



NEWGATE
CAPITAL MANAGEMENT LLC

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FLASH REPORT: GLOBAL RESOURCES

Portfolio Update

Too many signs of economic stability have been shaken recently as the markets resumed their decline after a short respite. Any good news is quickly washed away by further economic weakness. Confidence has waned due in part to impatience over announcements on plans for ensuring the solvency of the banking industry.

The most consistent bright spot has been China, which has recommitted to its official 8% GDP growth forecast. The market has also been supported by rumors of further stimulus plans, though no such plans have been announced. Commodity prices, especially base metals, have reacted positively to signs of Chinese economic acceleration and increased commodity imports. The Dry Bulk Index, the cost of transporting raw materials such as iron ore, coal and copper, rose in the first two months of the year; indicating increased demand. Newgate likes this index because it represents real prices that companies are willing to pay to receive materials, and it is therefore less impacted by market speculation or technical considerations in the futures markets.

Copper and zinc prices have increased recently on this newfound demand. Copper is up 25% from its lows at the end of December, though still down 60% from the highs of last summer. Aluminum, with large increases in inventories, only had modest declines. Base metals companies were generally higher as well, with the HSBC Global Mining Index up over 3%. The question remains, whether this demand is a short term opportunity to replenish inventories at lower prices, or if it represents a sustained increase in economic activity. We believe it's the latter, but it

is too early to know and the Portfolio is still positioned defensively with respect to this sector.

Gold prices are up sharply from their November lows, though they have fallen from the recent high of over \$1,000/oz. in mid February. Gold now acts according to global fear and the potential for economic calamity. Its price, and the price of gold mining companies, represents a gauge of fear that the economic crisis may spin out of control, but also that the actions of central banks to contain this crisis will create rampant inflation. Gold is used by some traders as an effective "short" against the US dollar. In many ways, it is the most effective position as well. For example, dollar weakness may be offset by yen weakness due to activity of the Japanese Central Bank. In contrast, gold has no central bank, and therefore no entity to stem its rise against the dollar or any other currency. Gold represents 16% of the Portfolio, a substantial increase since last fall at 4%.

Despite overall economic weakness, oil prices are advancing. Sometimes this is not obvious given the volatility, but prices are moving up. Supply has been constrained due to OPEC production cuts, with more forecast for March. Demand in the US has also started to increase and is now above weekly demand this time one year ago. While this increase in demand is no doubt helped by lower prices, year-over-year demand had been much lower from the previous period until recently. Not only are oil prices up, but so is gasoline.

Energy companies generally declined during the month. We have added to the largest integrated oil companies. An "integrated" company is one that operates in more than one aspect

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of production, typically engaging in extraction of oil and then in refining and distribution in the form of petrol and diesel. Low oil prices benefit refining companies, whether they are pure refiners or integrated companies. We recently purchased Exxon, the world's largest energy company.

Agriculture continues to be a bright spot in the Portfolio. The underlying business for fertilizer and seed companies is not really economically sensitive. Yet stock prices for these companies declined sharply last year, providing what we believe in tremendous value. We had gains in these companies despite price declines for most agriculture commodities.

Markets for commodities should be among the first to recover once some economic stability

is achieved. Commodity oriented companies may react even sooner, as these companies fell sharply once the recession became apparent. What continues to impress us is the transparency and simplicity of the underlying businesses of the companies that we invest in. The geology of a mining company may be highly complex, but its business is relatively simple. Even changes in the regulatory environment for these companies are simpler to evaluate than changes for complex businesses like healthcare and financial services. We believe that a combination of transparency, attractive valuations and the necessity of these industries in the economy will cause investors to consider the natural resource sector as they look to reintroduce risk into their portfolios. ♦

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