TERRACAPITAL

NATURAL RESOURCE FUND

MAY 2017

	1M	3M	FYTD	1Y (rolling 12mths)	3Y (p.a.)	Inception (p.a.)	Inception (cumulative)
Terra Natural Res. Fund	-4.1%	0.3%	9.7%	17.7%	21.7%	23.6%	324.5%
ASX All Ords	-2.6%	1.3%	12.8%	10.2%	6.2%	9.0%	80.0%
ASX 300 Mining	0.9%	-1.9%	28.0%	32.4%	0.4%	-2.0%	-12.7%
ASX Small Resources	1.6%	-5.1%	3.6%	13.0%	-1.2%	-11.1%	-55.3%
Unit Price	$ 2.88						

Terra Capital Natural Resource Fund movements are shown after fees. Inception: 1st July 2010

FUND PERFORMANCE

During the month the ASX 300 Metals and Mining was up 0.9% and the ASX Small Resources Index was up 1.6%. The ASX All Ords were down 2.6% for the month. Against this backdrop the Fund was lower 4.1%.

The Unit Price is currently $2.88

AUSTRALIAN MARKETS OVERVIEW

It was a brutal month for Australian equities as they suffered their largest monthly decline since Jan-16 (-5.5%). The ASX 200 fell -3.4%, driven by a -9.8% correction in Banks (ANZ (-12.1%), CBA (-8.9%), NAB (-8.5%) and WBC (-10.3%)) following the announced Bank Levy proposal in the Federal Budget and reinforced by rising concerns on the housing outlook and some mixed earnings results (subdued underlying revenue growth).

The market was also dragged down by REITS (-0.7%) (as retail concerns continue to weigh on WFD in the US and domestic retail heavyweights – VCX and SCG). Healthcare fell -2.4% (CSL -2.5%) with retail down a substantial -9.3% (down 18% YTD). Retailers – MYR (-22.1%), HVN (10.1%), JBH (-6.4%)- were hit hard by disappointing retail sales figures (ABS showed a 0.1% fall over March); increasing concerns on Amazon's pending entry into Australia; and news that Top Shop (which is partly owned by MYR) was placed into voluntary administration (adding to the growing number who have collapsed including – Marcs, David Lawrence, Pumpkin Patch, Payless Shoes, Herringbone and Rhodes & Beckett). Within Staples, WES (-0.7%) blamed poor equity market conditions for canning the IPO of its Officeworks business.

Gains came from Industrials (+4.7%), Telcos (+3.4%), Energy (+1.5%) and Utilities (1.0%), while Miners managed to shrug off another fall in the iron ore price to US$59/tonne – the Materials (-0.2%) finished relatively flat although the strongest returns came from outside the miners (led by BLD +11.2%, ORI +7.5% and DLX +5.9% and offset by CSR -14.9%, JHX -13.6% and FMG -8.7%).

The MidCap50 was the strongest size category with a total return of +0.85% (price return +0.7%), while small caps significantly outperformed their large cap counterparts. The Small Ords finished the month down –2.10% vs. the ASX20 leaders, down -5.76%.

GLOBAL MARKET OVERVIEW

Elevated political uncertainties (French election, Trump impeachment rumours, UK terrorist bombing) coupled with a downgrade on China's sovereign rating, and OPEC's decision to extend output cuts, made for a choppy May.

In aggregate, global markets traded through the uncertainty (MSCI World rising 1.6%), perhaps in part resting on the solid underlying economic data rather than the rising political uncertainty. However, rising daily volatility is perhaps an indication that markets are becoming less immune to changing circumstances as central banks continue to talk of a winding back in monetary policy support. Financials were weak across the developed world.

Volatility persisted in Asia, too. China shares initially rallied as President Xi Jinping's proposal of an international infrastructure program overshadowed data showing slower growth in factory output and investment. The markets soon after retreated, following Moody's downgrade on China's sovereign ratings to A1 from Aa3 (the first downgrade time since 1989), before recovering again towards the end of the month. As at month-end, the Shanghai Composite slipped -1.2%, while the Hang Seng remained at its highest level since Jul-15, finishing the month up +4.3%.

Japan was a big winner through May with the Nikkei rising strongly despite a substantial move higher in the JPY post stronger retail sales and steady unemployment data that pointed towards a stabilizing economic backdrop. The Stoxx Europe gained +1.6%, and emerging markets (+2.5%) outperformed their developed counterparts (MSCI World +1.6%).

COMMODITY OVERVIEW

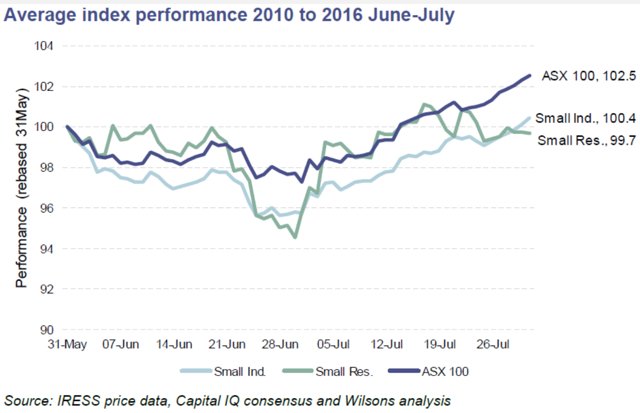
May was a weaker month for commodity markets. Amongst the base metals, Nickel and Zinc were both down -5.1% and -0.9%, respectively, while there were small gains from Aluminium up +0.9% and Copper was down -1.1%.

Precious metals were mixed - Silver up +0.6%, and Gold relatively steady at -0.2%. Iron ore dipped below US$60, finishing the month at US$59, down -12.6%. More volatility in ore prices than usual reflected sharp rises and falls in Chinese steel amid mixed assessments on demand and inventories.

Oil prices came under renewed pressure despite the agreement by OPEC and non-OPEC producers (including Russia) to extend output cuts until Mar-18. Fears are high that production cuts will not be enough to offset the addition from US shale producers who are now ramping output and who are looking through the production cuts post the nine month window. Brent finally settled at $51.2/barrel (down 1.3% for the month) after swinging between ~$48.70 and ~$53.60.

PORTFOLIO COMMENTARY

As mentioned in the market commentary above, yet again, May was a brutal month for equities. There's the seasonal North American beginning of summer as well as tax loss selling in Australia which together create a vortex, inducing sellers and sucking buyers out of the market.



Every year we try to take advantage of this by buying stocks when they're sold down in situations where fundamentally, they shouldn't. This often creates the situation where the Fund performance is strong in the September quarter and I think it should be this year as well.

Whilst pointing out its no guarantee, Morgan Stanley's chairman and chief executive James Gorman agrees with our sentiment on the global economy, as quoted in the AFR:

"I think the US economy is doing quite well. The obvious strengths are the housing market has recovered, state administrable finances are in better shape than they were post-crisis, the banks have recapitalised, unemployment is now at 4.5 per cent, GDP growth is around 2 per cent, the markets are at record highs creating a wealth effect."

"Global economic growth is pretty impressive. Japan is growing for the first time in 30-plus years, Europe has recovered, and Germany is doing really, pretty well."

"Despite Brexit, the UK and the rest of Europe are doing well. China's still growing, they said at 6.9 per cent – if it's 6 per cent it's good, and the US has recovered, so the economic backdrop is really pretty impressive."

"So, some confirming facts [to look out for]; Prime Minister May's election, Fed raises rates, runs on the board by the new administration, and less noise and less anxiety about some of the geopolitical stuff around North Korea – a few confirming facts and I think we're in pretty decent shape."

Whilst we're not in the market blindly buying stocks, ignoring the macro, I find it interesting to read so much negativity in the financial press when I agree with Gorman's comments around the health of the global economy. This brings to mind an interview I listened to recently with Marc Andreessen of Andreessen Horowitz, one of the world's most successful venture capitalists. As part of the stimulating interview, which you can listen to HERE, Andreessen talks to the theory in economics which economists call the depression baby effect.

Without going into too much detail the theory came about after some investors who were in the stock market in 1929 never went back into the stock market. They stayed out of the market for the rest of their lives because 1929 proved definitively that stocks are fundamentally unsafe. The point is that if you live through one of these scarring crashes, you get psychologically marked. Everybody is traumatized. It's not just the investors. It's also everybody who follows the market. It's also people who write about the market. It's also the people who work at the companies. Everybody gets traumatized.

This leads to people thinking there's going to be another stock market crash around the corner when really the GFC was a once in 20 year event and because of the proximity of the last crash many are erroneously placing too high a probability on a similar event occurring in the near term.

The read through is that while some stocks are currently overpriced and caution should be used, there are lots of great businesses out there which are undervalued and good stock picking, which is what we have always prided ourselves on, should prevail in the current market conditions.

In addition we have some significant thematics playing out in the metals and mining space. Speaking at the Bank of America Merrill Lynch Global Metals, Mining & Steel Conference in Barcelona recently, Ivan Glasenberg said government policies and transformational shifts in technology had accelerated the economic breakeven point for electric vehicles and electric storage systems.

"The electric vehicle revolution is underway and its impact is likely to be faster than expected – potentially creating material new sources of demand for enabling underlying commodities," Glasenberg said in his presentation.

As well as cobalt and lithium, he also cited copper, nickel and manganese as metals to benefit.

Glencore is already one of the world's leading producers of cobalt, nickel and copper, with the recent jump in cobalt making it the company's top four earner behind coal, copper and zinc.

Glasenberg noted that the commodities that would fuel maturing commodities were changing.

"The looming EV/ESS revolution looks set to unlock material new sources of demand for enabling underlying commodities," he said.

Glencore said almost all automotive players were accelerating their investment in, and adoption of, EV technologies, as governments around the world set aggressive emissions targets.

Glasenberg said the impact of electrification per vehicle was around 160 kilograms of copper, covering the battery, charging point and car itself.

If major countries meet their targets of 13.4 million EVs by 2010 and 52 million by 2025, that would have a drastic impact on metals, he said.

The 2020 target equates to an additional 373,000 tonnes of annual copper demand and 40,000t of nickel demand.

By 2025, those numbers would grow to 1.65 million tonnes of copper and 210,000t of nickel.

A scenario in 2035 where around 95% of global cars were electric would require more than 20Mt of copper, 1.8Mt of nickel and 679,000t of cobalt.

Glasenberg said this would present a challenge for the copper market, which was fighting aging assets, declining grades and a lack of investment.

He said copper supply would peak next year and decline thereafter at a 3.5% compound annual growth rate with no investment, with the copper project pipeline below pre-super-cycle levels.

More broadly, in the short-term, Glencore believes there is scope for "cautious optimism".

"Despite market concerns around Chinese monetary tightening, a repeat of the extreme weakness seen in 2015 appears less likely given stronger external demand and higher private sector investment."

Glencore estimates demand to grow across most commodities this year, with a forecast 4% CAGR in aluminium and nickel demand.

We look forward to updating you on our progress and welcome any feedback.