CORONATION RESOURCES FUND

Quarterly Portfolio Manager Commentary

The first quarter of 2019 (Q1-19) was a very strong one for the resources sector. The fund returned 16.9% against a benchmark return of 17.8%. 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 period under review, the fund benefited from overweight holdings in platinum group metal (PGM) shares, with Omnia detracting from performance.

We also added to our Sasol and Glencore holdings over Q1-19, while reducing the Anglo Platinum and BHP Billiton positions.

All mining companies have now reported their annual or interim results for the periods to end-December 2018. These results were characterised by a strong performance from bulk metals (iron ore, coking coal, thermal coal and manganese). The theme of strong cash flow, deleveraging and capital returns to shareholders continues. Anglo American has yet to start returning excess capital to shareholders, but we expect them to initiate in 2019, once their targeted gearing range is reached.

The quarter under review saw commodity prices get off to a strong start, which his was fairly broad based (nickel +25%, oil +23%, iron ore +21%, PGMs +17% and copper +11%). Abatement of fears around a potential trade war between the US and China was likely a contributing factor. Thermal coal declined 24%, although this was off a high starting price – a price we did not expect to be sustained.

The most topical of the moves higher was iron ore, which is a commodity we have been fairly bearish on. Our view is that recent supply additions from the majors, coupled with tepid steel demand growth, would see a market in surplus. In the long term, the rise of steel scrap is also expected to reduce demand for raw iron units. However, in late January 2019, a tailings dam of Brazilian iron ore producer Vale collapsed, a tragic event that led to the loss of around 300 lives. In addition, around 40mt of production was removed from the market in the short- to medium-term, while it and other Brazilian tailings dams are being assessed. Further to this, Cyclone Veronica in Australia looks like it will result in production being reduced at Rio Tinto's and BHP Billiton's operations. While our bearish thesis remains, these events should see iron ore staying stronger for longer before production resumes.

After a long, frustrating wait, PGM shares have finally begun to rally. We feel this is a vindication of our disciplined, long-term approach to investing, where we aim to assess information objectively and dispassionately and try to avoid being swayed by the news and sentiment of the day. Post-'Dieselgate', negative headlines called for the death of the internal combustion engine and platinum demand along with it. PGM prices dropped below marginal costs of production. At the same time, electric vehicle commodities like lithium and cobalt were rallying strongly (up three times). Tesla's share price rose seven-fold in the last seven years and its market capitalisation is comparable to traditional automakers such as General Motors (GM) and Ford, despite the fact that the company has struggled to turn a profit and produces only 3% of the vehicles that GM produces. While we are long-term believers in battery electric vehicles, we expect the process to be evolutionary rather than revolutionary. In the medium term, we also expect PGM demand to surprise positively as a consequence of tightening emissions standards, globally. In addition to this, material underinvestment in mine supply over the last decade means it will take many years before a sufficient supply can respond to current market deficits. We therefore expect structural PGM market deficits to persist for at least the next decade.

Coal is another example of 'headline risk'. While headlines were bearish due to renewables adoption, the growth in absolute demand for coal (even as it has been gradually shrinking its share of the energy pie), coupled with limited investment in new supply, has meant a tight supply demand balance and a buoyant price.

Portfolio manager
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as at 31 March 2019