The Fund returned 19.9% for the quarter and 44.5% over the last 12 months. Its long-term performance remains pleasing against both the peer group and the benchmark.

The largest contributor to performance in the first quarter of the year (Q1-22) was the Fund's overweight position in Thungela Resources, followed by an overweight in Exxaro Resources. Our largest detractors were overweights in Mondi and Northam Platinum.

In the quarter, we added strongly to our Sasol and Mondi positions. In turn, we took profits particularly in Impala Platinum and Gold Fields where initial fears around the Russian invasion of Ukraine provided very attractive exit points from these two stocks.

The long-term impacts of Russia's invasion on Ukraine on commodities

Naturally, the key discussion point this quarter is Russia's invasion of Ukraine and in no market has this been felt more keenly than the commodity space. Massive volatility has been present across the key Russian commodities and in the short term, at least, a risk/scarcity premium has been priced in almost across the entire commodity spectrum. There has been some level of official restrictions on Russian commodities and a degree of 'self-sanctioning' by Western corporations – this is unique by historical standards. In general, the commodity markets entered 2022 in short supply, with tight supply chains failing to keep up with strong and growing demand. Clearly in the short term, those with the needs for commodities are going to be willing to pay up for them. For us as long-term investors the key consideration is the long-term impact and we will discuss a few of the potential ones here. With the obvious caveat that this is a shifting platform.

The key commodities that Russia produce are palladium (27% of the global total), natural gas (19%), metallurgical coal (17%), crude oil (10%) and thermal coal (9%). There is a clear skew in their production towards the energy complex and this is where the effects have been most keenly felt thus far. Our attempt to assess the future for these commodities has been based off the base case scenario where, in general, most sanction-aligned economies try to move away from consuming Russian commodities. It does not include an outright banning of exports, but does assume that, to the degree possible, Western economies self-sanction over time. Large adjustments in trade flows are likely over time and Russia will increasingly focus its exports to the East, where buyers will be more than willing to take their commodities – potentially at a discount.

In palladium we think that the long-term outlook has been turned more negative by the recent events. Automakers will accelerate substitution in autocats from palladium towards platinum and are likely to further push their battery electric vehicle (BEV) strategies. We will also see governments pushing BEVs further, particularly in Europe in a bid for increased energy independence, and to reduce reliance on Russian oil and palladium. Rhodium (Russia produces 6% of global supply) will see similar negative themes to palladium in the long term. Platinum (11%) will however see long-term benefit as governments push their hydrogen strategies further. We have already seen this in Europe in recent weeks and no doubt other regions will follow. Platinum is a key beneficiary of the hydrogen economy and automotive applications. Platinum will also benefit from substitution away from palladium in autocats. On balance, for the combined 3E* platinum group metals (PGM) markets, our long-term outlook is more muted than it was before. Prices in Q1-22 were volatile for palladium, which at one point increased by 80% to an all-time high above $3 400/oz. By quarter end, the price had increased 19% and settled at $2 268, more than 100% above our $1 000/oz normal price.

In the coal markets, we see an incrementally more negative long-term outlook for thermal coal and little impact to metallurgical coal. In both coal markets, in the short to medium term (0-3 years) we see a positive impact on global supply-demand balances and benchmark prices. Within the next three years, as the Western markets move away from Russian supplies, they will have to source coal from other markets, which will boost benchmark prices. In this medium-term time frame, thermal coal is likely to benefit at the expense of gas in Europe, as countries look to replace gas (largely sourced from Russia) with coal (which they can source globally). For thermal coal the longer-term impact is negative, as we will see an increased push for green energy and the energy independence that this brings. Gas prices will be under pressure in the long term, which is negative for thermal coal pricing given the 'interchangeability' from an energy perspective. In the case of metallurgical coal, we don't see much of a market impact in the long term; Russia should be able to find Eastern markets for its coal and the demand picture is unlikely to be changed by this ongoing event.

As mentioned above, we see the long-term picture for gas pricing as incrementally more negative. High gas prices and the need to move Europe away from its Russian dependence will see an increased shift towards renewables as well as energy efficiency. Russia provides 40% of the European Union's gas requirements and it is this achilles heel that has left Russia's energy exports largely untouched by Western sanctions thus far. Europe's immediate response to the crisis has been a target to reduce total gas consumption by 30% and Russian gas consumption to zero by 2030.

The outlook for oil prices in the long-term is more positive than it was before the Russian invasion. Estimates vary but ~2-3MMb/d of existing Russian oil production is potentially at risk going forward. Given supply chain intricacies and foreign investment, it is likely that Russia will no longer be a growth region from an oil perspective, as it was originally forecast to be. With the world losing Russian oil as a dominant and potential growth source, new supply will have to be incentivised. With capital discipline currently being the mantra from the US shale industry and declining OPEC spare capacity, this new supply is likely to be at a higher cost. We expect a tight market over the next decade as oil demand growth outstrips supply.

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