Performance

The Fund returned 13.5% for the quarter and 16.2% for the last 12 months. The long-term performance of the Fund remains pleasing against both the peer group and its benchmark.

2022 marked a wild year for geopolitics and markets. This was driven by Russia's invasion of Ukraine, which sent prices of energy-related commodities far higher. On the other hand, China's continued enforcement of their zero-Covid policy for most of the year kept a lid on demand for the majority of industrial commodities. On the local front, the shambolic state of our SOEs, notably Eskom and Transnet Freight Rail, held SA back from participating in the boom in commodity prices, notably thermal coal.

The fourth quarter saw a pleasing rebound in industrial commodities. This was driven by signs that US inflation may be nearing a peak, and China indicating they will shift away from their zero-Covid policy.

Fund positioning

The key positioning of the Fund is an overweight holding in energy stocks and an underweight holding in gold stocks. Within our portfolio of energy stocks, the positions are concentrated towards oil producers. During the quarter, we reduced our holdings in Glencore and Thungela, applying the proceeds to a number of international oil names. The oil price is currently around $80/barrel. It is worth noting that it is at this level when 1) consumer demand is under pressure owing to high electricity/gas bills; 2) the US has been releasing strategic oil stockpiles to help lower the price; 3) China demand is subdued to its zero-Covid policy; and 4) Russian oil production has been surprisingly resilient since the start of the invasion. Over the medium term, we see a good chance that all or some of these factors reverse, which would likely see the oil price move materially higher. While many people say that they are bullish energy (suggesting that this is a crowded trade), low multiples and high free cashflow yields suggest the opposite.

The gold price has a number of drivers, but the one with the strongest correlation is real interest rates (typically expressed via US 10-year TIPS). The logic here is that gold offers investors no yield. So when real rates are low or negative, the opportunity cost for holding gold is low and gold prices are typically buoyant. Conversely, when real rates are high, the opportunity cost of holding gold is high. We have been surprised by global central banks' response to high inflation and the aggressiveness with which they have hiked rates to combat it. As a result, we have gone from a decade of accommodative monetary policy (with low/negative real rates), to a situation today where real rates are positive. As a result, we have a fairly muted outlook on the gold price. This feeds into our cautious stance on the gold equities. We have reduced our gold holdings during the quarter. Proceeds have been applied to energy stocks discussed above.

Outlook

The 'setup' for 2023 looks reasonable. Industry margins are around mid-cycle, if one excludes thermal coal. Chinese economic recovery should offset any European economic weakness, given that China represents a bigger share of commodity demand than Europe. Continued supply chain disruptions and miner supply discipline means that most supply-demand balances are on the tight side, while inventories remain low. That said, industrial commodity prices and equity prices have moved to price in some of the Chinese reopening news.

Portfolio managers
Nicholas Stein and Nicholas Hops
as at 31 December 2022