



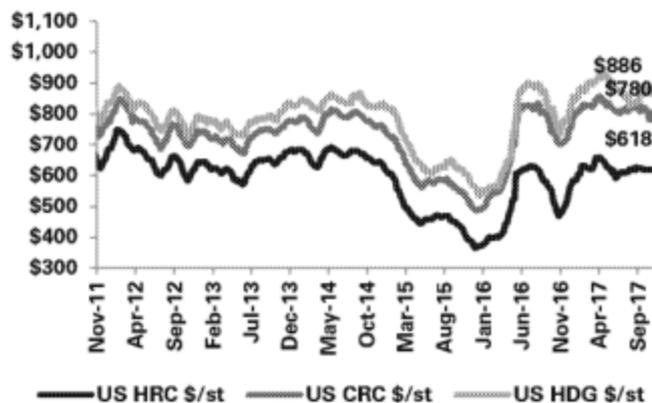
Investment Rationale

Absent a significant influx of imported steel, U.S. market demand is shaping up nicely as we enter 2018; however, we are wary of inflationary input costs...

We believe several U.S. steel companies have guided to a weaker Q4-2017 YoY due to input costs that have risen faster than steel selling prices. Hence Q4-2017 results are likely to be marred by input cost inflation and margin compression with the potential to recover in Q1-2018 if recently-announced selling price increases stick. Accordingly we believe the market is likely to be disappointed with Q4-2017 earnings yet bond prices are likely to recover given the more optimistic Q1-2018 outlooks from domestic steel companies.

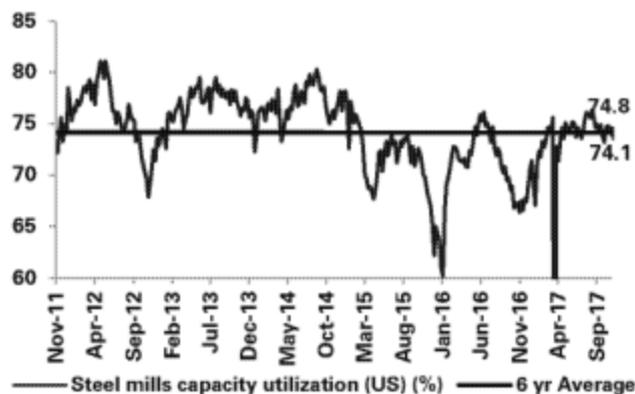
We believe the demand outlook for the U.S. moving forward is broadly positive and strengthening given positive steel indicators such as improving capacity utilization and higher U.S. domestic pricing amid a stable supply environment aided by China's pollution-driven supply curtailments during the winter months. Given our expectations for a stable organic demand environment in the U.S. in 2018, we believe that performance in 2H-2018 is likely to be more dependent on China's steel demand maintaining equilibrium with supply, otherwise the risk exists that the U.S. market may once again become inundated with imports absent any serious legislation restricting imports. That said, should demand trends wane in China in 2H-2018, we believe the government is more likely to implement additional stimulus measures to counteract a recession. **Against this mixed backdrop, we recommend that investors are overweight the U.S. steel sector entering 2018.** While we concede that earnings in Q4-2017 are likely to be softer than expectations, we feel they are more likely to present a buying opportunity for investors who are willing to tolerate supply-driven risks associated with Chinese fiscal tightening.

Figure 1: U.S. HRC, CRC and HDG Steel Pricing Trends



Source: Deutsche Bank, Bloomberg Finance LP

Figure 2: U.S. Steel Mills Capacity Utilization (%)



Source: Deutsche Bank, Bloomberg Finance LP