TERRACAPITAL

# NATURAL RESOURCE FUND

## MONTHLY REPORT – JULY 2015

| | Terra Res. Fund | ASX All Ords | ASX 300 Mining | ASX Small Res. |
|---|---|---|---|---|
| 1 Month | -14.8% | 4.2% | -3.0% | -9.0% |
| 3 Month | -8.7% | -1.0% | -11.7% | -18.5% |
| FYTD | -14.8% | 4.2% | -3.0% | -9.0% |
| Incept (p.a.) | 23.3% | 10.1% | -6.8% | -19.8% |
| Unit Price | $1.70 | | | |

## FUND PERFORMANCE

During the month the ASX 300 Metals and Mining lost 3.0% and the ASX Small Resources Index lost 9.0%. The ASX All Ords was up 4.2% for the month of July. Against this backdrop and after one of our larger holdings completed a heavily discounted rights issue, the Fund was lower 14.8% in July.

We find the timing of the aforementioned rights issue highly frustrating, especially coupled with the sell-off in commodities, however we remain confident in the story and expect to see a rebound over the coming months.

The past few years have presented periods of turmoil in both commodities and mining and energy equities. In saying that, the unit price has always recovered strongly in past years. For example from May to July 2012 the fund lost 17.0% to subsequently gain 32.6%, from April to June 2013 the fund lost 33.9% to subsequently gain 50.6% and from November 2014 to January 2015 the fund lost 16.3% to subsequently gain 30.4%.

These tumultuous times in the sector have afforded us fantastic buying opportunities in the market and this has in turn provided investors very attractive unit prices in the Fund for investment or re-investment.

At this time we are confident, given the high quality nature of our holdings that a similar recovery will take place over the coming months.

The Unit Price is currently $1.70.

## MARKET OVERVIEW

The S&P/ASX300 Accumulation Index returned +4.3% in July (CYTD +7.6%). The Market ex Resources (+5.5%) outperformed Resources (-2.0%) led by Healthcare (+9.4%), Consumer Staples (+7.5%) & Insurance (+6.8%).

Greece was again a key focus of global equity markets. After securing a “no” vote in a referendum on its creditors’ proposed reform package, the Syriza-led government subsequently caved in, agreeing to rush through long resisted economic reforms in order to access a new €86bn bailout and stay in the Eurozone. However, negotiations were continuing at month end and with still no agreement reached on key issues such as debt relief. European equity markets were generally stronger (German DAX +3.3%, France CAC40 +6.1%, Italy MIB30 +4.8%), supported by positive earnings reports and M&A activity.

China’s equity market volatility continued. The Shanghai Composite Index (-14.3%) experienced its biggest one-day fall in over 8 years during the month with more than 60% of all stocks suspended from trading after falling by the daily limit. The government was quick to react to the selloff, announcing a range of unconventional measures including a ban on short selling and IPO’s, forced share purchases by state-owned investors, a ban on sales by major shareholders and direct credit support from the central bank. Concern around broader economic impacts mounted as PMI readings contracted for a fifth consecutive month.

## Commodity Overview

When it comes to commodity prices these days, when it rains it pours. Commodity markets were weak in July on the back of the deteriorating outlook for China and sluggish pace of global growth.

Brent oil fell ~18% over the month with accelerating production from OPEC and expectations of additional supply from Iran also weighing on prices.

Elsewhere iron ore was down ~8%, copper off ~10%, and gold ~7% lower. Commodity currencies came under pressure, the A$ and CAD both depreciating ~5% against the US$.

Many commodities have now retested multi-year lows – a six year low for copper, nickel and aluminium, and a twelve year low for steel hot rolled coil. Coking coal and oil, are also flirting with multi-year lows. These are not just cyclically bad prices, these are prices more like those you'd normally associate with a major economic crisis. In terms of demand, industrial output, still the main demand driver for commodity prices, is not collapsing, even if commodity prices themselves would suggest it is.

## Outlook

The general resource market certainly looks in worse shape now than a few months ago, with commodity prices falling to their lowest level since 2009, dragging down mining and energy equity prices.

This market does evoke memories of 1999-2001, when many analysts and fund managers referred to mining as a sunset industry. They seemed to think that we would no longer need metals.

Quintana Resources Capital president Lawrence Roulston told *Mining Journal* that population growth and urbanisation were not just phenomena in China but in all parts of the developing world, and they were phenomena that required metals. These factors provided the basis for metal demand growth at an average of 2-3% per year.

On the other side of the equation, as we've written about in this report in previous months, Roulston said mine depletion implied that the industry should be replacing 5% of its productive capacity each year to keep up with demand, but low prices had nipped expansions and new mine projects in the bud, exacerbating the coming shortage.

We expected this to a degree and it's nothing new for those familiar with the nuances of the commodity cycle. But at times like these – gold: sub-US$1,100/oz, copper: sub-$5,300/t, iron ore: a smidge more than $50/t and coal in the basement – it's nice to hear a reassuring voice tell us things will get better.

The cumulative effect of multiple cycles is an increased difficulty in finding large, high grade deposits. The next generation of mines will be deeper, more remote, technically more challenging, and under increasing pressure from regulators and environmentalists. Together this means they will be more expensive and need higher prices still to justify.

"The longer the metal prices stay low, the bigger will be the eventual rebound," Roulston commented.

"The resource industry has always gone through cycles. It will continue to do so. Clearly, new mines will be built over time. The juniors that are finding and developing new mines are generally out of favour at this moment, but that will change, as it always has."

He said investors who had the foresight to invest at the depths of the last down cycle made fortunes into the billions of dollars.

"The really astute investors are the ones who buy at the bottom of the market, in the depths of the depression, when others are totally avoiding the mining industry."

Roulston said there were smart investors, including Quintana, putting money into mining right now, knowing that its cyclical nature points to serious future multiples on the right investment.

Interestingly a report in the AFR ($6^{th}$ August) says Glencore has resumed discussions about Rio Tinto's Australian coal assets. According to the report Glencore is going up against Mick Davis' X2 Resources which has been in "serious" talks to acquire Rio's Hunter Valley mines for months.

I must say it's encouraging to hear this given X2 is currently yet to make its first acquisition and this would be highly positive for the sector.

We thank you for your continued support.