The first quarter of 2018 was quite soft for both the resources sector and the fund, returning -3.8% and -7.6% respectively. The long-term track record of the fund remains compelling, with it performing well against both its peer group and benchmark over most meaningful periods.

For the quarter, the fund benefited from overweight holdings in Merafe and Omnia. Overweight positions in Pan African Resources and Northam detracted.

Over the last quarter, we have added to our holdings in Pan African Resources, Northam, Sappi and Exxaro. We reduced holdings in Glencore and Merafe.

All mining companies have now reported their annual or interim results. In general, results were in line with or better than market expectations. The theme of strong cash flow, deleveraging and capital returns to shareholders continues. High prices, limited capital expenditure, benign mining inflation and low freight rates have led to the mining companies generating above normal free cash flow. We are starting to see mining inflation and capital expenditure levels pick up. In addition, growth is starting to make its way back into mining executives' vocabulary (examples include greenfields copper at Anglo American and coal acquisitions by Glencore). Our hope is that it remains measured and that mining executives aren't lured into chasing growth at the expense of returns.

The news on the South African front has been decidedly more positive. The election of Cyril Ramaphosa as South Africa's new president has brought much hope and optimism for our country. With the new president's long history of involvement in the mining industry, the hope is that the sector's prospects improve. Indeed, one of president Ramaphosa's first actions was to replace the mining minister, Mosebenzi Zwane, with Gwede Mantashe. In addition, new leadership has been injected into Eskom. Our expectation is that the likelihood of increased policy certainty, a reduction in patronage and politically induced safety stoppages should go a long way to improve the operating environment for our local miners.

We have materially increased our position in local miner Pan African Resources (PAN). PAN has seen its share price halve over the last quarter. While some of this was warranted, we feel the extent of the share price move was overdone. The share price decline was caused by a lower rand gold price and a particularly weak operating result for their last six months. These six months saw lower grades and mining flexibility at Barberton, a lack of grinding capacity at their BTRP tailing operation and an insufficient recovery and continuation of losses at Evander. We are encouraged by management actions in this regard. Increased access points are being added at Barberton, grinding facilities are being added at BTRP and Evander is in the process of being placed on care and maintenance – a tough but brave decision. We have long been critical of PAN's decision to buy Evander. Old Wits orebodies time and again prove that they are tough to operate, are labour intensive and high cost. Looking forward, however, an investor in PAN today is effectively buying a stake in Barberton – a high grade, low cost ore body. In addition, they are buying a number of tailings plants. These plants are far more predictable, are low cost, and have low capital and labour intensity.

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

Portfolio manager
Nicholas Stein
as at 31 March 2018