2017 was a great year for both the resources sector and the fund. The fund returned 26.3% against the benchmark return of 17.9%. Its long-term track record remains compelling, with the fund performing well against both its peer group and the benchmark over most meaningful periods.

Over the year, key contributors to performance were overweight positions in Exxaro and Trencor, as well as an underweight position in Anglogold. Overweight holdings in Impala and Pan African Resources detracted from performance, as did an underweight holding in Kumba Iron Ore.

Over the final quarter, we added to our holdings in Mondi, Sasol, Omnia and Anglo American. We reduced our exposure to Exxaro, Sappi and Glencore on the back of good relative performance.

Omnia is now a top 10 holding in the fund. Each of Omnia's three divisions are well poised to grow earnings off the current base. The fertiliser division is expected to see increased planting by farmers and is enjoying a favourable urea/ammonia ratio, aiding margins. Mining volumes are picking up as miners increase mining activity on the back of higher commodity prices. The chemicals division should benefit from the recent Umongo acquisition, which is growing strongly and offers opportunities for synergies as the business is integrated into the existing chemicals business. We see good upside for Omnia from current levels.

2017 was another good year for the mining industry. Commodity prices continued their upward march off the 2015 lows. This was aided by production restraint as miners focused on balance sheet repair rather than production growth. China's clampdown on their own domestic production to address pollution in a number of industries increased demand for commodities from other countries. High prices, limited capital expenditure, benign mining inflation and low freight rates have led to the mining companies generating above normal free cash flow. Miners used this free cash flow to reinitiate dividend payments, as well as some M&A activity. While we do expect this to normalise, the fact that many of the diversified miners trade on single-digit price to free cash flow multiples suggests the market is pricing this in and that value does remain.

The 2018 growth outlook looks reasonable. China's growth rate is expected to slow as the Chinese government focuses on the quality of growth over GDP targets (continued pollution focus, eliminating inefficient capacity, and greater growth in consumption spending). Excluding China, growth rates remain buoyant in the rest of the world. That said, most commodity prices remain elevated and lack cost curve support. As such, they are liable to a correction. When or how this happens is anyone's guess.

We still think the resources sector remains attractive, with reasonable upside in most of the stocks within the portfolio.

Portfolio managers
Nicholas Stein
as at 31 December 2017