



FLASH REPORT

Global Resources Update

Commodity related investments had negative returns as the extent of the US economic slowdown became more apparent and began expanding around the globe. Equally important, and likely much more temporary, has been the sharp appreciation of the US dollar, the currency in which all commodity contracts are quoted. The dollar's increase made all commodities suddenly cheap, which also negatively impacted commodity related equities.

At Newgate, we do not believe the dollar's rise has been warranted by fundamentals. The US Treasury, along with other central banks, have been printing money to stave off the most severe aspects of the coming recession. All this printing, especially in the heavily indebted United States, should be inflationary, increasing commodity prices. Why did the dollar rise, reducing the value of other assets, including commodities and commodity related equities?

One of the primary reasons continues to be the incredible unwinding of leveraged investors and hedge funds. These funds borrowed money in US dollars (and Japanese Yen) at very low interest rates and purchased other investments. Commodity related investments were a common purchase, given the strong fundamentals of these markets. However, as even these markets began to falter this summer as the economy slowed, the reversal of this trade was sudden and severe.

Oil prices fell sharply in October, down over 30%, but oil stocks had significantly better performance, although still negative. Energy related stocks are trading at a significant discount to the broader markets, generally have relatively low debt and have had record earnings. It is likely that these earnings

will be reduced given lower prices, but relative to other aspects of the market, they remain attractive. Many investment strategists are now recommending allocations to this sector given the relative stability of their business and low leverage on their corporate balance sheets. During the month, we increased allocations to this sector, especially to natural gas focused production companies. We also increased allocations to integrated oil companies, which have refining businesses that benefit from lower crude prices.

The metals sector is highly economically sensitive and had declines over the past few months. Most industrial metals companies declined essentially in line with their underlying commodity prices. Copper and zinc were both down over 30% in October. Gold declined only 18%; we say only because given the prospects of future inflation, it is somewhat surprising that gold was down at all.

Traditionally defensive sectors like agriculture, and even pulp and paper companies, which did not participate in the commodity bull market, still declined by more than 10%. The fertilizer companies in the portfolio declined, despite record profits and the increases in fertilizer prices.

October was frustrating for investors across all asset classes. Yet we remain confident in our portfolio and its strategies for several reasons.

1) Stocks appear to now be reflecting a very severe economic slowdown. As usual, the financial markets are ahead of the economic figures. This also means that the stock market should begin to rally before we see improvement in official statistics.

2) Governments around the world are taking strong action to support the global economy.

3) Infrastructure spending is likely to increase, especially in the US, which will use infrastructure as a way to stimulate the economy.

4) Prices in many commodities are so low that production cuts have begun, most notably in oil producing countries. OPEC has already called for production cuts of 1.5 million barrels of oil per day; future cuts are almost guaranteed. At prices below \$70, oil production in parts of Canada and Venezuela are not economically viable. These prices are not high enough to stimulate increased production in places like

Russia and Mexico. As a result, we are likely to see shortages as soon as next summer. A similar situation is likely to take place in other materials, though perhaps not to the same degree.

During the past few months, we have experienced unprecedented volatility in the financial markets overall, and in our portfolio in particular. We continue to invest in high quality companies that are involved in essential businesses. Global economic slowdowns do not change the basics of these businesses. The world still needs oil for its cars and trucks, coal to generate electricity, food on its tables and metals to build its infrastructure. Those concepts, not ever rising commodity prices, have always been the basis for this portfolio. Thank you for your continued support. ♦