The second quarter of 2018 was a very strong one for the resources sector as well as the fund (returning 20% and 13% respectively). The long-term track record of the fund remains compelling, with it performing well against both its peer group and the benchmark over most meaningful periods.

For the quarter, the fund benefited from underweight holdings in the gold majors. An underweight holding in BHP Billiton, as well as overweight holdings in PGM shares, detracted from performance. Over the last quarter, we have added to our holdings of BHP Billiton, Omnia and the PGM shares. We reduced holdings in Sasol, Anglo American and AECI.

The Department of Mineral Resources (DMR) announced a revised iteration of Mining Charter III. This revision does add some certainty in that it recognises past empowerment deals (the "once empowered always empowered" principle). However, for new mining rights, as well as renewals of existing mining rights, it is onerous (although admittedly less so than the prior version). The requirement of a 10% free carry (5% each for communities and employees), as well as a trickle dividend of 1% of EBITDA to communities and employees, will increase the return hurdles mining companies seek and risks deterring future investment. Stakeholders continue to engage on the document, with the DMR hoping to resolve the charter by end-November 2018.

Thermal coal continues to defy gravity. From its lows (below $50 per ton in late 2015), the commodity is now trading at over $100 per ton. This was driven by several factors. Despite coal's reputation as a dirty energy source, the transition away from it is happening in a slow, measured way. Even though, for example, Chinese coal power as a percentage of total power is dropping, China's overall power demand is growing so strongly that actual coal tons demanded are growing. At the same time, China is reducing domestic coal production (due to environmental, safety and financial reasons), increasing their imported coal requirements. Recent low river flow has meant that Chinese hydroelectric supply has disappointed, further adding to the demand for coal.

Exxaro is well placed to capitalise on the strong coal price. Although a large portion of its supply goes to Eskom on fixed price contracts, it still exports c.8 million tons per annum, which is directly exposed to the seaborne coal price. It has also shown market-friendly actions by returning a large portion of the Tronox sale proceeds to shareholders. We expect Exxaro to do the same when it sells the second tranche of its Tronox holdings in late 2018/early 2019. We believe this will highlight to investors how cheap the underlying coal business is.

The fund continues to have a material weighting towards the platinum group metal (PGM) shares. Our largest holding is Northam, followed by Anglo Platinum (on a look-through basis via our Anglo American position). The PGM shares have continued to underperform the resources sector. Despite the rand PGM basket increasing by 14% during the quarter, the PGM sector delivered a return of 0%. Our bullishness on PGM shares is based on material deficits in the 3E PGM (platinum, palladium and rhodium) markets, which we believe are not reflected in either the commodity or equity prices.

Portfolio manager
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as at 30 June 2018