Global Resources

Quarterly Review and Outlook

As at December 2016

Key Highlights

- Global resources equities recorded positive returns in the December quarter.
- Commodity prices have generally increased after bottoming early in the year, driven by Chinese infrastructure.
- We maintain a positive view towards most base, bulk and energy commodities, with our preferred exposures being zinc, steel, thermal coal and oil in the near term.

Market Review

Global resources equity markets recorded positive returns in the December quarter, although results were mixed. Base metals prices broadly increased, led by copper. Stronger global manufacturing data, robust Chinese construction activity and increased prospects for US fiscal stimulus following Donald Trump's US presidential election win boosted demand. The US Federal Reserve's highly anticipated decision to raise interest rates in December saw sentiment towards precious metals decline. Iron ore climbed to its highest level since October 2014 as steel prices continued to rise. Prices for both coking and thermal coal declined from abnormally high levels as Chinese output curtailments were relaxed. Oil prices rallied as OPEC and non-OPEC producers reached an accord to cut supply from early 2017.

Strategy Performance and Positioning

The strategy rose by 1.9% in SGD terms, while its benchmark increased by 1.2%.

The strategy's diversified metals and mining holdings show as the largest contributors to performance. **Anglo American**, **BHP Billiton**, **Glencore, Rio Tinto, South32** and **Teck Resources** have all aggressively reduced operating costs and capital expenditure plans. Those with high debt sold assets and/or raised capital to strengthen their balance sheets. Recent improvements in commodity prices has accelerated their ability to pay down debt and in many cases reduced the need for additional asset sales.

Government and company policies to curb production have tightened the coking coal, nickel and zinc markets. Glencore, South32 and Teck are most leveraged to this commodity mix and their share prices have appreciated. We prefer these names to BHP Billiton and Rio Tinto. While BHP has enjoyed some exploration success with its oil and gas assets in the Gulf of Mexico, we have some lingering concerns around the ongoing investigation into the Samarco tailings dam incident in Brazil. While we have been impressed by Rio's operational improvements, stronger balance sheet and better growth profile, concerns remain over an investigation into payments made by the previous management related to the Simandou project in West Africa.

The strategy's exposure to copper equities was increased over the quarter, reflecting improving market fundamentals. Dr. Joanne Warner visited four copper mines in Chile during December. This included **Antofagasta's** operations - Los Pelambres, Centinela and Antucoya – in December. Management presentations focused on ongoing optimisation and efficiency programs that have reduced unit costs by around 8% YoY, moving Antofagasta from Q3 to Q2 on the copper cost curve. The company remains committed to its expansions at Los Pelambres and Centinela.

Los Pelambres (see Figure 1 below) is Chile's fifth largest copper mine and one of the lowest cost. They move over 140 million tonnes of waste rock and ore each year, high in the Andes. During the winter avalanches have to be controlled to protect the operations and the ore is conveyed through 12km of tunnels through the side of the mountain down to the plant site at lower altitude. The open pit appears very well managed, but geology is a challenge as the grades decline and the hardness of the ore increases over the 21 year life of the mine. The company is working to mitigate this with advanced blasting techniques, better grinding in the mill and longer term through a plant expansion.

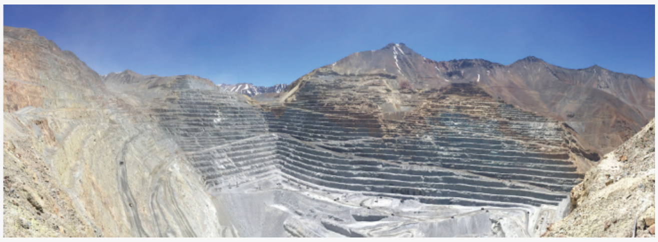


Figure 1: Antofagasta's Los Pelambres open pit is 800m deep and 2km wide.

Figure 2: Lundin Mining' Candelaria Open pit near Copiapo, Chile.

The site visit to Centinela focused on the US$190 million in cost savings achieved over the past 2 ½ years, as the sulphide plant finally reaches design capacity. Good progress is being made at the molybdenum circuit and Encuentro Oxides projects. Achieving design throughput at the sulphide plant is a key milestone which should allow for unit costs to fall from the US$1.35/lb copper achieved YTD.

Dr. Warner's visit to Candelaria (see Figure 2 above) re-affirmed our high conviction in Canadian-listed base metals producer **Lundin Mining**. Mine management is energised to continue to cut costs and optimise the ore body in order to justify investment in a future expansion. The proposed sale of Lundin's stake in Tenke (Democratic Republic of Congo) could provide the capital required to fund this. Currently three underground mines produce some higher grade material to supplement the bulk of the ore coming from the open pit. Production will continue until at least 2032, although the mine has excellent potential to grow if it is possible to negotiate with local copper miners to consolidate their landholdings and operations. There are numerous small to medium scale operations in the district, mostly owned by Chilean families with a long history of mining.

Gold stocks were strong performers over the first half of 2016, but gave-back some of these gains into year-end as the gold price declined in a rising US interest rate environment. Canadian-listed miners **Detour Gold**, **Goldcorp** and **Franco-Nevada** all detracted value.

Detour Gold's share price declined after the release of a disappointing Q3 2016 result and 2017 outlook. Unusually heavy rainfall lead to pit flooding at its Detour Lake mine delaying access to the higher grade calcite zone. Potential permitting delays with the potential higher grade West Detour development compounded negative sentiment. We believe the market reaction is overdone and that the current valuation is attractive relative to Detour's peers. Detour is a long-life, low-cost Canadian producer capable of producing over 500,000 ounces per annum, generating meaningful cashflow. It remains a potential takeover target for a larger gold producer.

Senior gold producer Goldcorp was weighed down by the declining gold price. Under CEO David Garofalo, Goldcorp continues to restructure its operations and divest assets in an attempt to improve efficiencies. While setting more achievable production targets, management are also cutting costs with a long term target of US$250 million in annual sustainable savings by 2018. Our senior analyst Pete Campbell will be in Toronto for their Investor Day in January.

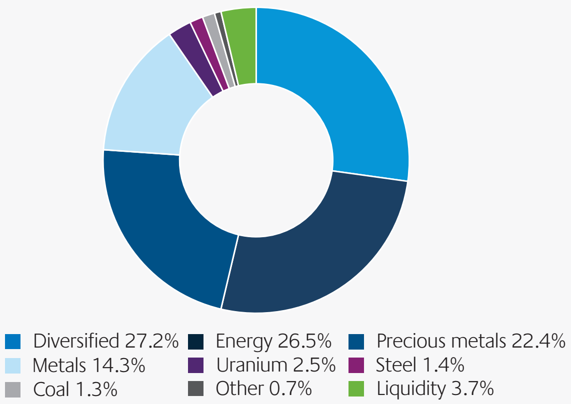
We consider Franco-Nevada to be one of the industry's highest quality precious metals royalty companies with strong long-term growth potential. Recent Q3 2016 results were better-than-expected, boosted by the strong performance of its Antamina silver stream located in Peru. Management increased its guidance for gold sales and oil revenue. Its net cash position improved. Franco recently agreed to purchase US$100 million royalty rights in the STACK shale play in Oklahoma's Anadarko Basin, further diversifying its portfolio. Despite the more challenging macro backdrop for precious metals, Franco should offer more downside protection than it's more financially levered and less diversified peers. The company continues to deploy capital and has ample liquidity to pursue future growth accretive transactions.

Although stocks are selected using bottom-up fundamental analysis, the fund is committed to diversification by sector and geography. The charts below show the **sector diversification** of the strategy as at 31 December 2016. Its largest exposures are to diversified metals and mining, energy and precious metals producers. The subsequent chart shows the sector contributions to fund performance over the period.

The charts on the next page show the **country diversification** and **contribution** to the strategy performance over the quarter. The geography is based on the stock's country of listing, not the domicile of the underlying assets. The largest exposure is to Canada and is generally constituted of small and mid-cap precious and base metals companies. The exposure to Australia is mainly comprised of large diversified mining companies, **BHP Billiton** and **Rio Tinto**. This is followed by the US which largely reflects the fund's holdings in a number of energy companies, such as **Exxon Mobil** and **Chevron**. The contribution outcomes in the December quarter generally reflect the divergence in oil and gas (the US) and precious metals (Canada) commodity prices.

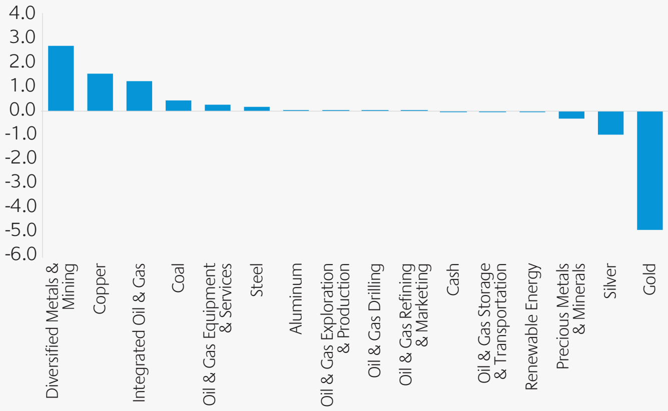
The strategy's geographic allocations result from balancing two factors. The first factor is portfolio diversification. We are conscious of the fact that diversification is one of the most important tools for ensuring portfolio risk and return is optimised. The second factor is political risk. Mining and energy projects require significant capital investments and once the capital has been spent, the project is immobile. Countries with superior track records of stable fiscal, labour and social environments are much lower risk domiciles for these immobile assets. Hence, the fund is diversified by geography, but with a tilt towards assets in lower risk jurisdictions like Canada, Australia, and the US.

Sector Diversification (%)



Source: First State Investments as at 31 December 2016.

Sector Contribution (%)



Source: First State Investments as at 31 December 2016.

Market Outlook

Commodity prices have generally increased after bottoming early in the year, driven by Chinese infrastructure led demand growth, backed-up by growing reflation expectations in the developed world. Supply growth has also slowed after several years of declining capex.

Mining companies have taken advantage of the bounce in raw materials prices to strengthen balance sheets and reinstate dividends after years of declining commodity prices. We believe the sector is attractive over the long term as free cash flow increases and financial flexibility improves, paving the way for a more robust business and earnings outlook.

We maintain a positive view towards most base, bulk and energy commodities, with our preferred exposures being zinc, steel, thermal coal and oil in the near term. The macro outlook for precious metals may be challenging if we continue to see a trend of rising interest rates in the US.

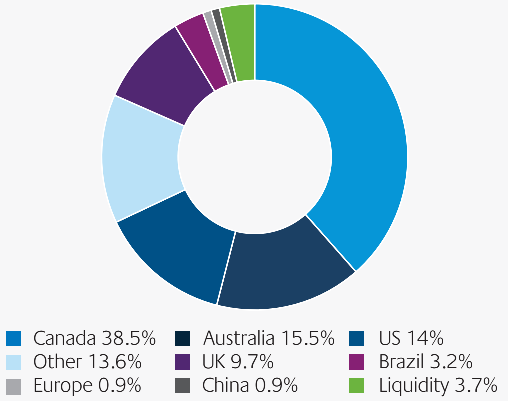
We have been increasing the fund's weight to the energy sector in recent months after some profit taking following a strong run in metals and diamonds prices. Sentiment has improved towards oil and gas stocks on OPEC and Trump headlines.

At this early stage in the cyclical recovery, large cap miners and energy producers need to continue to demonstrate capital discipline and to maximise free cash flow. Amongst the mid-cap and intermediate producers, high asset quality, low costs and balance sheet strength are qualities that we emphasise. Smaller companies are inherently higher risk, but catalysts such as exploration success, permitting and development, or operational turnarounds are drivers of the 'acorns' or small cap stocks in the portfolio. We believe these types of catalyst-rich names will increasingly be of interest from an M&A perspective.

Investment philosophy and process

Thank you for your support through what has been another volatile year. We remain committed to an investment philosophy that has remained consistent throughout the fund's almost 10-year life. The portfolio continues to be managed by one of the sector's longest-standing natural resources teams, led by Dr. Joanne Warner and co-managed by Mr. Tal Lomnitzer. We believe that focus on quality, and visiting the assets we're invested in, provides you with the best risk-adjusted return through the good times as well as what can be very trying times. This is a cyclical sector and after the downturn of the last 5 years, we believe the sector is well positioned for a brighter future.

Country Diversification (%)



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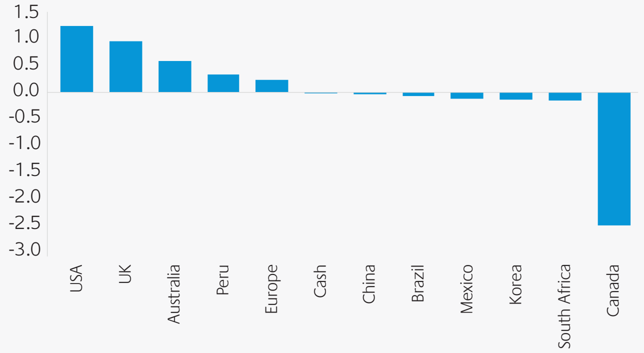
Country Contribution (%)



Source: First State Investments as at 31 December 2016.