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The final quarter of 2019 (Q4-19) saw a particularly strong performance from the resources sector after the pullback experienced in the third quarter of the year (Q3-19). The fund performed very well and returned 21.1% for the quarter against the benchmark return of 13.8%. For the full year, the fund returned 35.4% against a benchmark return of 28.5%. Its long-term track record remains compelling, with the fund performing well against both its peer group and the benchmark over most meaningful periods.

For the full year, the fund benefited from its large overweight positions in Northam and Impala Platinum (Implats), with our overweights in Glencore & Merafe detracting from performance. We have been trimming our holdings in the platinum group metals (PGM) miners, as these shares have continued to outperform, and deployed this capital into the diversified miners, as well as Pan African Resources, in the recent quarter.

2019 saw highly divergent returns within the commodity suite to which the fund is exposed. Rhodium's 146% year-on-year rise saw it lead the way over second-placed palladium, which only rose 54% in comparison. Palladium and rhodium now make up the vast majority of the average PGM miners' revenue basket, despite being considered minor metals to their sister metal platinum in years gone by. Cobalt and the two coals were the lowest-performing commodities during the year as the exuberant bubble continued to pop in the cobalt market and coal prices came back on demand weakness. Cobalt was down 41% for 2019 and thermal and metallurgical coal were down 36% and 37% respectively. Gold had its best year in some time on the back of geopolitical concerns and declining interest rates, to post an 18% gain for the year. Iron ore rose 26% in 2019 due to continued strength in Chinese steel demand, coupled with the Brumadinho tailings dam failure in January, taking a material portion of supply out of the market.

Contrasting the best- and worst-performing commodities of 2019 is useful analysis and lends credibility to taking a long-term view and not getting caught up in the hype that so often surrounds commodity markets. Both cobalt and rhodium are tough commodities to value, given they are mined nearly exclusively as by-products of other commodities. Cobalt comes largely from copper and nickel mines and rhodium from orebodies that are platinum dominant. This fact weakens traditional cost curve analysis because the cost of extracting the by-product is then impacted materially by the price in the market for the primary product.

Over the last few years, the rhetoric surrounding the cobalt and rhodium markets (and, by extension, the PGM complex) has been remarkably divergent. Cobalt is used in batteries and, as a result of the electric vehicle (EV) revolution, is forecasted to see a dramatic long-term increase in demand, as EV's begin their way to mass adoption. In 2016, when market participants got overly zealous about the opportunity EV's represented for the cobalt market, the price was pushed up over four times in under two years and cobalt miners were making supernormal returns on their invested capital. Since then, expectations for EV adoption have moderated and the cobalt price is down 67% from its 2018 peak, with market weakness deteriorating further throughout 2019. As a result of the precipitous price declines, Glencore has scheduled to put the world's largest cobalt mine, Mutanda, on care & maintenance in an attempt to boost prices. Quite an about turn from the high-flying days of 2016-2018.

On the flip side of the EV equation is the internal combustion engine. While the EV was being forecast to take over the world in a matter of years, the implication was that combustion engines, and thus a large portion of PGM demand, would soon be rendered obsolete. While cobalt was hitting its peaks in 2018, the PGM basket remained at trough levels. What we believe was underappreciated by the market, both then and still now, was the long road to mass EV adoption as well as the tightening of global emissions standards, which are independently driving PGM demand.

Rhodium has a crucial role to play in emissions reduction from light duty vehicles over the coming years. National regulators have placed an increasing focus on reducing the nitrogen oxide emissions from the vehicle tailpipe, and rhodium is second to none in its ability to do so. Since April 2018, at the peak of the cobalt mania, we have seen the price of rhodium increase three times to the end of 2019 versus the 67% decline in cobalt prices. While PGM miners are now cashflow positive, they are barely making mid-cycle returns on capital. The commodity behind the technology that was written off just two years ago has outperformed the 'sure thing' by multiples and, thankfully, the fund has maintained a healthy exposure to rhodium and the rest of the PGM basket over this timeframe.

Portfolio managers
Nicholas Stein and Nicholas Hops
as at 31 December 2019