CORONATION
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Performance

The Fund returned -5.7% for the quarter and -8.6% for the last 12 months. The long-term performance of the Fund remains pleasing against both the peer group and its benchmark.

It was a divergent quarter from a commodity perspective, which saw vastly different price performances being recorded. Copper and gold finished the quarter up 8%, the latter being driven by the US mid-size bank crisis. Iron ore was the standout in the commodity space as it posted 10% gains on the back of continued optimism over the reopening of the Chinese economy. This boosted copper as well. The real pain was felt in the PGM space as soft internal combustion sales, particularly in China, dragged palladium down 18% and rhodium down 40%. Thermal coal declined 56% from incredible levels due to the warmer-than-expected European winter and successful energy demand curtailment in that region.

Early in the quarter, the Fund shifted the majority of its platinum group metal (PGM) exposure from the equities into the platinum metal itself via an ETF. We meaningfully reduced our Anglo American position and rotated the exposure into BHP Billiton, Glencore and Teck Resources. Top contributors to performance in the quarter were our underweights in Anglo American and Anglo American Platinum. Top detractors were our underweights in Gold Fields and AngloGold Ashanti.

Fund positioning

Mining sector

From 2016 to the late part of 2022, the mining sector in general benefited from a combination of favourable elements. Prices rose strongly off a low base whilst costs and capex reduced off high bases. These three factors led to a massive shift in the income statements and balance sheets of the mining sector. This surplus free cash flow was initially applied to reducing debt and once balance sheets were sufficiently strengthened there was a redirection of this capital towards shareholders. The resulting experience from a shareholder perspective was very favourable as shareholders benefited from rising stock prices and increased dividend yields.

Across the board, 2022 was a disappointing year from an operational perspective for most commodity companies. Miners grappled with elongated supply chains, inflation across the board, community unrest, higher employee turnover and intermittent Eskom supply for those operating in South Africa. Volume, unit cost and capex were disappointing vs. expectations in 2022, with external inflation a big contributor. The risk going forward is that cost and capital discipline slips in an environment where prices are either flat or down. Capital allocation then becomes more important and, at a sector level, we are seeing an increase in large M&A activity which is something to worry about given miners have historically not added value from these endeavours. Across the board, we are valuing the mining companies on assumptions that account for this dynamic and we still see value throughout the sector. Individual equity selection is likely to be a lot more important going forward as the environment toughens.

Shifting platinum exposure

As mentioned, we rotated a large portion of our PGM equity exposure into the platinum ETF. As battery electric vehicles (BEV) have continued their rise in the face of many hurdles, we have had to consistently increase our BEV penetration forecasts over all time periods. A key driver of the change has been China as the region has managed to install and ramp up BEV capacity at a rate far exceeding that of the Western world and our initial expectations. Our long-term optimism on the PGM sector hinged on the investment case for platinum as declining supply meets growing demand from the auto sector and long-term potential from the hydrogen economy. The PGM basket price has been kept elevated by high palladium and rhodium prices which we expect to fall further in the long term. We think that in the long term the upside from platinum ETF exposure is similar or greater than that of owning the various equities. Importantly the risk is a lot lower as the platinum ETF mitigates against a lot of the risk in owning the PGM equities at this point in the cycle. Cost overruns and production disappointments hurt the equities negatively and will positively impact the outlook for platinum pricing. The impact of Eskom leads to both of the above factors, while the platinum ETF is once again protected in this regard. Importantly it also reduces to zero the capital allocation risk that owning the companies comes with. Offsetting this, is the fact that the ETF does not pay its owners a dividend. There may be a time in the future where shifting the exposure back towards the equities makes sense from a risk-reward perspective; most likely from a point of much lower PGM producer margins.

Outlook

On balance we remain optimistic about the outlook for the commodity sector and the individual equities within the Fund. There remains an insufficient level of project activity at the sector level to deliver the supply needed to satisfy global demand over the next decade. It is our hope that the companies within the portfolio are able to maintain operational and capital discipline in order to capture high commodity prices and return this surplus to shareholders.

Portfolio managers
Nicholas Stein and Nicholas Hops
as at 31 March 2023