The second quarter of 2019 (Q2-19) saw returns from the resources sector stabilise after a particularly strong first quarter (Q1-19). The fund declined by 3.9% against a benchmark return of 2.4% during the quarter under review. However, its long-term track record remains compelling, as the fund has performed well against both its peer group and the benchmark over most meaningful periods.

During Q2-19, the fund benefited from overweight holdings in platinum group metal (PGM) shares, while its Omnia position and not owning gold equities detracted from performance. We reduced our Anglo American and BHP Billiton positions, while adding to Glencore and Merafe.

Iron ore continued its strong run unabated, up 37.3% in Q2-19, after having risen 16.3% in Q1-19. A combination of strong China-driven demand and weak supply (resulting from the Vale tailings dam disaster) has led to ideal conditions for the iron ore producers, with current prices well above both incentive prices and marginal cost. What to do with the iron ore windfall will no doubt be topical in the upcoming results season for those companies with exposure to the red metal. Excess returns to shareholders, either through share buybacks or dividends above minimum levels, are expected. Thermal coal continued its march downwards for the quarter, with a decline of 17%. Performance across the rest of the large commodities was mixed, with nickel and oil both down, PGMs up 0.7% and copper down 7.9%.

The Omnia share price is down 88% from its peak in 2014 to current levels of R30 per share, inclusive of a 64% decline year to date. This precipitous decline has resulted in Omnia being one of the top detractors from fund performance over both the short and the long term. Primarily exposed to the South African mining and agricultural sectors through their fertiliser and explosives businesses, Omnia's earnings have seen a material decline in recent years. As the largest player in the fertiliser space, Omnia has suffered alongside local farmers as poor growing conditions have led to lower plantings and downtrading from Omnia's premium product. We expect earnings from the fertiliser business to increase from today's base, due to a pickup in planting and efficiency benefits from their new production facility. In the mining business, real operating profit has declined by nearly 80% in the last five years as South African mining activity has been under pressure.

By nature, Omnia is a cyclical business and the combination of cyclical lows in their two key divisions could not have come at a worse time for the company. Having recently completed R2 billion worth of acquisitions, which have not performed as expected, the business was left with a large debt balance just as earnings declined materially. The result has been an announced R2 billion rights issue, compared to today's market capitalisation of R2.1 billion and the raising of a R6.8 billion bridge loan to tide the company over until equity is raised. We feel that the whole process has not been handled particularly well, which has exacerbated the operational issues and led to dramatic underperformance of the share. The rights issue announcement was light on detail and was followed by an information vacuum in the market, shareholders exiting en masse and short interest increasing materially. Going forward, we see good operational prospects for the business and believe that there is significant upside from today's levels. Omnia now represents a 1.9% position in the fund since we have added to the position during the quarter.

Portfolio management update

Nick Hops has been appointed as co-manager of the fund with effect from April this year. He joined Coronation in January 2014 and is responsible for researching BHP Billiton, African Rainbow Minerals, Assore, the South African-listed gold stocks and the PGM sector within the resources space.

Portfolio managers
Nicholas Stein and Nicholas Hops
as at 30 June 2019