NEWGATE
CAPITAL MANAGEMENT LLC

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• FLASH REPORT: GLOBAL RESOURCES •

Portfolio Update

Natural resource related investments rose sharply in July. Financial markets have discounted the end of the recession, and the debate has shifted to the timing and strength of the recovery. Generally, this bodes well for economically sensitive commodities, though they have been rallying all year as the gloomiest predictions of last year proved too dire. The Dow Jones-UBS Commodity Index (former the Dow Jones-AIG Commodity Index) rose 3.2% in July and is up 8% year to date. Natural resource equities generally were up even more as the global equity market advanced.

Oil prices were largely flat during the month, depending on the grade and market. Oil is up over 50% for the year. On the surface, this is somewhat surprising since inventories are well above average and demand has been relatively flat after last year's decline. However, inventories of refined products, such as gasoline and diesel, are at normal levels. In the US, oil refineries are running below capacity for several reasons, including low gasoline prices relative to the price of crude and the effects of the credit crunch postponing expansion plans. The result is poor margins for refining companies and upward pressure on oil as refineries are expected to increase production to meet demand for heating oil.

Given the pressure on companies with large refining businesses, we eliminated pure refining company holdings. We continue to favor exploration and production companies that are attractively valued given current energy prices. Overall energy exposure remains relatively low at 38%.

Base metals had a sharp price rise in July. Copper prices went up another 11%. Chinese imports of copper year to date have already exceeded imports for all of last year. Aluminum and zinc, that rose 14.6% and 8.8% in July, respectively, experienced similar demand. The question remains how much of this demand is truly driven by end use and how much is simply restocking. Chinese companies are engaging in a mixture of both real activity and inventory building, but the size of this combined activity is enough to support the markets.

During July we re-introduced zinc companies in the Portfolio. Diversified mining companies, especially those with significant production of iron ore, remain the core of our holdings in this sector. Bulk transportation companies, both marine and rail, are still attractive and represent 3.6% of the Portfolio. Steel and gold stocks have modest allocations of 3.2 and 2.8%, respectively.

Agriculture is now 20% of the Portfolio. Demand for fertilizers has rebounded, and North American companies have been successful in opening up new markets in both Asia and Latin America. The industry is undergoing consolidation, which should reduce costs and increase profitability. We also added to agriculture to benefit from continued demand for food across the globe.

This year's sharp recovery in the Portfolio has come with relatively little improvement in underlying business and economic conditions outside of Asia. Financial markets generally, and commodity-related markets in particular, have moved away from doomsday scenarios but are not forecasting robust recovery. Nor are companies increasing production in this era of tight credit and uncertain demand. Even marginal increases in demand are likely to lead to higher prices given current conditions. ◈

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PUBLISHED BY NEWGATE CAPITAL MANAGEMENT LLC • One Sound Shore Drive, Greenwich, CT 06830
Telephone 203-661-0700 • Fax 203-661-4005 • www.newgatecapital.com