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M i n i n g f o r O p p o r t u n i t i e s
(G F I , A N G , A G L & A N G)



Digging Into The Mines – Diversified, Gold or Both? Which One to Trade?

One thing the JSE Top40 has offered to traders in the past few months is some attractive opportunities in terms of short-term profit making both for short and long only traders. Embedded as one of EAR's decision science approach is the Hurst (H) and what the H reveals is some strong signal of mean reversion of commodity stocks on the JSE; in particular Anglo American (AGL), BHP Billiton (BIL), Gold Fields (GFI) and AngloGold Ashanti (ANG). From an H perspective, AGL and BHP (which are diversified mining/commodity stocks) have gone off against ANG and GFI (mainly operating gold assets) and vice versa, in what appears to be a bet by traders (and investors alike) on where to position themselves at a particular point in time.

Hurst (H) of the 4 Commodity Stocks

In the past 2 weeks, AGL and BHP shared the almost the same degree of mean reversion in terms of strength as indicated by their respective H. This "almost identical" mean reversion level dates back from July 2017 with the H on the two respective stocks showing some strong mean reversion ranging from 0.27 to 0.29 throughout various observed periods in July. During August, the two diversified miners' mean reversion levels weakened to range between 0.3 and 0.34, although still considered good levels of mean reversion, which suggests that the stocks moved in between a particular average over the trading period, presenting short-selling and long-buying opportunities for traders who played at levels "outside" the mean. Intriguingly, GFI had an identical H with BHP during July, placing it in the same basket as AGL and BHP, but moved from that basket in subsequent trading periods to show "almost identical" mean reversion levels with ANG, which one can term as a comparable/companion commodity stock. Interestingly, as GFI's Hurst deviated from being

"in line" with the diversified miners, it weakened slightly in July to be in line with ANG's. Then came August, where the two gold stocks reflected some strong H levels, whilst the diversified miners reflected some weak H levels, suggesting some shift in terms of how these competing stocks (diversified miners vs gold miners) presented opportunities from a mean reversion trading perspective. However, it is important to note that despite the change; all the stocks had good H levels in comparison with the majority of other Top40 constituents.

Shared Volatility and Excess Volatility

Where would traders be without volatility? Volatility may be favourable to most, especially if one caves in to fully understand the type of volatility in the context of a particular trading strategy. As mentioned above, AGL and BIL reflected almost identical Hurst levels (mean reversion) over the observed period. The question that may arise for most is: what about the shared volatility of the two diversified miners, assuming one places a bet on both, either to benefit from both stocks or to hedge the bets? The periods observed suggest that the shared volatility, through rolling correlations, between the two diversified miners has been relatively strong although declining as the volatility window period is extended. In the first observation period, AGL and BHP reflected some relative strong shared volatility in their daily returns with correlation coefficient of 0.82. However, the strength of the shared volatility declined to 0.76. This means that AGL and BHP daily returns moved in the same direction 76% of the time between July and August. Not the same can be said about the gold miners, although the rolling correlation shows some minor improvement in the shared volatility of the returns of the two gold miners in the form of ANG and GFI.

Given the shared volatility levels, as mentioned above, between the stocks in terms of returns, what about the excess volatility in the stocks? The way these commodity stocks behaved over the past two months may be characterised as fascinating. Whilst the two diversified miners showed some strong degree of mean reversion combined with relatively high shared volatility (between AGL and BIL) in July, the excess volatility was significant suggesting that the returns were too jumpy. The returns and prices on the diversified miners were accompanied by some “wide” variation as shown by the excess volatility, which means that the stocks (as well as related returns, which were measured separately) were not trading under normal market conditions or gravitating towards conditions that would be deemed as “normal”. Furthermore, as the degree of mean reversion shifted slightly, the two gold miners reflected the high excess volatility in their daily returns.

Where to Next?

Considering the relatively strong mean reversion levels reflected by the H on the two gold mining stocks, i.e. GFI and ANG in recent times, a mean reversion trading strategy may prove successful on the two gold stocks. Furthermore, EAR’s price projections indicate that ANG may trade between R119.50 and R135.50, 95% of the time and therefore a mean reversion trading strategy should be within this range. GFI also presents similar opportunities to ANG. Interestingly, the price range on GFI is expected to be 13% given a 95% probability, whilst the expected range on ANG is 12% given the same probability. While it is likely that the targeted prices shown below may be breached, the odds remain fairly low (e.g. 4 out of 80 trading hours).

Table 1: Trading Range

	AGL	ANG	BIL	GFI
Trading Range	R213.25 - R226.25	R119.50 - R135.50	R229.57 - R243.54	R51.16 - R57.44
Max Loss Per Contract	R 21.08	R 19.42	R 20.09	R 7.87

Source: EAR’s Workings and Bloomberg

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