



FLASH REPORT: GLOBAL RESOURCES

Portfolio Update

Fundamental factors are affecting the natural resource markets; valuations, supply and demand, inventories, have been overwhelmed by macroeconomic considerations. The “resolution” to the US debt ceiling increase did not seem to resolve much, prolonging anxiety about a potential credit rating downgrade. The European debt crisis appears immune to a real solution. The US dollar has been relatively weak and gold prices higher in July, activity consistent with fears of monetary instability. However, commodity prices have generally been higher, inconsistent with predictions of a “hard landing” or double-dip recession. Given the weakness of the global economic recovery, financial markets are feeling the strain of constant uncertainty.

Bulk commodities, including iron ore, metallurgical coal, and to some extent copper, tend to be highly sensitive to the global economy and especially to China. The Chinese economy is slowing in response to government policy, though we believe that fears of a severe Chinese slowdown are overdone and not reflected in either Chinese equities or in global commodity prices. Copper rose 4.6% in July; zinc and aluminum gained 5% and 3.3%, respectively. Iron ore spot prices rose as well, though without a liquid futures market, prices for commodities such as iron ore and coal are more difficult to ascertain. Bulk commodity stocks had mixed performance, yet bulk shipping and mine equipment companies were uniformly negative.

Oil prices were flat in the US and up slightly in Europe, although both have fallen sharply in early August. Crude oil inventories have declined, but are still above their five year average. Demand in the US has been weaker than most expectations; however,

demand has been greater outside the US, especially in Latin America. Production growth outside of OPEC has not met expectations. Energy related stocks were positive on average, especially in servicing and drilling, though engineering stocks remained relatively weak. Natural gas related stocks were up even as gas prices themselves fell 5.6%.

Precious metals stocks continue to underperform their underlying metal. Gold rose 8.4% and silver 15.2%, while the Philadelphia Stock Exchange Gold and Silver Index (XAU) gained only 2.3% and is down over 9% this year. The correlation between stocks and bullion tends to be low because the drivers of the two are different. Gold buying is driven largely by fear of monetary instability. Therefore, the enthusiasm for gold doesn't translate into enthusiasm for gold stocks.

Agrichemical stocks gained in July, though diversified chemical companies declined. Demand for the products in both industries remains robust in one of the few industries where companies can pass along cost increases.

We have seen great volatility so far in early August based on macroeconomic concerns. However, the Portfolio holds companies with very solid balance sheets that supply materials that are absolutely essential. We live in a world of great uncertainty. But there are things we know without doubt: people will drive cars, heat their homes and eat food requiring fertilizers. We also know that governments around the emerging world will do what it takes to increase the standard of living for their people. All of this provides support for natural resources and the companies that provide them, regardless of what happens in the short term. ♦

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