



FLASH REPORT: GLOBAL RESOURCES

Portfolio Update

Commodity prices climbed in October as the global economy, especially Asia, pulled out of recession. Prices were boosted by the dual effect of strengthening economies and the continued decline of the US dollar, especially against the currencies of commodity producing countries. It is not coincidental that the only two developed markets to raise interest rates (Australia and Norway) are both commodity exporters. The Dow Jones-UBS Commodity Index gained 3.3% during the month. Natural resource equities lagged and generally had negative performance. For the year, the Index is only up 12.6%, with most equity based investments much higher.

Crude oil broke out of its trading range, with oil briefly breaking above \$80/bbl before settling to the high \$70s, depending on the grade of crude. Inventories have been sharply reduced, though they still remain high by historical standards. Increased economic activity has not yet translated into higher demand for oil. Exploration and production activity, as measured by the number of drill rigs in service, has increased recently but is still much lower than a year ago. The rise in oil prices reflects a belief that demand will improve and production will decline, thereby working down inventories. Integrated oil companies had positive performance in October, in part because investors have favored stability and high dividends as the global equity markets retreated slightly. Oil servicing and drilling stocks generally declined.

Newgate has been gradually increasing the allocation to energy names in the Portfolio. We have added to integrated oil exposure, now 5.4% of the Portfolio. Poor refining margins have been a hindrance to these stocks, but at some point these margins are likely to expand. Inventories for refined products, especially gasoline, are not tight but are tighter than crude oil inventories. This should allow for some margin expansion and therefore greater refining profits. Coal exposure is 3.6% of the Portfolio,

focused mainly on metallurgical coal used to make steel. Our primary focus remains exploration and production companies (20.8% of Portfolio) with an emphasis on natural gas companies with a long reserve life.

Base metals have been the largest beneficiary of renewed global growth. Copper futures were up 5% in October and have doubled in the past 10 months. Base metals companies continue to outperform broad equity benchmarks and most commodity related ones as well. The HSBC Global Mining Index rose 8% in the month; it too has more than doubled this year. We have reduced allocations to diversified mining companies. They now represent 10% of the Portfolio, down from nearly 15% earlier in the year. Pure copper investments comprise and additional 4.8% of the Portfolio. Both have been positive contributors to returns this quarter and year to date. We eliminated direct exposure to nickel but retain a 4% allocation to zinc companies. The most profitable sector overall this month was mining equipment, with double digit returns. We eliminated one company, but still have a 2.5% position in the sector.

Gold has been more volatile than usual. More than any other commodity, it represents the battleground between hyper-inflation fears on one side and great depression predictions on the other. Gold rose 3.2%, though gold companies generally had price declines. We maintained an allocation of just over 6% in gold but reduced silver to under 2% of the Portfolio.

We have included diversified utilities in the Portfolio, seeking to benefit from high dividend yields and low prices for natural gas and coal. The Portfolio has included alternative energy investments before, whereas our investments today are more traditional electric utilities. We also maintain a small (1.5%) allocation to commodity shippers, both rail and marine. ♦

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