish for industrial metals. China credit tightening = bearish.

Energy transition supply story

Long-cycle bullish thesis: copper, lithium, nickel, cobalt, rare earths, uranium, silver all have demand growth from EV / battery / grid / nuclear / solar / wind buildout. The demand story is more reliable than the supply response timing.

Geopolitics / sovereign supply concentration

Some commodities are heavily concentrated in single jurisdictions:

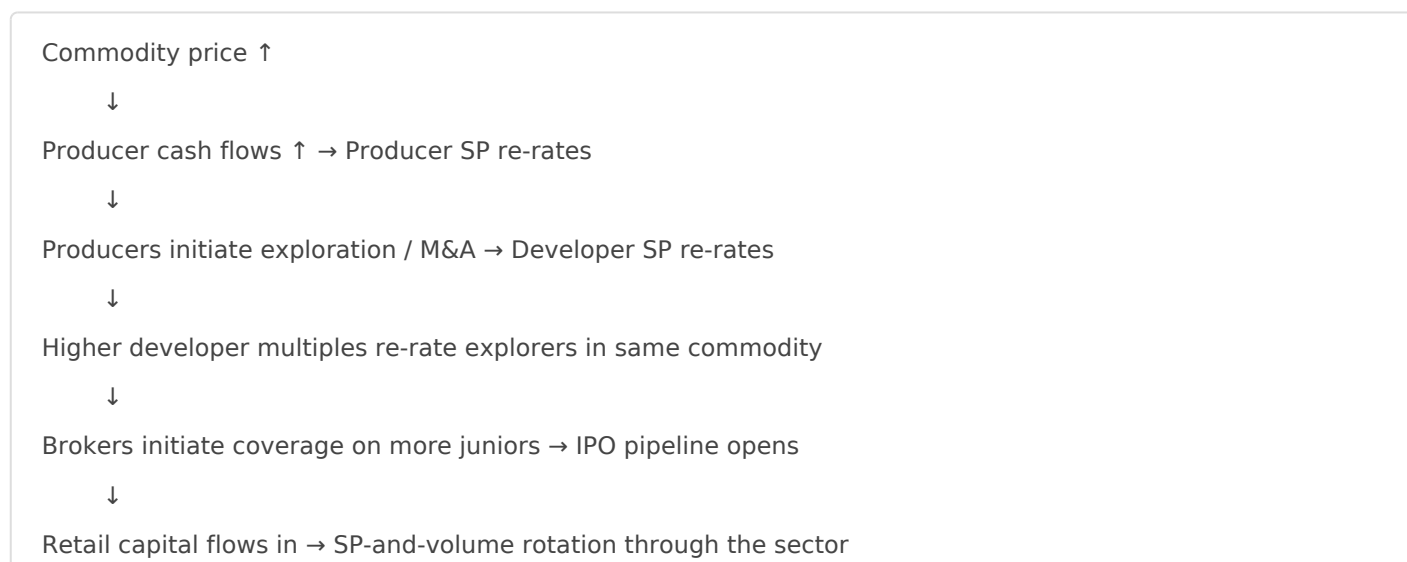
- DRC: ~70% of cobalt

- China: ~85% of rare earth refining
- Indonesia: ~50% of nickel
- Russia: significant palladium, nickel, aluminium
- Niger / Kazakhstan: significant uranium

Disruption in a concentrated source = price spike. This is actively driving Western "friendshoring" capital — including ASX explorers in friendly jurisdictions.

How macro feeds back to junior valuations

The transmission goes:



The lag from each step to the next is months. By the time retail is buying juniors, the early money is already rotating to the next cycle's leaders.

Track the producers in your commodity of interest. They are the canary in the coal mine for the rest of the sector.

Sector rotation patterns

When one commodity tops, capital often rotates to whichever commodity is "next". Rough recent pattern:

- 2020–2022: Lithium mania
- 2023: Lithium top, capital rotates
- 2023–2024: Uranium re-rate
- 2024–2025: Gold re-rate, rare earths
- 2025–2026: Copper themes building (verify timing/state at point of reading)

Don't fight the rotation. If your commodity has had its move and capital is rotating elsewhere, even good projects will see SP decay until rotation returns to that commodity.

How to use macro in your process

Step 1 — Identify which commodities are in early-cycle vs late-cycle

Look at prices vs incentive levels, inventory trends, and producer behaviour (cap-ex announcements signal late-cycle; defensive cap-ex cuts signal late-bear).

Step 2 — Distinguish structural drivers from narrative drivers

For each commodity in the portfolio, ask: is the current price level supported by structural supply/demand factors, or by short-term narrative? Position sizing should reflect this — heavier in structural moves, lighter and shorter-duration in narrative moves.

Step 3 — Allocate weighting between commodities accordingly

Heavier in early-cycle commodities, lighter in late-cycle ones. Avoid commodities mid-bust unless you have very long horizon.

Step 4 — Pick stage within commodity to match cycle phase

- Early bull: producers and near-production developers
- Mid bull: developers and resource-stage explorers
- Late bull: rotate out of explorers into producers (defensive), or to cash

Step 5 — Apply the China-dominance check for relevant commodities

If China dominates supply or demand for your commodity, factor in the playbook risk. Be especially cautious about late-stage juniors where the thesis depends on sustained supply tightness.

Step 6 — Stress test individual stocks at lower commodity prices

Even in a bull cycle, your individual position thesis must work at -20% commodity price. Otherwise you're betting on the macro, not the company.

Practical exercise

For each commodity you have exposure to:

1. Where is the spot price vs incentive price for that commodity?
2. Where are inventory levels (rising, falling, neutral)?
3. What are the major producers saying about supply growth?
4. What's the demand growth narrative and is it credible?
5. **Is the current price level structural or narrative-driven?**
6. **Does China dominate supply, demand, or refining for this commodity?**
7. **Is this a thin-thematic market that's prone to extreme valuation swings?**
8. Which phase of the small-cap cycle is the ASX universe in for this commodity?
9. Does your individual stock match the cycle phase (producer vs developer vs explorer)?

If the answers don't align — e.g., you own a Stage 2 explorer in a commodity at peak mania, or a late-stage critical-mineral developer that needs sustained Chinese supply tightness to be economic — you're misaligned with the cycle.

What I'm uncertain about

- Specific incentive prices change with input cost inflation, grade trends, and discount rate environment. The ranges above are rough; use as direction, not precision.
- Sector rotation timing is impossible to call precisely. The pattern that "commodity X follows Y" is much weaker than narrative suggests.
- China's demand share for various commodities is gradually shifting as their economy rebalances. The 50%+ share for base metals is broadly current but trending differently for different commodities.
- The energy transition supply story has been narrative-rich for years but actual demand growth has often disappointed vs forecasts (especially EV adoption rates outside China). Be skeptical of long-dated demand projections.
- The China playbook framing above is a generalisation. Individual commodity dynamics differ. Use it as a lens, not as a predictive model.
- Thin-thematic premium dynamics are real but also genuinely opportunistic — sometimes the thematic move is also the start of a structural change. Tin in 2024–2025 had elements of both. The framework is most useful for distinguishing pure thematic moves from durable shifts.

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