



NEWGATE  
CAPITAL MANAGEMENT LLC

September 2009

FLASH REPORT: GLOBAL RESOURCES

*Portfolio Update*

Natural resource related investments were, on average, unchanged in August. Financial markets generally were slow during August; traders were on vacation and the financial community waited (and is still waiting) for confirmation that a global economic recovery is in place. Some countries, most notably China, appear to be firmly in recovery/reacceleration mode. Other countries, most importantly the United States, appear to be recovering, but only due to unprecedented government actions. Fears persist that once unusually accommodative policies are reversed, the economy will slip back into recession. With this much uncertainty and light trading, financial markets seldom make significant moves, higher or lower. The DJ-UBS Commodity Index (formerly the Dow Jones-AIG Commodity Index) lost 0.6%. Commodity equity stocks overall rose, but not in all sectors.

There has been one development across many commodity related segments of the equity markets: increased merger activity. For the past few months there have been takeover battles in fertilizers and among the major diversified mining companies. That activity has now extended to the energy servicing sector. We believe this is only the beginning of the next wave of consolidation among these natural resource companies.

Oil prices were down slightly in August, as oil has stayed near \$70/bbl for the past few months. Inventories are still high and demand weak, which suggest lower prices. However, oil has joined gold as a hedge against global inflation and a weak US dollar. While many oil pros have been calling for declines, oil prices have remained firm due to financial buyers. The oil stocks themselves are already factoring in the current weak demand and were generally higher during the month.

Natural gas is the market that has drawn the most interest, as prices have plummeted, creating

extremes in the usual relationship between oil and gas. Many investors appear to have been long gas and short oil in order to benefit from an anticipated mean reversion of prices. However, this mean reversion has not occurred and gas prices continue to fall, quite possibly on the unwinding of such a trade. Though both are energy commodities, they are quite different in use; oil is used primarily as a transportation fuel and gas for electric power generation. There are relatively few users that can switch between these two commodities, so relatively little new demand for gas has been created by its multi-year low in prices.

We have been adding to gas exposure modestly during the current decline. Natural gas is pricing in continued declines in demand. However, supply has come down as well, and the number of operating natural gas drill rigs is down 50% from one year ago. We also reduced coal during the month, as there can be some movement away from coal to natural gas. Metallurgical coal (used in steel production) is favored over steam coal (used for power generation). Total energy exposure in the Portfolio is below 37%, low by historical standards.

Basic electric utilities were added during August, representing 4.7% of the Portfolio at the end of the month. These companies benefit from natural gas lower prices and increased interest in alternative investments such as nuclear and hydroelectric power. In addition, these stocks offer high dividends, making them attractive as investors search for safe yield in a time of low rates on government bonds and credit concerns on corporate bonds.

Base metals prices were generally mixed, with copper and lead showing gains and aluminum and nickel declines. Base metals, especially copper, are highly sensitive to demand from China. We have taken profits in some of the diversified mining companies. These also have a high level of exposure to iron ore, a material that has done

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extremely well this year. We also took profits in copper companies (though they still represent 4% of the Portfolio), that have been a source of significant returns this year. Direct exposure to aluminum was eliminated, but we reintroduced nickel. Shipping companies that transport natural resources were also reduced, leaving the Portfolio with a 2% exposure at the end of the month.

Gold had little movement, while gold stocks were down slightly. Gold has benefited in the past from fears of higher inflation and a weaker dollar. We expect this pattern will continue, though it seems that other commodities, including oil and copper, have joined gold as an inflation hedge.

The Portfolio is up substantially this year despite, and in some ways because of, economic uncertainty. By and large the themes put into place earlier in the year, the emphasis on base metals over energy and the weighting to agriculture, have been fruitful. As we get greater confirmation of economic recovery, we anticipate moving the Portfolio into more later-stage recovery industries, such as energy and services related to natural resource extraction and refining. For now, these changes in the Portfolio have been incremental as we await more data and a more normal trading environment once the summer is over. ♦

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