Performance and fund positioning

The Fund returned -2.4% for the quarter and 7.6% for the last 12 months. The long-term performance of the Fund remains stong against both the peer group and the benchmark.

In the quarter the Fund benefited from being underweight Sasol, AngloGold and Anglo American, whilst being overweight African Rainbow Minerals (ARM) and Northam detracted. For the year to date, being underweight the Platinum Group Metals (PGM) sector has contributed strongly to performance.

Key trades in the quarter were adding meaningfully to our Anglo American position after it sold off nearly 30% following the failed takeover bid by BHP. We also added to Impala and Northam. On the back of continued gold price and equity strength, we sold down AngloGold and Pan African Resources. Encouragingly, the Fund has been able to outperform the benchmark in the last few years despite being on the wrong side of the large gold rally.

A key change in the last three to six months has been the Fund's exposure to PGMs. By the end of the quarter, we had moved to an overweight position in pure-play platinum stocks, which is amplified by look-through PGM exposure in ARM and Anglo American. Whilst we do not run the Fund with a focus on benchmark weightings, which is clear from historical positioning, it is helpful in this instance to understand our change in view. Commodities are the epitome of a cyclical industry and changing ones mind from an investment positioning perspective happens on a regular basis!

The last few years have been challenging for the PGM sector and disappointing for equity investors as an inventory-driven oversupply has brought down metal prices materially. Combined with cost pressures and shareholder unfriendly capital allocation, the experience for equity holders has been very poor. Equity prices are down dramatically from their 2021 peaks. From their highs in 2021 to the lows of 2024, when we started buying, the PGM share prices declined by 67%-81%. We felt the market moved from extreme optimism to extreme pessimism and have been taking advantage of low prices at present. Within this portfolio, we had been massively underweight the PGM equities since December 2022.

Pro-cyclical behaviour by the majority of PGM producers has amplified value destrucution in the last few years. High prices brought about new projects as well as poorly timed M&A. Tens of billions of rands worth of shareholder capital was invested in these ventures instead of being paid out to the shareholders who supported the industry in the downcycle. Large impairments have followed these investments, confirming the capital destruction we have seen. We think it is unlikely that this kind of behaviour is going to change in the long term, at the sector level. Any individual PGM producer that is able to invest and behave countercyclically will create a lot of value on an absolute basis and certainly relative to its peers.

Reduced profitability is starting to have an impact on supply as high cost shafts and companies come under presure. We have seen projects shelved as well as the announcement of mine closures, particularly those that are palladium heavy. While this tends to hurt at the individual company level, it signals an improving outlook at the sector level from a supply and demand perspective. We have also seen a slow recovery in PGM supply from recycled catalytic converters and we believe it could continue to be constrained in the medium term; which improves the outlook further.

Finally, from a market perspective, we have seen BEV growth falter while plug-in hybrids (which are neutral from a PGM point of view) have grown strongly. A lack of affordable low cost models has meant that, outside of China, BEVs have not been able to successfully penetrate the mass market. In the long term, these models will come to the market but with a moderating of political pressure it looks likely that car manufacturers will focus more on hybrids in the next few years. On a long term basis, we think that BEVs will continue to grow and thus there is a lot of uncertainty surrounding market balances, with risk to the downside for the PGM sector.

While the fundamentals over the medium term have been improving, we have seen the metal and equity prices continue to deteriorate. For us, this represents a compelling opportunity given our ability to look through the current market noise. Our concerns over the very long term remain and we have taken this risk into account through position sizing. The long-term risk of BEVs is compounded by the shareholder unfrienly capital allocation we have seen in recent years and also expect in the future. Whilst mining companies on the whole have not covered themsevels in glory in this regard, the PGM sector has been particularly disappointing.

Within the portfolio, we have bought Northam and Impala, where we think the risk to reward is most in our favour. The downcycle may extend for some time still, given the inherently uncertain nature of calling the bottom in any commodity cycle. Outside of PGMs, we are more optimistic about the Fund's exposure to the companies outside of the diversified sector. We see a lot of value in businesses like Grindrod, HCI, Mondi and Whitehaven Coal in contrast to the diversified miners and the gold sector.

Portfolio managers
Nicholas Hops and Nicholas Stein
as at 30 September 2024