CORONATION
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Performance

The Fund returned 4.2% for the quarter and 13.9% for the last 12 months against a flat resources sector. The Fund's long-term performance remains pleasing against both the peer group and the benchmark. For the quarter, the sell-off in gold and PGM shares drove outperformance, given near-zero exposure to either of the sectors. Continued strength in the oil price drove our offshore listed names higher, which was offset very slightly by our relative underweight in Sasol. Not owning Sappi or Thungela detracted from performance in the period.

Fund positioning

In the quarter, we purchased Mondi and shifted our exposure into the offshore energy stocks where relative valuation moves provided the opportunity. Our ownership of the offshore energy business in the last 18 months has added significant value to the Fund. These companies are covered internally by our international investment team and represent an attractive alternative to Sasol, where idiosyncratic risk and poor capital allocation over time have meaningfully impacted shareholder returns. We sold down our AECI position after a 26% rally year to date left a diminished margin of safety.

The last 12 months have seen a large amount of volatility in the commodity sector as the mood towards China swung from pessimism to optimism and then back to pessimism again. A key commodity theme from the Fund's perspective has been long energy and short precious metals. The PGM short leg has, as has the long energy, worked very well. Being short the gold sector has hurt as central bank purchases have driven the gold price higher than anticipated, and the South African listed gold equities experienced their own rally separate from the rest of the sector. AngloGold has since given a lot of this outperformance back and is down 44% from the 2023 peak, while Gold Fields has been more resilient and is down 33% from the peak. Gold Fields has been the leading global gold major from a cost perspective in the last five years and strikingly still trades on a similar multiple to AngloGold despite the latter being one of the worst cost performers in the sector over that same period. The recent sell-off has made valuations more palatable, but we don't think the margin of safety is significant enough yet to own the shares.

We remain negative on the outlook for the PGM sector, and after having owned no direct equity exposure for the last few months, we remain very underweight. We believe that the range of outcomes for metal prices in the next five years is extensive but with a strongly negative skew as battery electric vehicles continue to take a massive share from internal combustion engines worldwide. South African PGM producers with high-cost mines face hard decisions requiring them to rationalise their asset bases at a significant social cost. Ultimately, the industry needs to be smaller and more cost effective to earn an economic return for shareholders. Unfortunately, capital allocation from much of the sector during the boom years does not give one confidence in the sector's ability to navigate the coming environment. There is potential for a short-term metal price rally given how far prices have fallen and the potential for an inventory rebuild at the vehicle manufacturers. Based on our negative long-term view we believe that any rally will be short-term in nature and would expect short-term underperformance from the Fund if it does come to pass given our absolute and relative weighting.

We added Mondi to the Fund in the last quarter as it continued to languish in the wake of the "loss" of its Russian business and a downturn in the markets for its end products. Mondi is a low-cost integrated producer of paper and packing with predominantly European and American exposure. When Russia invaded Ukraine last year, the group effectively lost its key Syktyvkar asset, which comprised approximately 20% of group earnings. It has taken 18 months for them to dispose of it, and surprisingly they have managed to salvage €775mn in cash for the asset, where many Russian subsidiaries of other companies have gone for minimal values. After the invasion, the market effectively marked the Russian asset to zero, as evidenced by a >20% decline in the share price in the following weeks. In buying Mondi, we felt we were paying a reasonable multiple for a high-quality business at the bottom of its commodity cycle and any Russian proceeds represented an upside to our valuation. Mondi has a long-term track record of consistently investing through downcycles, which they have continued to apply in the last 18 months with brownfield expansions across their operations as well as an acquisition in the USA.

Outlook

We remain most optimistic about the energy sector as well as the outlook for base metals in the years to come. The Fund is heavily exposed to these commodities through high-quality mining companies trading at attractive valuations.

Portfolio managers
Nicholas Stein and Nicholas Hops
as at 30 September 2023