MACRO OPS
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THE LONG PULL: Resource Nationalism & Testing The Backtester

We've got a couple things to cover in this week's *Long Pull* report.

First, we discuss Indonesia's latest plans for Resource Nationalism and its effects on various commodities (including tin and gold).

Then, we'll break out the new MO HUD Backtesting tool and test different strategies on copper.

Let's get after it.

Indonesia's Resource Nationalism Plans

Imagine you're a lemon salesman. You go around the country and sell fresh lemons to lemonade stand entrepreneurs. You have no control over lemon prices. You simply sell at the last quoted price.

It isn't a great business. And after a while, you realize that the *lemonade stand* is where the *real* money's at. It has the distinct advantage of charging a premium on the sum of its commodity parts (lemons, sugar, water).

Eventually, you say, "screw it, I'm getting out of the lemon business. I'm selling lemonade now!"

That's basically what [Indonesia is doing with its critical minerals.]()

Indonesia will choose a new president in a few months as Joko Widodo completes his second term. The current frontrunner is Defense Minister Prabowo Subianto. Whoever wins has big shoes to fill.

Widodo will finish his 10-year term with an 80% approval rating (not a typo). In other words, if you're the new president and want to make a good first impression on the country, you probably shouldn't change the policies.

One such policy is an export ban on critical minerals (emphasis added):

> *"Widodo has led efforts to promote export restrictions on raw minerals while advocating for **'adding value to resources.'***
>
> *Beginning with a ban on exports of raw nickel ore in January 2020, Widodo has expanded restrictions to other metals, imposing an export ban on bauxite, the ore used to make aluminum, in June this year. **The list will grow next June after the country adds five more items, including copper concentrate, tin and gold.**"*

Indonesia doesn't want to sell lemons. They want to sell lemonade. And it's worked *very* well for them (emphasis mine).

> *"The ban on nickel ore exports has been a big success. According to the Jakarta Post, **nickel-related exports, which amounted to 17 trillion rupiah ($1.1 billion) in 2017, rose 19-fold to 323 trillion rupiah last year as key export items shifted from raw metal ore to products with higher unit prices.***
>
> *Those products include ferronickel, an alloy containing iron and nickel, and nickel matte, which is used in the processing of nickel ore."*

When asked about Indonesia's history as a raw material exporter, Widodo said, "*For years, we have always exported raw materials. This is a mistake that we must not repeat."*

Before we explore the consequences of Indonesia (and other emerging countries') shift from raw materials to value-added products, we should ask ourselves how we got here.

For a while, developed economies like the US had all the leverage in the raw material relationship. The West was like, "hey, we're making all these cool toys that need your raw materials. Why don't we cut you in on the action and allow you to export that stuff to us?"

This wasn't the worst deal for emerging markets. They received foreign investment, international credit, and state revenues in exchange for their raw materials.

The "problem" occurred when the West got drunk on its NIMBYism. Yes, the US cares about the environment, and we don't want to drill mega-holes on our soil. Instead, we'll farm off CO2 emissions and environmental destruction to some jungle in the Congo.

Eventually, the US/West stopped investing in raw material production. They didn't need to because they sold high-margin value-added products.

The tide is turning.

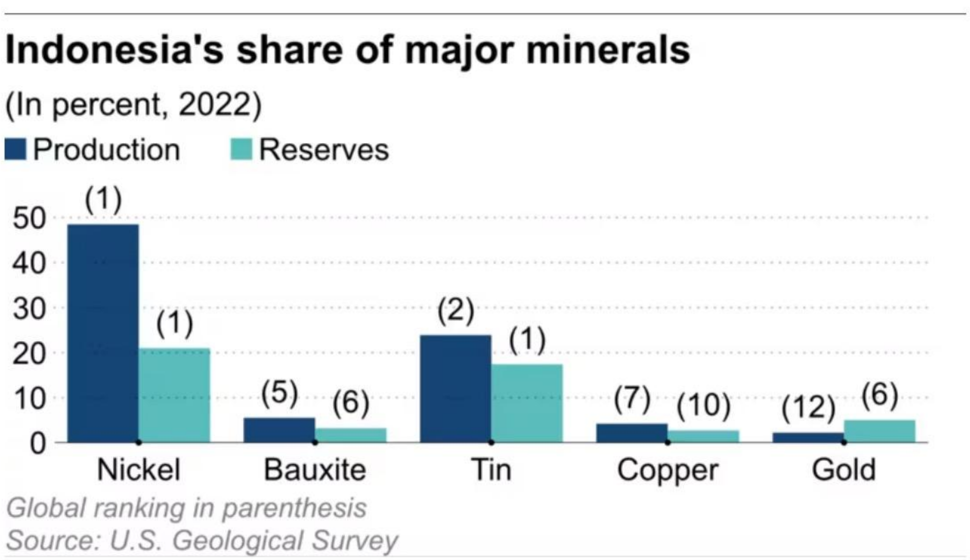
> *"For a long time, developing countries have had no choice but to accept the terms of industrialized powers, which have capital, technology and markets. But the picture has begun to change, with an increase in the economic power and influence of emerging and developing countries, collectively known as the Global South.*
>
> *Some are now "in rebellion" against the system which, under the name of free trade, has long constrained their efforts to develop domestic industries."*

From lemons to lemonade.

But it's not just Indonesia and China. Mexico and Chile are nationalizing lithium production. With all the money flowing into EV production, why should Mexico and Chile be content selling lemons? Even the Philippines is considering an export ban on nickel.

Resource Nationalism is staring us in the face, yet nobody seems to care or notice. We *will* care only when commodity prices skyrocket in response to a massive supply shock.

Let's use tin as an example. Indonesia will likely place some export ban on tin next June. The country is responsible for over 20% of global production and ~18% of global reserves.



What happens if they use 25% of production on value-added products instead of raw materials export? Who's picking up the slack in a market where the world's third-largest tin exporter loses money at $27K/ton?

The bear case for tin (and every other base metal) is that we'll eventually have a recession. That recession will crush demand and balance the already supply-constrained market.

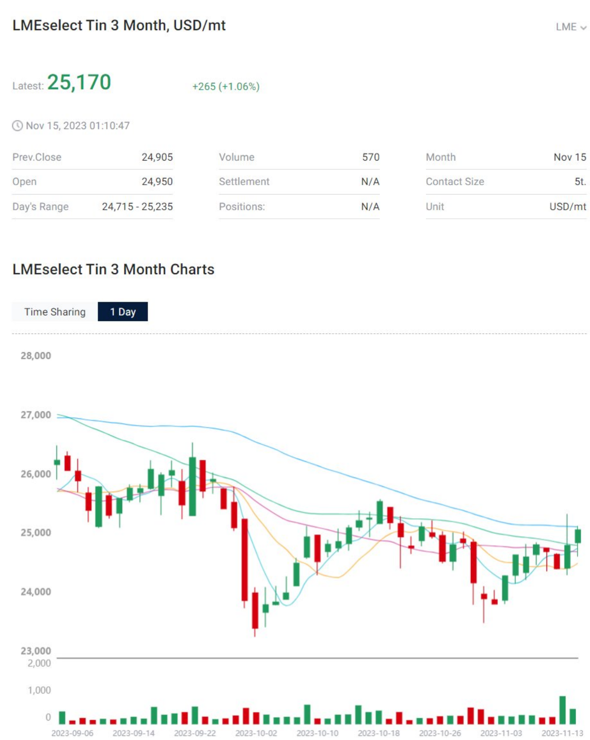
But there's no supply/demand model for "what happens if Indonesia takes 25-50% of its supply offline to make its own widgets instead?"

And so you have this setup where the baseline price to bring new supply online is ~$3K higher than the current spot price in a market where 20% of the world's supply might take 50% of it offline.

And AFM's stock hasn't moved in two years. It doesn't make sense.

When things don't make sense, especially in commodity markets, it's best to KISS and focus on changes in supply and demand. The demand story, barring a global recession, remains unchanged. The supply story, however, looks more bullish with each news release.

Also, it looks like tin prices are inflecting (see below). We'll likely get a starter/tracking position on by the end of the month and look to add over time.



Speaking of tin, my friend Antonio Atanasov released [a great tin podcast this week] with professional ags commodity trader, Nick Jones. Give it a listen. You don't often see tin-focused podcasts.

Testing The MO Backtester

Big shoutout to Octavio for creating the HUD Conditional Backtesting tool. It's in beta mode, but I know it will be a powerful/helpful tool in our process.

I ran some backtests on copper to see if I could find anything interesting. Let's dig in.

Backtest 1: Large Specs <10% Long

This is the classic contrarian signal where you buy when everyone's short/selling. Here's what I got.

Forward Returns

	5 Trading Days	21 Trading Days	63 Trading Days	126 Trading Days	189 Trading Days	252 Trading Days
Median	0.17%	1.05%	2.30%	3.98%	3.59%	2.70%
% Positive	51.46%	56.63%	59.87%	60.52%	59.22%	55.34%
Max	13.96%	25.76%	56.95%	71.78%	78.69%	102.80%
Min	−25.64%	−40.87%	−91.98%	−84.81%	−48.06%	−89.05%

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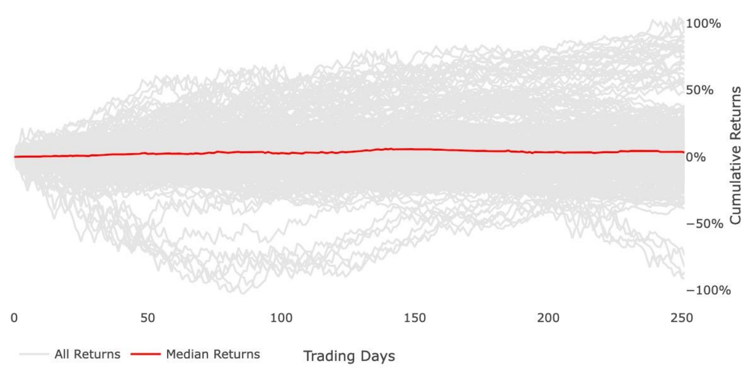

Interestingly, not much better than a coin flip at 55%, with the median return after 63 days only 2.30%.

What about Small Specs? Here's the result.

Forward Returns

	5 Trading Days	21 Trading Days	63 Trading Days	126 Trading Days	189 Trading Days	252 Trading Days
Median	−0.03%	0.09%	0.05%	2.37%	1.32%	−0.34%
% Positive	49.47%	51.05%	50.00%	53.16%	52.63%	48.95%
Max	13.96%	16.53%	26.63%	48.31%	86.54%	102.80%
Min	−18.07%	−40.87%	−91.98%	−84.81%	−48.06%	−67.74%

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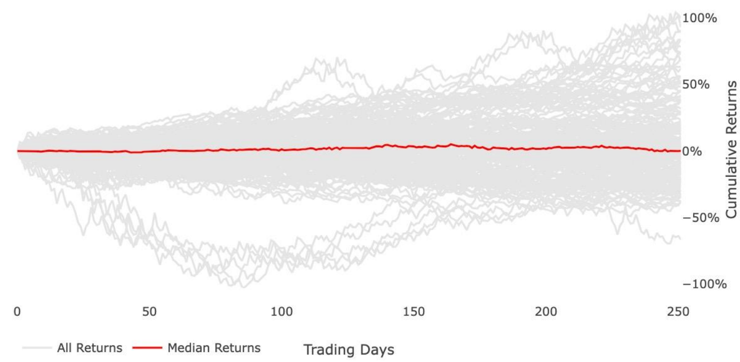

Small Specs were less reliable and generated an average return of 0.05% after 63 days and -0.34% after 252 days with 49% positive trades.

That's Spec positioning. Let's try Large Speculator Sentiment. The hypothesis is that the worse the sentiment, the higher the forward returns (i.e., "fade consensus"). The results:

Forward Returns

	5 Trading Days	21 Trading Days	63 Trading Days	126 Trading Days	189 Trading Days	252 Trading Days
Median	0.49%	0.74%	2.26%	0.57%	−2.31%	−0.16%
% Positive	56.25%	60.94%	64.06%	53.12%	35.94%	48.44%
Max	5.50%	10.40%	21.39%	27.98%	47.40%	57.89%
Min	−9.91%	−18.67%	−12.73%	−16.34%	−22.73%	−36.18%

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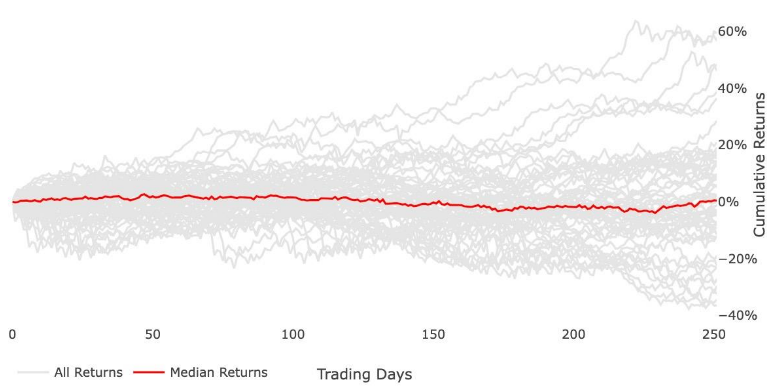

According to the backtest, Large Spec Sentiment is a **decent signal over shorter timeframes** (21 and 63 days) with average returns of 0.74% and 2.26% respectively.

Finally, I tested another classic signal … **Oversold Reversals**. I backtested forward returns for copper when Mind The Gap (200D) was at least 2.5 standard deviations below the mean. Here are the results.

Forward Returns

	5 Trading Days	21 Trading Days	63 Trading Days	126 Trading Days	189 Trading Days	252 Trading Days
Median	−0.19%	0.92%	0.72%	5.12%	7.36%	10.47%
% Positive	48.53%	53.92%	55.39%	64.71%	70.59%	62.25%
Max	18.86%	14.44%	23.24%	35.72%	61.53%	67.94%
Min	−25.64%	−37.98%	−61.18%	−31.71%	−30.46%	−33.57%

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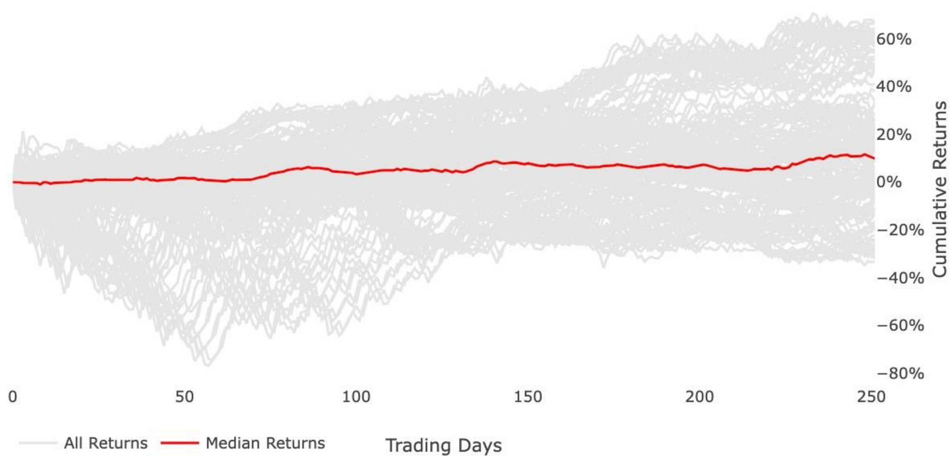

This is cool. Getting long copper at least 2.5 standard deviations below the mean results in an average 252-day return of 10.47% with 62.25% positive expectancy.

It's also interesting to note that 5 Trading Day returns are negative, suggesting that buying something *that* oversold usually means enduring a few more days of negative returns before the reversal.

I could spend hours diving down the backtesting rabbit hole. I encourage you to start using the tool. Test different assumptions. Let's get the Collective Hive Mind on this to generate insights and new trading strategies.

That's all for this week. I should have the ***Tungsten 80-20 Industry Primer*** done for next week. I'm learning so much and can't wait to share my findings with you.