

“MINING SECTOR FUNDAMENTALS ARE STRONG”

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The fundamental backdrop to the metals commodities and mining equities is very positive. Demand for metal commodities is strong, the supply/demand picture is favourable, metal prices are firm and the mining industry has limited capacity to expand production in the near term to meet the improving demand.

Global economies are experiencing a coordinated period of accelerating growth with good breadth as both advanced and emerging economies are participating. The J. P. Morgan Global Purchasing Manager Index chart below illustrates the robustness of the trend to global growth.

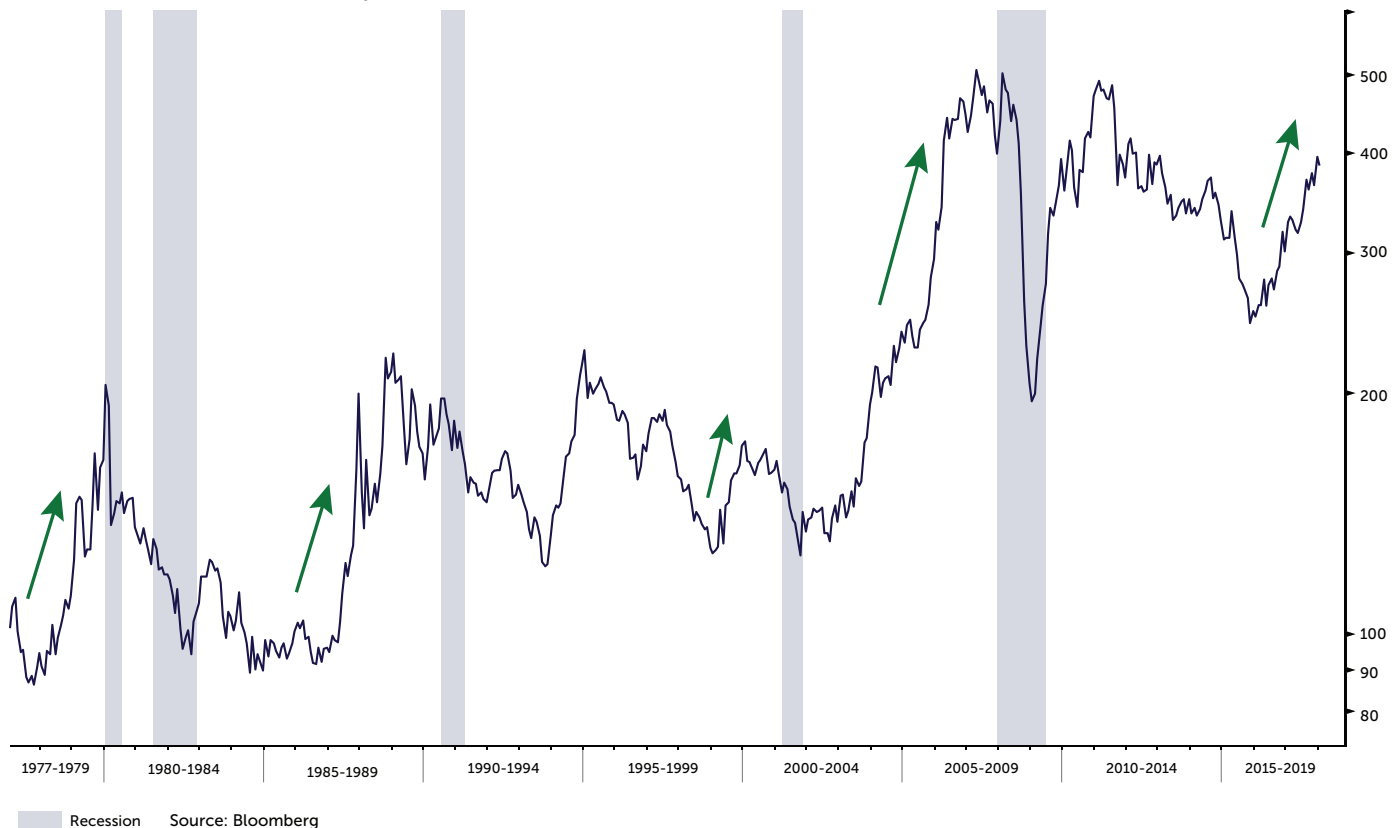


As can be seen in the above chart global growth has been improving since the middle of 2016 and gained further momentum in 2017. The economy is in the latter stages of the economic cycle which is characterized by firm labour markets, rising interest rates, strong commodity prices, increases in capital spending and rising inflation. As a result of the sustained improvement in economic growth capital spending has begun to expand as companies increase capacity in response to rising demand. This economic environment is very positive for cyclical stocks particularly the mining sector where a combination of firm metal pricing and expanding demand dramatically enhances cash flow and earnings.

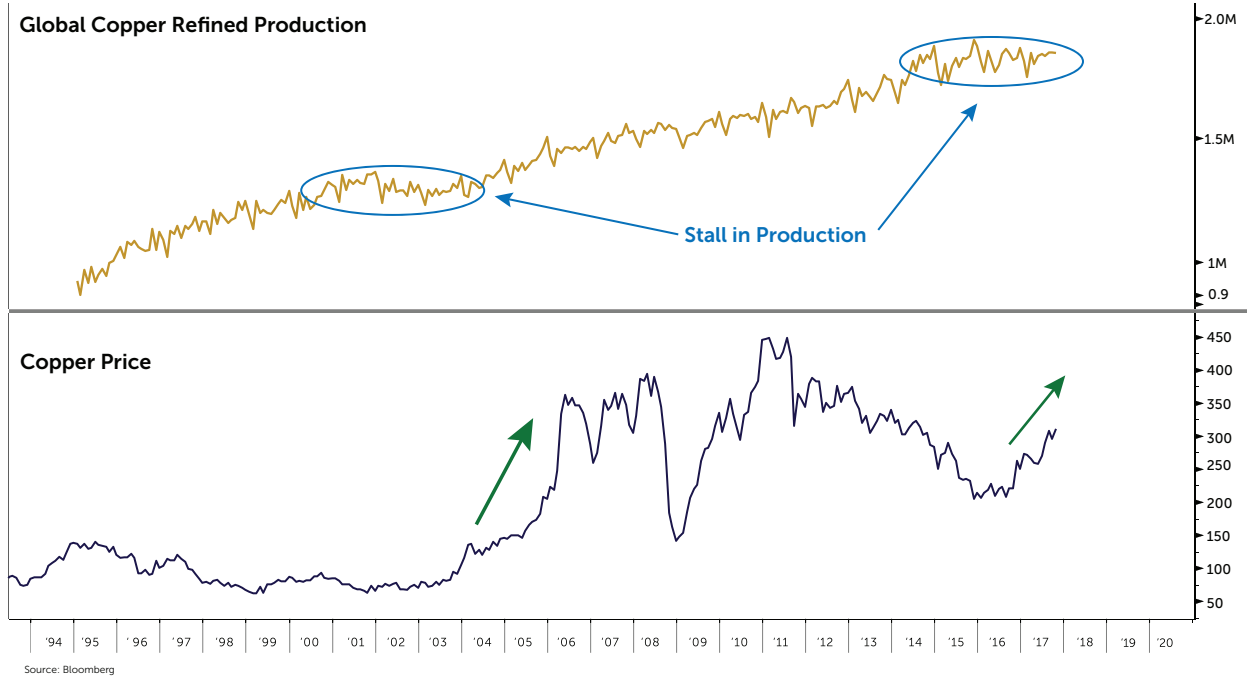
Metal commodities are very sensitive to increases in capital spending particularly when inventory levels are relatively low as they are today. The chart below shows the S&P GSCI Industrial Metals Spot Index. Note how industrial metal prices rally strongly in the latter stages of the economic cycle.

While the demand environment for metal commodity pricing is very strong the metal supply side of the equation is equally bullish. The mining sector suffered a severe down turn between 2011 and 2015 as it adjusted to the over-supply of metal commodities following the capacity buildup due to strong Chinese and Emerging market demand.

S&P GSCI Industrial Metals Spot Index

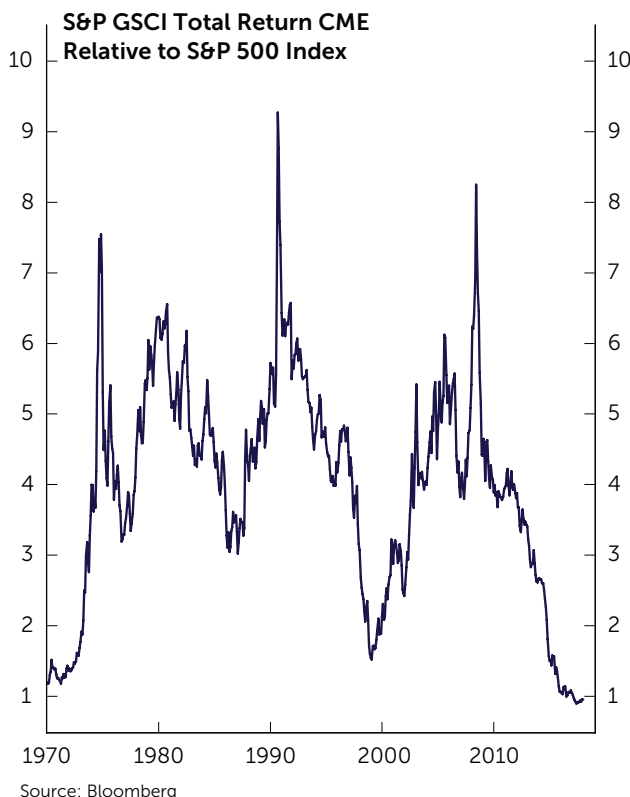


In response to this weak period for metal commodities, the mining industry dramatically cut capital expenditures, rationalized operations and high graded mine production in order to enhance cash flows. As a result production capacity stalled and inventories declined. The chart below illustrates that following periods of flat growth in the production of Refined Copper the Copper price stages a strong rally as supply/demand improves.



Due to high grading of mines in the past few years the industry’s ability to expand production from existing operations has been to a great extent impaired. Therefore the ability of the industry to respond to incremental increases in demand is limited. As a result we have a perfect storm for metal commodities where inventories are relatively low, demand growth is expanding and the industry has a limited ability to respond with increased production in the near term. Copper and zinc are our most favoured commodities due to their strong supply/demand characteristics. In this environment however all metal commodities will experience a firming of prices.

Investors have not embraced the mining sector due in major part to the relatively weak performance of metal commodity prices versus the equity markets over the past few years. The chart below shows relative performance of metal commodities compared to the S&P 500 Index and how extreme this underperformance has been. Given the “perfect storm” scenario outlined above we believe the metal commodities and the mining sector stocks have the potential to strongly outperform for the balance of the economic cycle.



The fundamental prospects of the mining sector have strengthened over the past few months due to a combination of improving global economic growth and firming in metal prices as supply/demand balances tighten. We expect earnings and cash flows for the sector will continue to recover at an exceptional rate of growth due to both higher volumes and better pricing. We believe investors will take notice of these strong fundamentals as the results are reported over the next few months and we expect the mining sector stocks will perform strongly as a result.

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