First State Investments

Global Resources

Quarterly Review and Outlook

As at June 2016

Key Highlights

- Global resources equities were volatile, but continued to recover in the June quarter. Performance was driven by Chinese policy stimulus which boosted steel prices, iron ore and coking coal. The oil price gained during the period as supply was constrained by sectarian violence and fires in Canada. Rising geo-political risks, including Brexit, increased safe haven demand for gold and silver.
- The First State Global Resources strategy increased in value during the June quarter, driven primarily by our exposure to precious metals producers, which benefited from rising gold and silver prices.

Market Review

Global resources equity markets continued to recover in the June quarter. This was largely attributable to Chinese policy stimulus earlier in the year, which boosted real and apparent demand for industrial metals. Global growth concerns, low inflation, muted wages growth and a soft May employment report all contributed to the cautious policy stance of the US Federal Reserve. This subdued the USD, which further supported metal prices. Britain's unexpected decision to leave the EU ('Brexit') boosted safe haven asset demand with silver and gold prices reaching two-year highs. Oil prices rose in Q2 16. Faster declines in mature, high cost production areas (i.e. US unconventional shale) underpinned the rebalancing of the market, augmented by outages in Kuwait, Nigeria, Canada and Libya.

Strategy Performance and Positioning

The strategy rose by 10.8% in SGD terms, while its benchmark increased by 16.4%.

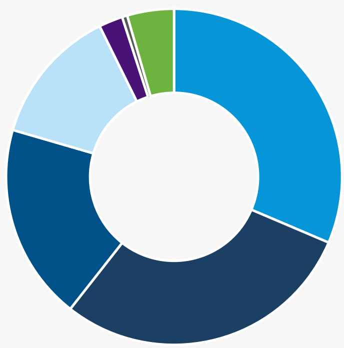
The strategy's precious metals holdings show as the largest contributors to performance, reflecting rising spot gold and silver prices, in particular. Investments that fall into this category include Franco-Nevada, Silver Wheaton, Detour Gold, Pretium Resources, Fresnillo, Tahoe Resources and Goldcorp. We increased the number of smaller and mid-cap gold names in the strategy following several positive North American site visits. Positions increased were Pretium Resources, Integra Gold, TMAC Resources and Alamos Gold.

Diversified mining company, Glencore, detracted from performance. This was largely due to currency effects as this UK-listed company was impacted by British Pound Sterling (GBP) depreciation following the 'Brexit' vote. We added to the strategy's position in Glencore given its leverage to zinc and coal commodity prices on share price weakness. The company has exhibited strong capital discipline in H1 16, announcing US$3.7bn of asset disposals, including the sale of half its agriculture unit in June, reducing its debt load.

The share price of Cameco, one of the world's largest uranium producers, was held back by the declining uranium price. Sentiment has been negatively impacted by the announcement of early reactor shutdowns in the US. We consider Cameco to be a high quality and defensive company. It has a number of low cost, long life mines and significant growth potential. Its new mine, Cigar Lake, located in the uranium rich Athabasca Basin of northern Saskatchewan, Canada, is in the process of ramping up. Cameco has a strong balance sheet and free cash flow generation is positive. We retain conviction in this name despite some near-term challenges and have added to our position.

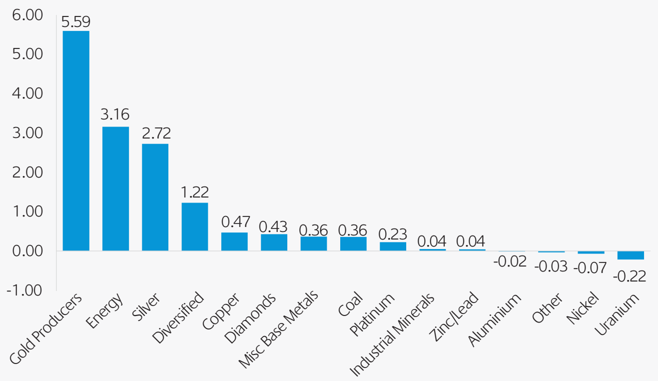
Although stocks are selected using bottom up fundamental analysis, the strategy is committed to diversification by sector and geography. The charts below show the sector diversification of the strategy as at 30 June 2016. Its largest exposures are to diversified metals and mining companies, energy companies, precious metals companies (gold, silver, palladium and platinum), and base metals companies (principally copper, zinc and nickel producers). The subsequent chart shows the sector contributions to strategy performance over the period.

Sector Diversification (%)



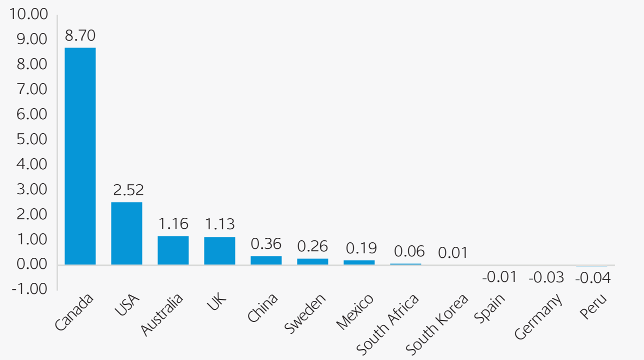
Source: First State Investments as at 30 June 2016.

Sector Contribution (%)



Source: First State Investments as at 30 June 2016.

Country Contribution (%)

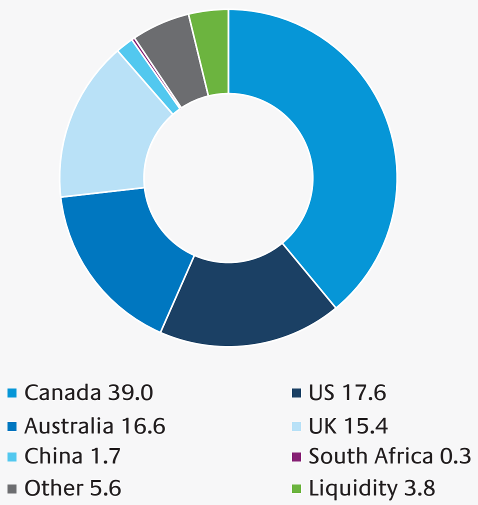


Source: First State Investments as at 30 June 2016.

The following charts show the geographic diversification and contributions to strategy performance over the quarter. The geography is based on the stock's country of listing, not the domicile of the underlying assets. The largest exposure is to Canada and is generally constituted of small and mid-cap precious metals, and base metals companies. The exposure to Australia is mainly comprised of large diversified mining companies, BHP Billiton and Rio Tinto. This is followed by the US which largely reflects the strategy's holdings in a number of energy companies, such as Exxon Mobil and Chevron.

The strategy's geographic allocations result from balancing two factors. The first factor is portfolio diversification. We are conscious of the fact that diversification is one of the most important tools for ensuring portfolio risk and return is optimised. The second factor is political risk. Mining and energy projects require significant capital investments and once the capital has been spent, the project is immobile. Countries with superior track records of stable fiscal, labour and social environments are much lower risk domiciles for these immobile assets. Hence, the strategy is diversified by geography, but with a tilt towards lower risk jurisdictions like Canada, Australia, and the US.

Country Diversification (%)



Source: First State Investments as at 30 June 2016.

Market Outlook

While a nascent recovery is underway, we are likely to continue to bounce along the bottom of the commodity cycle. Oversupply in some commodities may persist for some time, and we expect volatility to remain. Given heightened geo-political risks and macroeconomic uncertainty, we prefer precious metals over base metals and bulks in the near term. Upside in steel appears capped by China's maturing materials-intensive growth cycle. In China, industry reform in mining, steel and aluminium production should help reduce surplus material coming from low productivity or highly polluting sources. Palladium and zinc also remain preferred commodities due to expectations for an undersupplied market. Oil prices have stabilised and the market appears set to rebalance in 2017. Balance sheets will remain key to equity performance with most mining and energy companies focused on reducing debt, costs and asset sales, while generating free cash flow at spot prices. This sets the tone for tighter supply/demand fundamentals in the longer term. Ultimately the cure for low prices is low prices.

Investment Philosophy and Process

The strategy continues to be managed by one of the sector's longest-standing natural resources teams, led by Dr Joanne Warner. Our approach is to combine stable companies, with high-quality assets and low costs of production, with earlier stage opportunities to create the potential for sustainable returns over the course of a full cycle. We continue to look for opportunities to add to preferred names on market weakness. In absolute terms, we expect the strategy to perform well when sentiment towards the sector improves.