Amati Global Investors

Finely crafted investments

Could 2024 be a transformative year for investors in the commodity sector after a particularly tough year in 2023?

WS Amati Strategic Metals Fund

By
Georges Lequime, Fund Manager

Since the beginning of the year, we have seen a washout in stocks across a number of the commodity sectors, notably the battery metals sector and precious metals equities (although gold and silver prices have held up very well). Without any clear line of sight of a turnaround in sentiment towards commodities, investors and fund managers are equally frustrated right now.

However, for investors with a medium to longer term investment horizon, the sector becomes really interesting when commodity prices fall well below incentive pricing (the price needed to incentivise producers to economically invest in ample new production for future supply) and we start seeing supply curtailments and the postponement of development projects – exactly the situation that we are currently seeing in lithium and nickel.

China and the commodity market

Weakness in China's key commodity-consuming sectors – property and infrastructure – has definitely been acting as a drag on demand for commodities. Unfortunately, in 2023, this came at the same time as the delay to the promised US infrastructure rebuild program and a production slump in Europe.

The green shoots for investors in commodities are that China's economic data is improving and lower commodity prices are leading to production curtailments and the delay of new projects – classic cyclical behaviour!

China's economic data started to trend higher into the end of 2023, particularly in the industrial economy. While there are still plenty of structural concerns, trade showed signs of improvement through the year and the energy transition sectors continued to outperform. With yet another front-loaded fiscal impulse looking probable, we expect that, even though sentiment towards the Chinese economy as a whole remains muted, metals-intensive areas are likely to hold upwell even with the drag of the property sector.

Lithium

We expected the energy transition sector to hold up better than the economically sensitive metals (copper & aluminium) sector in 2023,and for lithium prices to fall back and settle at a more sustainable level –both of which happened in 2023.

However, the scale of the destocking from China– we believe from inventory levels of over 85% to a current level of 10-12% -pushed lithium prices well below prices that are deemed necessary to ensure adequate supply into the future (~$25-30/kg). The entire lithium stock sector was crushed in 2023 irrespective of whether you had a project in the lowest quartile of the cost curve or not.

Lithium prices look like they are bottoming here. Lithium production curtailments have already been announced with several spodumene mines in Australia mothballed. We question whether lepidolite production out of China~12% of global supply, can continue to operate at current prices without significant government financial support.

While sentiment towards the global EV rollout has cooled, auto manufacturers continue to plan and build battery facilities, requiring significantly more battery metals than the mining industry plans to produce. On January 24, General Motors announced a commitment to invest $1.4billion in Brazil between 2024 and 2028 to expand the automaker's vehicle portfolio, mostly in EVs and hybrids. Chinese electric vehicle manufacturer, BYD, are reported to be in talks with Sigma Lithium – a spodumene producer in Brazil. Mining holding company, Assore, have just acquired an increased stake in Atlantic lithium. We expect mergers and acquisitions to continue in 2024 as corporate buyers are less concerned about the short-term volatility as equity investors in the sector.

Nickel

Nickel prices, which slumped more than 40% in 2023 on the back of accelerated supply from Indonesia and the Philippines, leading to mine closures in Australia – BHP's Kambalda operations, and probably Nickel West as well. As with lithium, the nickel price seems to have found some support at current levels. While Indonesia and the Philippines are flooding the market with pollutive nickel, consumers are not willing to pay a premium for responsibly sourced metal, at this stage. At current nickel prices, the conversion of pig iron nickel to high grade nickel required for batteries is questionable– implying that we are probably close to hitting floor prices.

Precious Metals

Although we can point out how cheap precious metals stocks are for hours on end, the return of investment appetite for precious metals equities seems reliant on the timing of the start of the rate cuts in the US.

Precious metals equities performed well in the last two months of 2023 as the gold price rallied towards its all-time high. However, we have since seen a sharp pullback in gold and silver equities while the gold and silver prices have held up relatively well. This is largely driven by a change in sentiment towards to the timing of the first rate cut – from 90% probability in March 2024 down to below 50% probability and from 100% by May down to 85%.

The operational results released over the past few weeks for the precious metals sector have been mixed but not disappointing, which has supported some of the equities since the beginning of the year. Shares are currently discounting a gold price some $500-600/oz below spot.

The question is whether the market is right in anticipating a pullback in the gold price to this level, or whether there is going to be a big catch up rally? What is clear is that this large discount has lasted for four years now. Although one could justify the lack of appetite for gold shares during the aggressive rate hike cycle, this trade seems difficult to justify when the Fed starts to cut rates – which is usually when the appeal for gold stocks returns...

WS Amati Strategic Metals Strategy

The Fund was established in 2021 to invest in quality companies across the mining spectrum by diligently researching as many companies as possible across the world and investing in companies low on the cost curve with huge exploration upside, especially when they appear to be trading well below their intrinsic value based on longer-term incentive pricing for the associated metals.

Unfortunately, we did not escape the aggressive sell-off of the lithium and nickel companies last year by remaining invested in quality development projects – all with takeover appeal and value-unlocking catalysts.

On the precious metals side, since the launch of the Fund, we have remained agnostic with regards to the price of gold and silver and identified many producers, developers and late-stage exploration companies trading at significant discounts to the commodity price. Again, this did not help investors into the Fund as interest in the precious metals sector dried up as soon as the US Fed started hiking interest rates in 2022 and the large discount to the current gold price has remained in place through the whole period. Although the gold and silver price performed well in 2023, the equities massively underperformed.

Right now, we believe that we could be seeing the last washout of mining equities, especially in the battery metals sector and the precious metals sector. We cannot predict exactly when the sentiment will change but there are signs that prices are stabilising and merger and acquisition activity is picking up. While it is impossible to say whether there could be more downside in the coming weeks or months, we remain confident that investors with a medium to longer term investment horizon will be handsomely rewarded for their patience. The supply versus demand imbalances facing the commodity sector over the coming years have not gone away, and, if anything, will be exacerbated by delays to much needed projects.

The uranium sector performance over the past three years is a clear example of what can happen when investors focus on a supply-demand imbalance going forward. Interestingly, the supply-demand imbalance in the uranium market is far smaller than most of the commodities that we observe and uranium equities are already discounting much higher prices going forward. Classic despair to euphoria in the commodities sector.

Just as much as investors despised the uranium sector in 2020, investors currently despise the Lithium, Nickel and Precious Metals sector... food for thought.

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 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 subect 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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