Amati Global Investors
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WS AMATI STRATEGIC METALS FUND

Quarterly Review

December 2023

By
Mark Smith, Fund Manager

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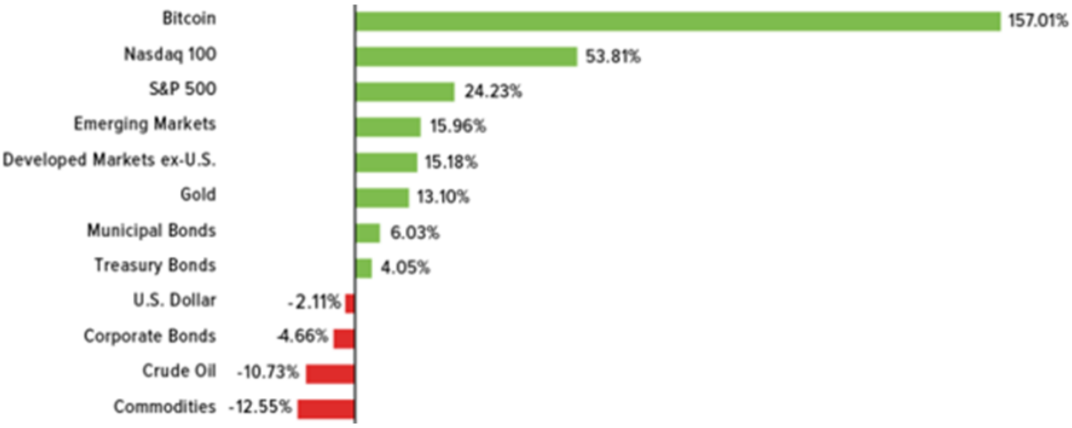
Commodities as a whole had a challenging year, with the group finishing down 12.55% due to a number of factors, including rising rates, recession fears and China's disappointing pandemic reopening.

Figure 1: Fund performance vs Base Metals & Gold



Source: Bloomberg

During Q4, gold reached a high of US$2,135/oz and touched a low of US$1,811/oz, with an average gold closing price of US$1,975/oz, up ~2.5% Q on Q and up ~14% Y on Y. The average silver price was US$23/oz, down ~1.4% Q on Q and up ~9% Y on Y. Base metal prices were mixed Q on Q and Y on Y, with copper mostly flat, and zinc experiencing the largest price decline on a year-over-year basis.

Battery metal fatigue continued into Q4, with spot Lithium commodities down over 40% and over 80% Y on Y, to lows not seen since June 2021. Nickel and cobalt were down 13% over the quarter, and down over 40% Y on Y. This was a function of over stocking of Asian batteries and weaker consumer demand in western EV markets.

The fund was down -2.2% during the period.

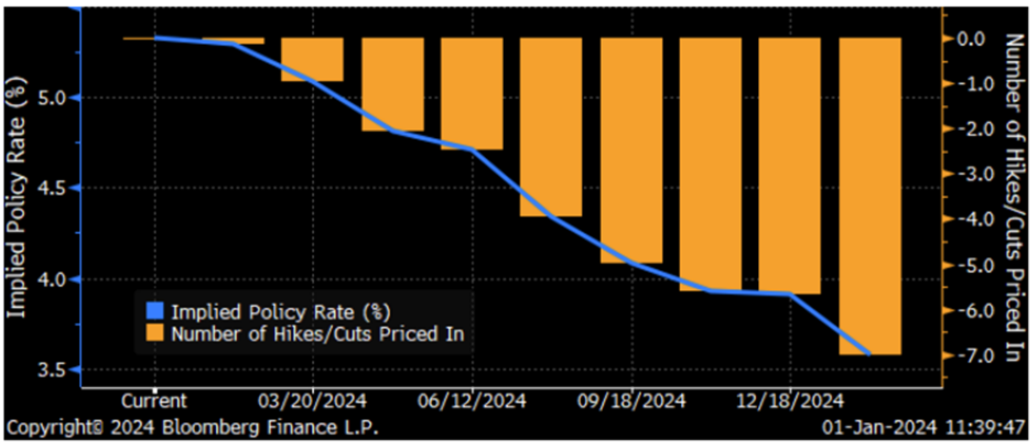
Precious metals markets

Gold performed surprisingly well during the year, climbing a wall of interest rate increases, and powering through a strong US dollar and economic conditions. Western investors represented by ETFs were selling into the rally, a new factor with the price close to all-time highs. The most notable driver was significant accumulation by central banks, led by China (increased 11% in 2023) and including Turkey and Qatar.

The main focus of markets during the year was continued obsession with monetary policy. Rates were hiked 37 times by central banks in 2023, with many investors fretting over the inevitable consequences after an extended period of the loosest monetary conditions ever.

The long-anticipated 'pivot' started in November with Fed chat turning dovish after inflation receded. The market is now assuming a 57% chance of a March rate cut, compared with 67% at the beginning of the year, however this above average rate cut view is not yet priced in to the gold equities.

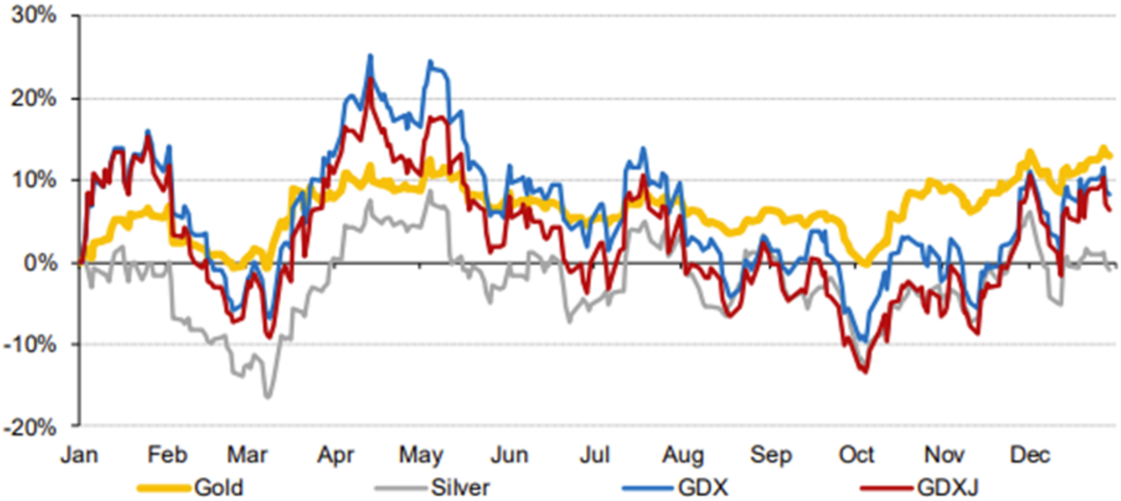
Figure 2: Fed funds futures curve



Source: Bloomberg

In contrast to the gold price, precious metal equities generated disappointment during 2023. Notably, in terms of total returns, the juniors suffered disproportionally with the TSXv Precious Metals Index losing 33% from June 2023 to year-end, compared to GDXJ (-0.8% over the same period) and NYSE ARCA Gold miners Index (+0.3%).

Figure 3: Gold and gold equity performance in 2023



Source: Refinitiv

The primary reason for producers' underperformance relative to gold pricing is margin compression due to increasing costs. Producers who issued bold predictions regarding cost and capex control have disappointed investors as labour and equipment costs soared. Investors are both nervous and tired of chasing free cash flow prospects that have not materialized.

Junior mine developers are burdened by several factors which have combined to challenge shareholder value. High margin ore discoveries are rare, mine planning takes longer, social and government licences are increasingly difficult to obtain and maintain, and capital costs have soared. It is not an easy business, and single mine companies also suffer a much higher cost of debt and capital than senior producers.

These challenges have driven major valuation dislocations, providing opportunities to those investors willing to do their homework and not concerned with monthly share price volatility. Those developers with world-class operations in the planning or construction stage have never traded at larger discounts to their senior counterparts. We expect that those intrepid senior companies still interested in growth will find it more appealing to buy ready-to-go projects than stake them, and that acquisition bidding will provide a further catalyst for re-valuation of quality juniors over the next few years.

We see a special opportunity in silver, a sector previously dominated by uber-bulls which has been largely abandoned by investors. Silver demand is finally turning the corner with new applications in photovoltaics and other crucial decarbonization technologies, such that it has been labeled as a strategic mineral, and new silver mines are extremely difficult to develop. On the energy side, the renewable energy market saw significant strides in 2023, with over 440 gigawatts of added capacity. Notably, both the U.S. and Europe set new benchmarks for solar installations, while China's contributions dwarfed everyone else's, adding between 180 and 230 gigawatts (GW).

Silver always moves more than gold as investment demand swamps the market. Silver prices are vulnerable to short-covering now due to massive short positions, and should piggy-back and then exceed gold's percentage gains.

Battery metals market

Over the past few years, investors have been attracted to this area as it has become clear that western-based supply chains are needed to provide minerals crucial to decarbonization. The US government codified the effort through the Inflation Reduction Act, and their Critical Materials List. While China controlled most strategic mineral markets, many of these specialty minerals suffered decades of under-investment in mines and the required advanced processing technologies and facilities.

We believe that this situation will build excesses in the form of mini-bubbles such as recently experienced in lithium, and also in speculation for new technologies promising the next best thing. The inevitable boom/bust will also create opportunities for investors to pick up globally significant deposits on the cheap, and benefit from M&A. It is increasingly evident that it is cheaper for the majors to buy than build.

Lithium

China aggressively forced the spodumene and lithium chemicals price up in 2022, in a bid to secure supply. Even the most inefficient converters buying high priced spodumene were making chemical margins because of the very high price received for chemical lithium products. Now China's response over the last 12 months to the problem they created is increased production from ESG unfriendly lepidolite and DSO creating unsustainable low prices below the cost curve.

Until lithium conversion from hard rock precursors becomes a global rather than China dominated business, we expect more wildly fluctuating spodumene prices as the current low prices inevitably delay investment in new hard rock lithium projects and limit the market's ability to respond to rapidly growing demand. Hopefully, significant new conversion capacity in Australia, North America and the EU is in place in the next few years.

The drift lower in pricing is beginning to interact with the cost curve beyond higher cost Chinese lepidolite operators. While there is still some additional supply entering the market from brine sources, we had been hearing anecdotal evidence of high-cost lepidolite producers exiting the market. We think demand growth will eventually prevail over stocking/destocking behavior. In the short run companies manage inventory. In the long run they purchase to meet their supply needs.

A technical outlook

Although we are value investors in the resource space, it is sometimes important to judge the technical perspective the powerful quant funds consider in moving the market (at least in the short term).

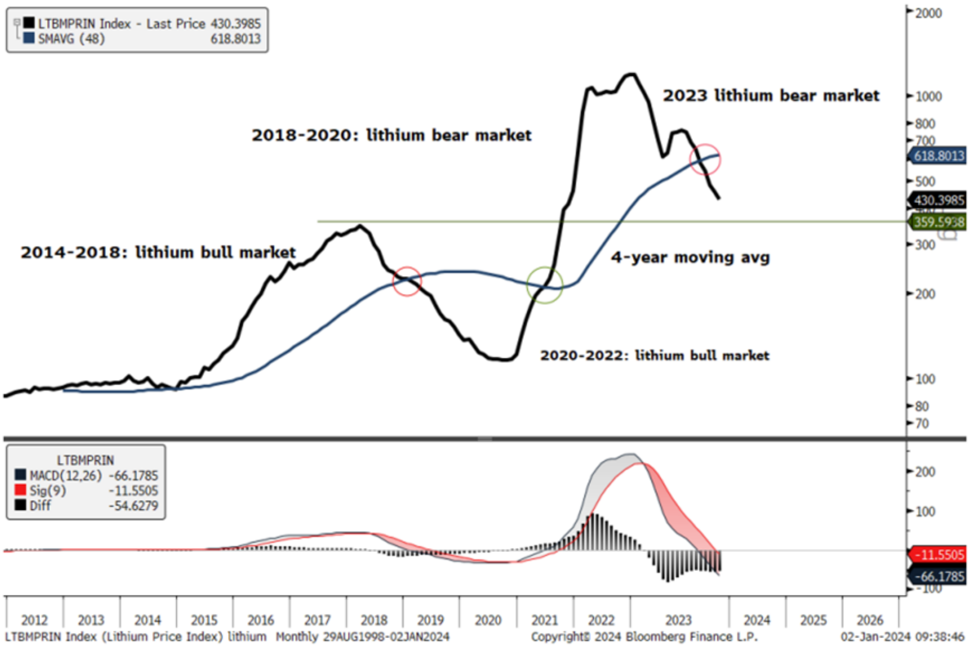
Gold Miners

Gold Miners vs. Physical Commodity (GDX/GLD): Remains in long-term basing structure and finding support around the 2022 lows. Equities gaining momentum to break the 2022/2020/2016 highs to confirm a new primary uptrend in favour of gold miners.

Source: Paradigm Capital

Lithium Equites

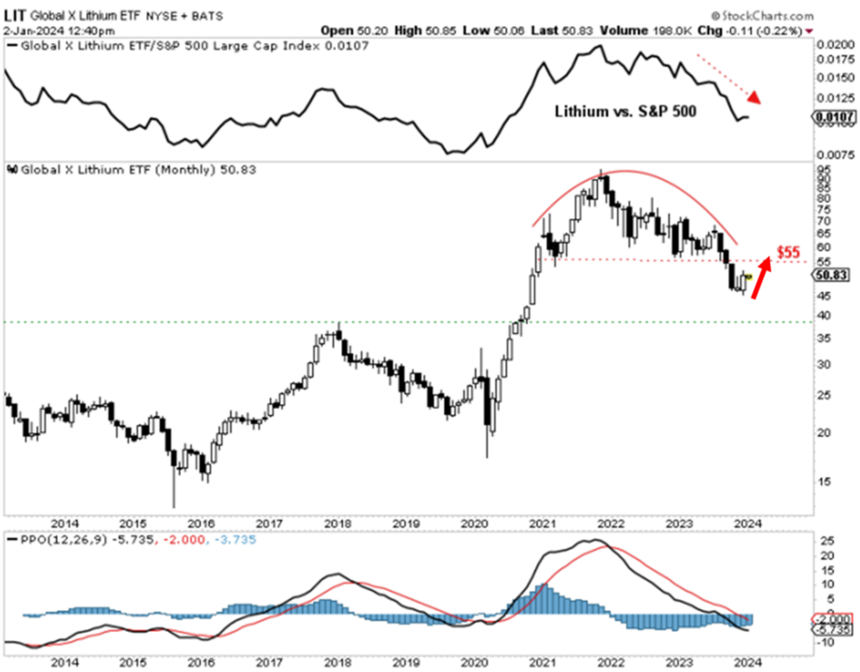
Technically lithium is in a bear market as the price broke through the 4-year moving average. However as the price is now below the cost curve, we expect the price to bounce off its lows, as supply-demand economics plays out.



Source: Paradigm Capital

Using the Global lithium ETF as a proxy for lithium equities, we are starting to see the lithium stocks pricing in this future commodity behaviour. They are in an uptrend to break the $55 resistance level and signal a failed breakdown pattern.

As an actively managed resource fund we have the ability to be selective in our investments. We will watch how the market reacts to the (assumed) Fed rate cuts in 2024 and act accordingly. We will continue to search for exciting exploration and development stories by attending resource conferences and making site visits.



Source: Paradigm Capital

Should you wish to view the video summary with the fund manager, please **click here**.

Sales Team Contacts

Rachel Le Derf
Head of Sales & Marketing
rachel.lederf@amatiglobal.com
07979601223

Colin Thomson
Head of Intermediary Distribution
Northern England, Scotland & NI
colin.thomson@amatiglobal.com
07884026517

Jonathan Woolley
Sales Director
London, Midlands, SW England & Wales
jonathan.woolley@amatiglobal.com
07818203013

Thomas Whitfield
Sales Director
London & SE England
thomas.whitfield@amatiglobal.com
07714839155

Samantha Dalby
Sales and Insights Manager
samantha.dalby@amatiglobal.com
+44 (0) 131 503 9116

Olivia Pattison
Senior Sales Support Executive
olivia.pattison@amatiglobal.com
+44 (0) 131 503 9126

Milly Stevenson
Sales Support Executive
milly.stevenson@amatiglobal.com
+44 (0) 131 503 9125

Risk Warning

Past performance is not a reliable guide to future performance. The value of investments and the income from them may go down as well as up and you may not get back the amount originally invested. Tax rates, as well as the treatment of OEICs, could change at any time. The investments associated with this fund are concentrated in natural resources companies, which means that the fund is subject to greater risk and volatility than other funds with investments across a range of industry sectors. The fund invests in companies that have operations in developing markets and which therefore may be subject to higher volatility due to political, economic and currency instability. Shares in some of the underlying companies in the fund may be difficult to sell at a desired time and price. A dilution levy may be applied to the share price when the fund is expanding or contracting. Should you buy or sell in these circumstances it may have an adverse impact on the return from your investment.

This review does not provide you with all the facts you need to make an informed decision about investing in the fund. Before investing you should read the Prospectus, the Key Investor Document (KIID) and Supplementary Information Document (SID). The Prospectus sets out the main risks associated with the fund, the KIID shows you how costs and charges might effect your investment, and the SID details your cancellation rights. If you are in any doubt as to how to proceed you should consult an authorised financial intermediary. Fund documentation can be requested from Waystone or Amati and is available to download from our website.

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