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SUNARES-Report July 2020

Since our April report, markets have continued their recovery, with clear winners and losers. Investors are looking at the re-opening of economies and are hoping to be able to answer questions about how strong the rebound will be. It is worth remembering that stocks have tended to perform well in years that register negative GDP, as there is an attempt to anticipate and price-in recovery. The fear of recession is worse than the recession itself.

Negative Real GDP Years		
Year	Real GDP	Current Year Return
1947	**-1.1**	0.0%
1949	**-0.6**	10.3%
1954	**-0.6**	45.0%
1958	**-0.7**	38.1%
1974	**-0.5**	-29.7%
1975	**-0.2**	31.5%
1980	**-0.3**	25.8%
1982	**-1.8**	14.8%
1991	**-0.1**	26.3%
2008	**-0.1**	-38.5%
2009	**-2.5**	23.5%
% Times Down or Flat		**27%**

Source: RBC

In the April SUNARES report we wrote about the speed and scale of central bank intervention and it is this support that has continued to under-pin all asset classes. The United States and the Federal Reserve have been especially active in terms of monetary intervention, and this has given US markets the means and the confidence to rally. We should also bear in mind that the size of the intervention by the central bank has moved up from *“mere”* billions to trillions – a change of semantics and numbers.

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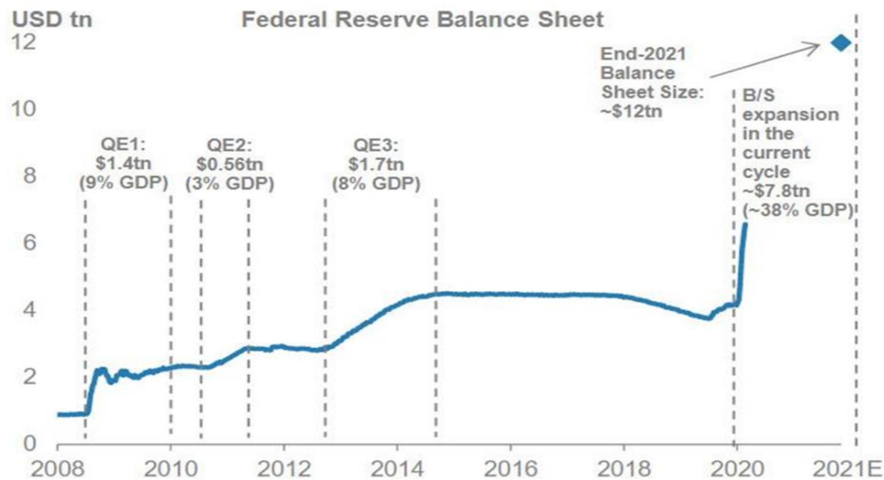
Exhibit 1: Fed's balance sheet to expand by more than QE1, 2 and 3 combined in this cycle



Source: Federal Reserve Board, Federal Reserve Bank of New York, Morgan Stanley Research

This should give cause for serious concern, as it highlights just how much money has been needed to stabilise the debt pile. Is there any way to row back from this? JP Morgan has recently pointed out that there are signs of stress appearing again in the US Treasury yield curve. They conclude that the Federal Reserve will need to add additional liquidity and measured in the trillions again. Politicians should also act and offer support on the fiscal side. The initial interventions that have taken place appear to be too small (!), a conclusion that other investment bank analysts have also reached. JPM conclude that:

"very accommodative central bank policy policies and low interest rates are likely to continue for a very long time to make it possible for both the government sector and the private sector to sustain their much higher debt levels.....More credit and more monetary stimulus in the form of QE, which in turn would result in more asset reflation."

The battle to maintain a grip over global debt and prevent a cascade of failures i.e. a deflationary collapse, means that the world has reached a point, where the only answer is to continue to create money, to ensure that debt can be rolled forward. We have always understood that ongoing money creation was needed to keep "kicking the can down the road". The fact that this view is moving into the mainstream, and is being blithely accepted as a universal truth, lays open the way for asset markets to keep marching on, based on further injections of money into the system. The alternative of allowing a deflationary debt collapse is untenable.

This establishes that we are now entering a world of tacit yield curve control, even if the Federal Reserve has not explicitly confirmed this as being their official policy. It is interesting to note that the US experienced yield curve control during, and post the Second World War, which was intended to keep a lid on the costs of financing the war effort and to get the economy moving after the war ended. The following chart shows that this was a period of strong returns for stock markets:

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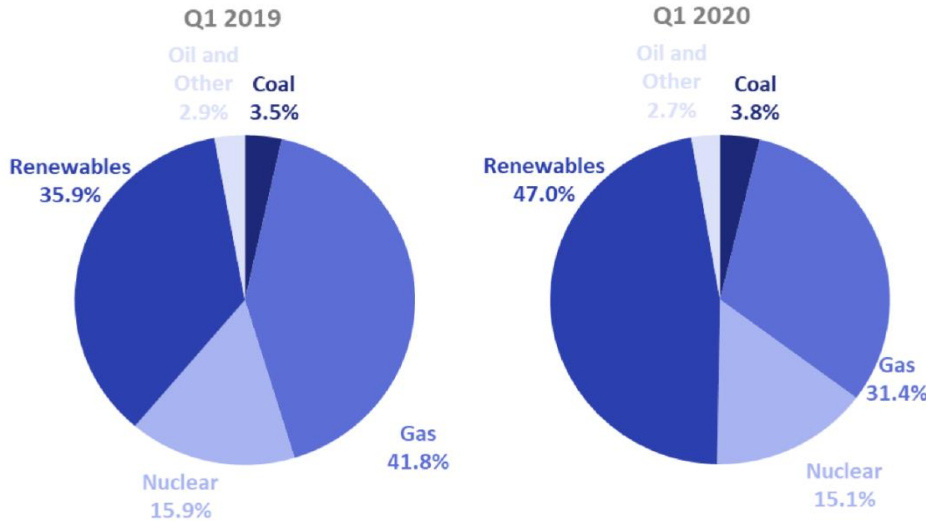
Bond yields were capped at 2.5%, allowing stocks to run up. We appear to be entering a similar phase.

Alternative Energy

It will perhaps have come to your attention, that the fund no longer has exposure to oil companies. Sustainability is one key reason for this but, in addition, it is the quick technological progress that alternative energy has made, that explains the change. The relentless and rapid drop in the price of alternative energy, means that oil is now suffering extreme competitive pressure.

In the first quarter of 2020, 47% of the UK's electricity needs were met by renewables (wind, solar, hydro and bioenergy). At the same time last year renewables accounted for 35.9% of energy produced. The figure for Q1 in Germany was 52% and progress on increasingly efficient production continues – further gains and improvements lie ahead. There is no doubt that we are in a major transition in our use and production of energy. The defining challenge concerns the electrification of the world's transport systems. Resolving this will be truly transformational.

The first quarter of 2020 also saw the lowest share of generation coming from fossil fuels at 35.4%. This is the first time the fossil fuel share has dropped below 40% of total generation, continuing the trend away from fossil fuels (figures from ofgem).



Source: ofgem.gov.uk

The European Union and the Green Deal

The EU has been at the forefront of international efforts to fight climate change. It was instrumental in brokering the Paris Agreement and continues to show global leadership.

The EU's nationally determined contribution (NDC) under the Paris Agreement is to reduce greenhouse gas emissions by at least 40% by 2030 compared to 1990, under its wider 2030 climate and energy framework. All key EU legislation for implementing this target was adopted by the end of 2018.

At the end of 2019, European Commission President Ursula von der Leyen launched the Green Deal, a 30-year plan intended to make the bloc climate neutral by 2050.

"This is Europe's man on the moon moment. Our goal is to reconcile the economy with our planet, to reconcile the way we produce, the way we consume with our planet and to make it work with our people."

Not all of Europe's countries are on board with the plan and especially not coal producing countries in the East. However, money is being made available to ensure that these countries are able to transition away from their reliance on coal mining.

This grand project targets annual spending of some €260 billion of additional annual investments just to meet existing targets. Larger sums will be needed in order to meet more ambitious goals. With current monetary policy in Europe, and elsewhere, with interest rates at historic lows, we can expect further announcements regarding ambitious projects, infrastructure spending etc.

Companies that are engaged in this sector are performing well, in contrast to the price moves of companies active in the oil sector. The fund has developed and added to exposure in this sector over an extended period of time, and the aim of meeting a climate neutral target by 2050, means that there will be many exciting opportunities to be invested in over the coming years.

SUNARES
SUSTAINABLE NATURAL RESOURCES FUND

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Hydrogen

In our June 2020 factsheet we mentioned Plug Power, one of the positions held in the fund, as they are executing on their stated aim of achieving vertical integration in their hydrogen business. The company came to market back in 1999 and therefore has a long history as a designer, developer, manufacturer and seller of fuel cell systems for electric fork-lift trucks and materials handling equipment.

They recently bolted on two exciting acquisitions, United Hydrogen and Giner ELX. United Hydrogen Group brings on board experience in hydrogen generation, liquefaction and distribution logistics. Giner ELX brings along a leading, efficient and cost-effective PEM (proton exchange membrane) hydrogen generator as well as on-site hydrogen generation systems for fuel cell vehicle refuelling stations and industrial uses. Importantly, they also have a good European network.

Plug's strong position in hydrogen fuelling infrastructure is important, as hydrogen could prove to be more efficient for commercial trucking than battery power, although this battle will be hard-fought over the coming years. The two acquisitions are expected to be earnings enhancing with revenue predicted to reach US$1.2 billion in revenue in 2024, up from the prior forecast of US$1.0 billion.

Interest in hydrogen solutions is picking up, as demonstrated by the chart added below and navigating through the maze of possibilities is already an exciting task for us amidst the volatile market conditions we are all operating in.

Source: Stockcharts.com

We leave the last words to Plug Power's CEO Andy Marsh:

"Plug Power is working to build the modern clean hydrogen economy. Every decision we make is with an eye to the future, not the past. This closely aligns with the efforts that companies like United Hydrogen and Giner ELX have made to secure broad participation in the hydrogen economy, and to achieve the objectives of a clean environment and reduced dependence on foreign oil. We welcome these organizations into the Plug Power family where, as a team, we can accelerate the adoption of low carbon and zero carbon hydrogen on a global scale."

Copper – the metal with a PhD?

This industrially critical metal has often been credited with predictive powers concerning the strength and well-being of the world economy. A strong copper price is a signal that the world is doing well.

Copper has made progress from the March intra-day low at US$2.0595 and the following weekly chart shows that the price is now challenging the upper channel of a downtrend line, that has been in development since June 2018. We are therefore at a key resistance level. If copper breaks through this channel towards US$2.90 then a more sustained upward price move is in the offing.

Copper price 8.7.2015 to 6.7.2020 shown with downtrend channel. Source: Bloomberg

Gold and Gold Mining Companies

There have been few standout sectors in 2020. Technology, cleaning products and biotechnology have benefitted from the Covid-19 pandemic, as the world looked for answers to working from home, cleanliness and the candidates likely to provide a vaccine.

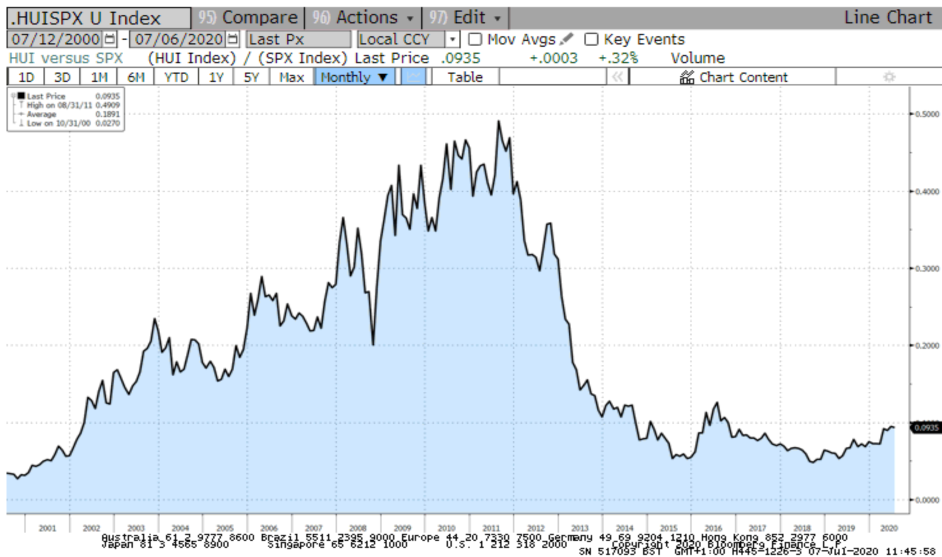
However, gold has also made steady progress, along with the gold mining companies themselves. If money continues to be printed/ created then an alternative form of money should benefit, especially if it cannot be created out of thin air. We have long been positive abut the sector and we have been steadily increasing the fund's exposure, as price action has warranted it. The fundamental picture, along with relative valuation, gives us reason for continued optimism. The following chart of gold shows that it has made a new high for 2020 and quickly exceeded the price drop it experienced in the March 2020 rush to liquidity. The price has held firm and looks set to test resistance that lies above, potentially moving to test the old highs.

Gold mining stocks relative to the S&P500 have been making good progress over the last 5 years, with higher highs and higher lows.

Gold price in US$ 2009 to 7 July 2020. Source: Bloomberg

Gold mining stocks represented by the HUI index relative to the S&P500 last 5 years
Source: Bloomberg

If we look at this relative pattern since 2000, we see that there is a possibility that the sector can continue to make progress against the broad market and deliver significant outperformance – see below.



Gold mining stocks represented by the HUI index relative to the S&P500 since 2000.
Source: Bloomberg

We are already seeing takeover activity in the precious metal mining sector and we think that this consolidation phase of merger and acquisition is going to continue – a land grab is underway to fight for the best resources.

Chinese gold miners are making all-cash offers for small-cap juniors at substantial premiums, which has caused some seasoned investors to scratch their heads, as they question the prices being paid.

In March Zijin Mining Group Co., Ltd. paid C$1.3 billion for Canadian miner Continental Gold.

In May Shandong Gold Mining, one of China's biggest gold producers, agreed to acquire Toronto-listed TMAC Resources for C$230 million.

Zijin made another move and outbid Canadian miners to purchase Guyana Goldfields for C$323 million, with an offer that was 35% higher than a previously accepted offer from Silvercorp Metals.

Shandong stepped in again with its takeover of Cardinal Resources for A$0.60 a share in cash. This offer is at a 75.5% premium to Cardinal's pre-offer 20-day average price.

This flurry of takeovers has unsettled the "local" players to such an extent that both Canada and Australia are looking to place limits on takeovers by foreign entities, a form of resource nationalism.

North American miners have been much more cautious in launching bids, in spite of Barrick Gold's announced intention to act as a consolidator in the sector. This caution can be explained by the sector's prior profligacy and over-spending, during the last bull run for gold. There has been intense shareholder scrutiny of any takeover moves, and management teams are fully aware of the need to keep balance sheets clean. Indeed, Kirkland Lake was severely punished for its unexpected stock offer for Detour Gold in November 2019, with the share dropping sharply, having been a darling of the sector up until they made their move. The current vogue is for nil-premium mergers such as the one between Alacer and SSRM – value creating deals that benefit both sets of shareholders. Will these deals continue with other predators lurking?

Indeed, will North American companies pick-up the pace and be forced to bid more for any deals they want to make? With Chinese companies paying cash and wanting to get their hands on what they can, there are interesting times ahead for those owning gold and silver miners.

SUNARES fund price development last 7 years – 7 July 2013 to 7 July 2020 (Source: ariva.de)

For daily price updates, factsheets etc, please visit the fund's website at: www.sunares.com

Keep well, enjoy the summer and the great outdoors wherever you happen to find yourself this year.

The SUNARES team

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