



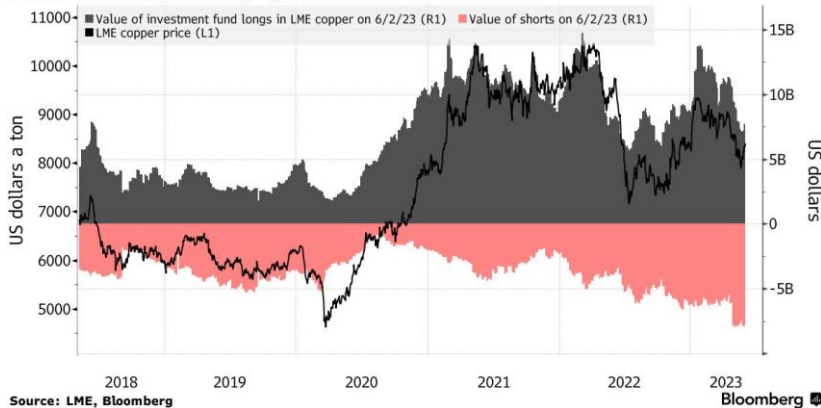
The red metal and the green world

Copper: The core of the green revolution

In early 2022, the price of copper rose to a record high of nearly \$11,000, as the industry found itself with very low inventories due to the surge in demand during the pandemic, together with the war in Ukraine fuelled fears about supplies from Russia. During the rally, Goldman Sachs, BlackRock and Trafigura Group predicted that the green energy revolution would drive copper prices much higher, but so far this expected demand has been more than offset by China's tepid post-Covid recovery, an industrial recession in Europe, and rising interest rates.



Funds Turn Bearish on Copper Investors are now betting against copper on a net basis



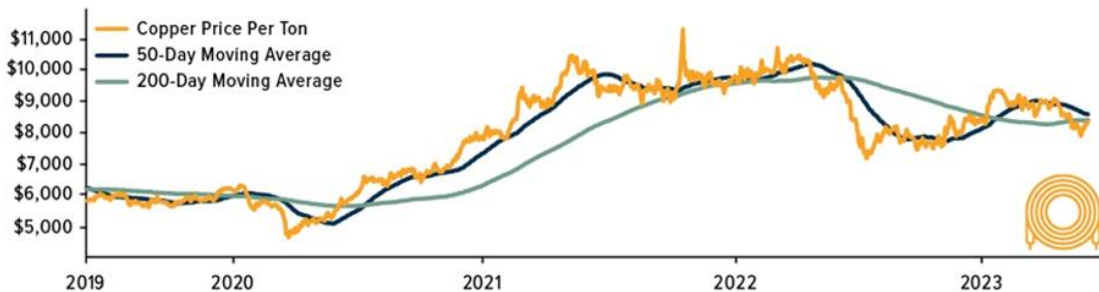
Sentiment has deteriorated to the point where investors on the London Metal Exchange have witnessed a copper price decline for the first time in three years. However, the bellwether metal has held up far better in 2023 than most other industrial commodities such as zinc or oil, and Max Layton, managing director of commodities research at Citigroup, has said investors would bet much more heavily against copper, if the long-term outlook for demand were not so good.

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Layton stated in an interview with Bloomberg that now is an ideal time for investors to buy, as the price is still subdued owing to concerns about recession. He believes copper could reach a price of \$15,000 a ton by 2025, a jump that "would make the oil bull market of 2008, look like child's play."

Citi Sees Copper Topping Out at \$15,000 by 2025

Three-Year Period Through June 6



Source: Bloomberg, U.S. Global Investors

Copper is fast becoming the commodity of choice for investors looking to participate in the energy transition theme, and they are likely to jump in quickly once the bleak global growth outlook improves, according to Layton.

This will set the stage for a buying spree, as orders from car manufacturers and power grid operators roll in. Citi forecasts that rising allocations from index-focused investors and hedge funds could help boost net bull positioning in the copper market to about 4 million tons by 2025, a significant reversal of the current bearish sentiment. This would be equivalent to about one-fifth of global supply, and double the previous peak of 2021.

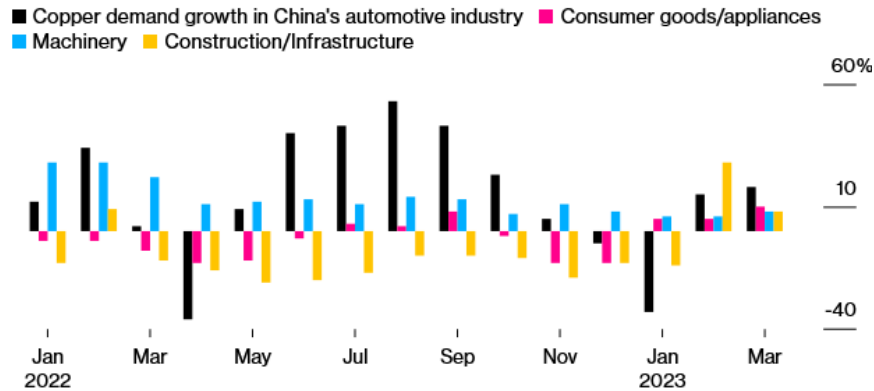
As consumption skyrockets, increasing hedging activity by car manufacturers could lead to another 1 million tons in long copper positions, bringing a flood of money into futures markets just as demand begins to outpace supply in the physical industry. That will help drive copper to a record high in Citi's opinion.

Copper mining companies are already making high margins at today's spot prices, but there are widespread warnings that the industry will fall well short in providing the additional supply needed, as part of the energy transition. As prices rise, Citi expects to see significant substitution of copper in traditional sectors such as consumer goods and air conditioning, as well as more economical use of copper in electric vehicles and power generation. However, the bank expects an unprecedented gap between demand and mine supply to open up over the next five to ten years.

Rising battery metal prices have prompted automakers in recent years to partially replace rare and volatile metals like cobalt with iron and other alternative materials. But copper - which is not used in the battery itself, but transfers energy from the cells to an electric vehicle's motor - is not as affected by these changes in battery chemistry. Copper's higher liquidity is also likely to attract far more investment than other battery metals such as lithium and nickel.

Green Growth Supports Copper Demand

Rising usage in China's car industry has offset weakness elsewhere



Source: Citigroup

For many years, the global copper industry has struggled with productivity and grade declines at existing copper mines, caused in part by the conversion from open pit to underground mining, as well as a deterioration in ore quality and resource nationalism. Combined with the lack of new copper ore discoveries caused by a lack of investment in exploration, this is leading to an increasing shortage and gap between supply and demand of mined copper.

It should be noted that of 224 copper deposits discovered between 1990 and 2019, only 16 have been discovered in the last decade.

Also of note is that, according to consulting firm McKinsey, the trend toward electrification is expected to push annual copper demand to 36.6 million tons by 2031, while supply is expected to be 30.1 million tons (up from 22 million tons currently), creating a deficit of 6.5 million tons at the start of the next decade.

Some of the world's largest mining companies and metals traders warn that the deficit could occur as early as 2025.

According to the International Copper Study Group (ICSG), the copper market is facing another year of deficits. In its April forecast, published by Reuters, the group projects a supply deficit of 114,000 tons in 2023, following a deficit of 431,000 tons in 2022.

At its last meeting in October, the ICSG expected global mine production to grow 3.9% in 2022 and 5.3% this year. It now expects growth to be 3% last year and has lowered its forecast for 2023 to 3%.

The ICSG cites "operational and geotechnical issues, equipment failures, adverse weather conditions, landslides, revised corporate policies in some countries, and community actions in Peru" as reasons for its lowered growth expectations for the mines.

Despite this growth outlook for copper demand, and many unanswered questions about the necessary supply, copper prices corrected from a peak of U\$4.80/pound in March 2022 to U\$3.25 in summer 2022. The price then recovered to U\$4.25 by the end of the year and is now trending in a sideways pattern in 2023. On a positive technical note, the price has always held above the important long-term 200-week moving average line (red) with 'only' minor violations and tests. Also, the 50-week moving average line (blue) has so far always remained above the long-term 200-week moving average. Currently, the copper price was able to push itself above the 50-week average line again and thus confirm its upward trend - see the following chart:

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Chart: Price of the copper futures Continuous Contract on the CME in U\$ (21.6.2019 – 21.6.2023) (source: www.stockcharts.com)

Headwinds for copper prices include the slower-than-expected economic recovery in China and concerns that the United States could fall into recession, following 10 straight interest rate hikes by the Federal Reserve to curb U.S. inflation.

A glimmer of hope for copper and other metals emerged on 14th June when the U.S. Federal Reserve decided at its regular meeting to pause interest rates - the first time it has done so since the rate-hiking cycle began in 2022.

While copper declined on the news, the red metal rebounded after the People's Bank of China (PBOC) cut short-term interest rates to spur economic growth. Markets now expect the PBOC to make further rate cuts to help revive China's slow economic recovery. Further stimulus in the country is expected to boost economic activity and fuel copper demand later this year.

This reinforces the view of some key market participants in the copper sector, that the current setback in copper is only temporary, and that the upward trend is likely to resume soon.

Robert Friedland, the billionaire founder of Ivanhoe Mines, said that although copper prices fell below \$8,000 a ton on 24th May for the first time in six months, the metal, which is essential to decarbonizing the global economy, continues to face a supply crunch.

The EV revolution - 10.5 million electric cars in 2022 - 27 million in 2026

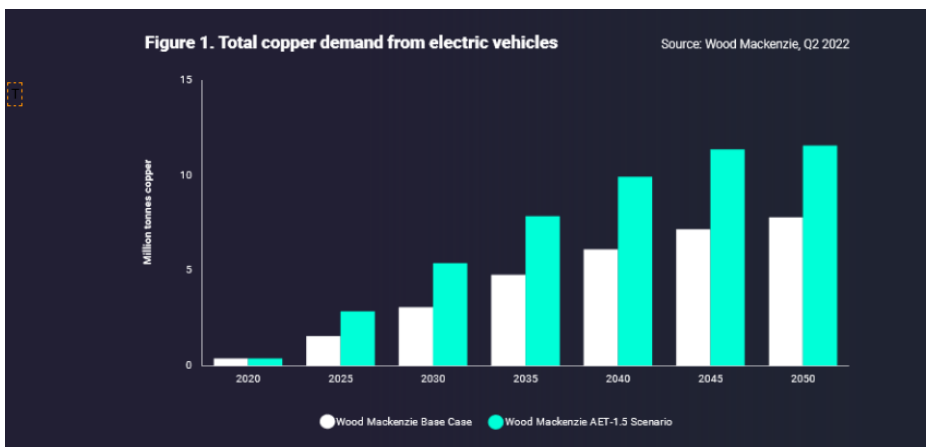


Electric vehicles will form by far the largest element of demand growth for green copper over the next two decades, accounting for 55% of demand.

The premise that copper demand will benefit from energy transition has already turned from opportunity to reality. Global sales of electric vehicles have tripled in three years. Government subsidies in China, the USA and Europe have also contributed to greater market penetration. Plants to produce copper foils for batteries are being developed at full speed throughout Asia, North America and Europe. In the last year alone, production capacity for electro-deposited copper foils of at least 1 million tons p.a. was announced. These production facilities will be completed in the next few years to meet the expected demand.

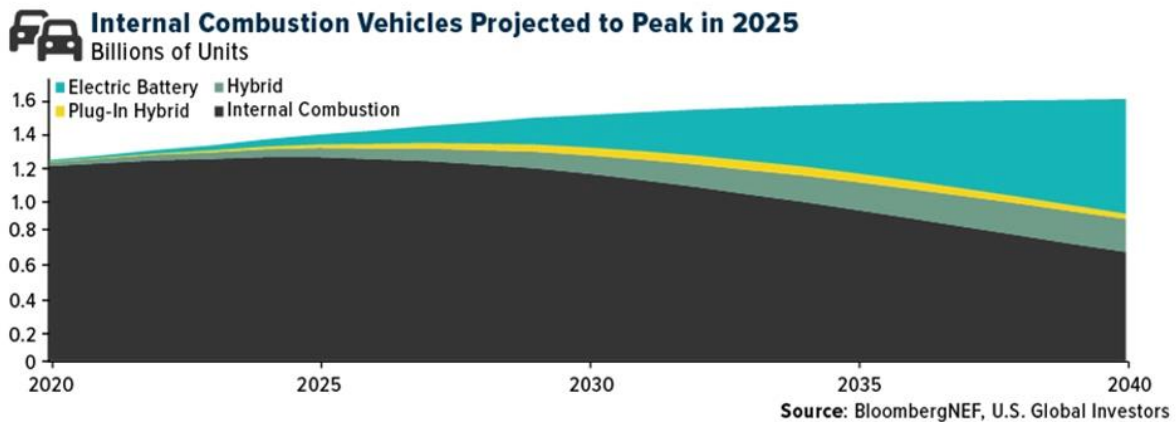
Owing to the foil in the batteries and additional wires needed for the motors, a battery-powered electric vehicle can consume more than three times as much copper as a conventional vehicle with an internal combustion engine. For commercial vehicles, the difference is even greater.

To put the world on the net-zero path of the Paris Agreement, the share of plug-in electric cars in total vehicle sales must rise to more than 35% by 2025 and reach nearly 70% in the following ten years. In 2021, the figure was still less than 9%. This higher market penetration of copper-intensive e-vehicles will drive up overall copper consumption. In the AET-1.5 scenario (Accelerated Energy Transition - www.woodmac.com), copper demand for electric vehicles will be 40% higher by 2040 than in the baseline climate scenario. Overall, demand in the EV segment should increase by 9.6 million tons over the next 20 years.



As Robert Friedland has already indicated, much of copper's bullish fundamentals exist on the demand side. Electric vehicles require three to four times the amount of copper as regular cars and trucks, and then there's all the copper needed for electric vehicle charging stations, renewable energy, and new transmission lines.

Although there are barriers to electric vehicle adoption, such as the relatively high price, and anxieties over the range they can achieve, sales of electric vehicles are on the rise. Last year, there were 10.5 million, and according to Bloomberg New Energy Finance, there could be 27 million by 2026. Bloomberg predicts that the global inventory of internal combustion engines will peak in just two years, at which point the market will be dominated by e-vehicles and hybrids.



Renewable energy generation

Just as we are seeing in the automotive market, the decarbonization of power generation is already underway. Global wind power generation capacity has increased by more than 40% in the last three years. Cable manufacturers such as Prysmian and Nexans are expanding capacity in North America and Europe to meet the necessary growth in expanding power grids. Increasing targets for offshore wind energy and upcoming orders will boost demand for copper wire rod.

Apart from the wind turbine itself, copper cables are used to connect turbines to the onshore grid. Offshore wind farms are therefore more copper-intensive due to the higher cabling requirements. Copper demand in the offshore segment will increase sevenfold by 2040, according to Wood Mackenzie's base case scenario. In their AET 1.5 scenario, it increases more than 13-fold. Wind power generation will require an additional 1.0 million tons of copper over the next 20 years under a net-zero scenario.

The use of copper in solar power generation has as great an impact, as wind power. Copper consumption in photovoltaic (PV) systems can be divided into two areas. The Balance of System (BoS) includes all components of a photovoltaic system except the modules. This includes wiring, switches, a mounting system, one or more solar inverters, a battery bank, and a battery charger. The solar panel itself uses copper ribbons to connect the solar cells contained in crystalline silicon.



Copper demand for solar energy under the 1.5 °C climate goal scenario is estimated to more than double the baseline scenario over the next decade, while additional consumption under a net-zero pathway will be 1.1 million tons over the next 20 years.

The Distribution of Electricity

The transition to a more electrified world and higher power generation will require the modernization and expansion of power grids connected by wires and cables. This will lead to higher growth in demand for refined copper-intensive wire rod.

For the world to accelerate on the path to carbon free energy distribution, new power grid infrastructure will need to increase copper demand by 6.7 million tons by 2040 - nearly 4 million tons (or 50%) more than Wood Mackenzie's base case.

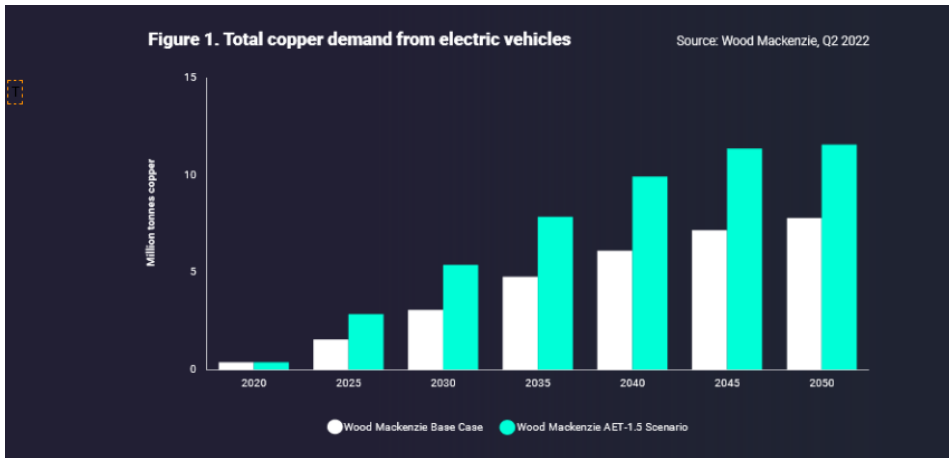
In total, e-vehicles, renewable energy and related infrastructure will account for 18.4 million tons of additional copper consumption over the next 20 years. This represents 60% of the current total market volume of copper and compares with additional growth of only 11.7 million tons in the last two decades, during the period of the Chinese economic miracle.

Mine supply: Where will the copper come from?

To achieve these new targets, the supply of new mines must be increased considerably. The mining industry needs to bring numerous new projects into production, and maintain a constant level of investment, which is not something that is happening.

The additional volume of copper required means that 9.7 million tons of new mine material will be needed over the next ten years, from projects that have not yet been approved. This corresponds to almost one third of current consumption of refined metal. This compares with 6.5 million tons in Wood Mackenzie's baseline forecast, which is itself already a challenging target.

This estimate of the need for new mines also assumes that there will be a greater contribution of copper from secondary material, to meet overall demand for refined copper. This requires investment in further scrap processing capacity and a significant increase in the availability of scrap.



Scrap metal and recycling: Can we close the loop on copper supply?

Copper can be recycled an infinite number of times, and it can be reused indefinitely without sacrificing quality. These inherent properties reduce its longer-term environmental footprint and make it attractive from a social perspective, to focus on using more of what was previously considered waste material or destined for landfill.

Copper already relies heavily on the circular economy. More than one-third of total consumption comes from secondary sources. There are estimates that this share could increase to 45% by 2050, and with higher recycling rates, the contribution of recycled metal could be even greater.

Increasing investment in the collection, sorting and use of scrap will help to close the supply gap. However, there are limits to the speed at which scrap can be returned to the product cycle in large quantities. Therefore, as part of achieving the 2050 targets, increased availability and higher collection and recycling rates, additional processing capacity and improved recyclability of products are required.

Although we expect scrap demand to grow faster than primary metal growth, it remains underutilized relative to its overall availability. Why is that the case? The principal reasons are because of prices, profit margins, as well as quality and technology limitations.

Any increase in scrap use will have to be supported by additional policies that stimulate, and generate more attractive economic conditions, that will encourage the sector to grow. One catalyst for change is carbon emission targets. A consumer-driven preference for greener and more sustainable raw materials should provide incentives for the increased use of scrap. Recycling alone, however, will not eliminate the need for primary metals.

CHILE: The largest global copper producer, but with stagnating output

Chile is a good example of why it is so difficult to find and develop new copper deposits. The country's copper production is stagnating due to deteriorating ore quality and water restrictions in the arid north. Permitting processes are also becoming increasingly difficult.

In 2021, leftist Gabriel Boric was elected president of Chile with a mandate to impose higher taxes, startling the mining industry, which argued that it would hurt competitiveness.

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Constitutional reform was also on the agenda. Since being elected tempers have calmed. A proposed new constitution was rejected by voters last September, while an ambitious plan to overhaul the tax code was rejected by Congress in March. A government plan for new levies on mining, currently working its way through Congress, was reduced to 46%.

The major integrated mining companies have been following these developments closely. BHP, majority owner of the world's largest copper mine, Escondida in Chile, wants the Chilean government to make further concessions on tax legislation before investing an estimated \$10 billion in the country. A BHP executive said the tax burden at its main Chilean competitors was 41% to 43%.

In a recent note distributed via Bloomberg, Fitch Ratings said Chilean companies are likely to scale back their growth plans this year as the likelihood of higher taxes and labour costs, reduces returns on new projects.

The most obvious example is Codelco. The state-owned copper mining group and world's largest copper producer lowered its 2022 production forecast, citing lower recoveries at some of its mines and lower ore grades at its Chuquibambilla mine. In November, the company said it expected 2022 production to be between 1.49 million and 1.51 million tons, down from its previous forecast of 1.61 million tons.

Recently, Codelco CEO Andre Sougarret stepped down after less than a year on the job as the copper mining group struggles with lower production. Although Codelco is investing about \$3.5 billion annually to upgrade its existing mines, its copper production has fallen more than 11% this year to a 25-year low, as per a report from Mining.com.

1 ton of copper requires 90m³ of water!



Copper mining is complex and requires significant amounts of water. Water is used in various steps to concentrate copper ores, including crushing, flotation, classification and thickening. To extract one ton of copper, about 90 cubic meters of water are needed.

Last year, Chile experienced its 13th year of an historic drought, prompting Santiago to impose unprecedented water rationing on residents. Miners are also feeling the effects. A Reuters article from 2022 states that production at Anglo American's flagship Los Bronces mine in central Chile fell 17% in the first quarter of 2022 compared to the previous year, partly due to water shortages.

Mining companies are being pressured by the government, which has tightened environmental regulations, to reduce their freshwater withdrawals, and many are turning to unconventional methods such as desalinating seawater.

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Mines such as Los Bronces, located high in the Andes, face the most serious water problems, as drought is likely to persist, and building desalination plants near the sea, building pipelines to transport the water hundreds of kilometers inland, and pumping the water to the high elevations pose major technical challenges and costs.

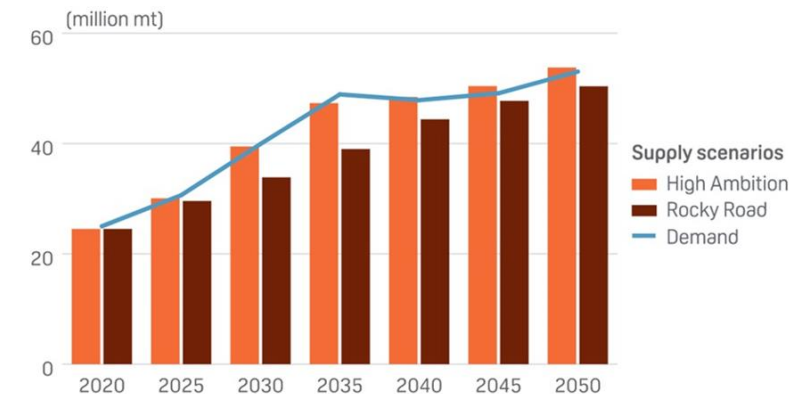
According to Cochilco (the Chilean Copper Commission), the use of seawater - either direct or desalinated - in mining will increase by 167% by 2032, while the use of freshwater will decrease by 45%. By then, 68% of the water used by the industry will come from the sea.

Copper shortages loom

It is estimated that more than 20 million tons of copper are consumed each year in a variety of industries, including construction, power generation, power transmission, and electronic products.

In recent years, the global shift to clean energy has further increased the demand for copper, as much more of the metal is needed to power our renewable energy infrastructure. BloombergNEF estimates that copper demand, driven by various clean energy initiatives, will increase by 53% to 39 million tons by 2040. Analysts at S&P Global expect an even faster and larger jump: copper demand is expected to double to 50 million tons by 2035.

GLOBAL COPPER SUPPLY SCENARIOS AND DEMAND



Source: S&P Global

The consulting firm McKinsey projects that electrification will create a copper deficit of 6.5 million tons at the beginning of the next decade, indicating a significant production gap that the mining industry will have to fill.

Glencore's outlook on copper supply is far more pessimistic than, say, McKinsey's. The company believes the world will be short 50 million tons of copper by 2030 if it is to meet its zero emissions targets.

Of course, the world needs new copper mines, but they can not be built and put into operation that quickly. In North America, 20 years can pass between the first discovery and the first production. We have less than seven years before the demand ramps up substantially.

Nearly 80% of the use of copper is related to its property as an electrical conductor. Consequently, future growth in global electricity demand will also boost copper consumption as economies develop. However, the use of copper for EVs and renewable power generation is much more intensive than for their fossil fuel-powered counterparts. Together with the associated expansion of electric power grids, this increases the expected future demand for the metal.

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According to a study by copperalliance.org, copper will play the decisive role in the energy transition along the way to Net Zero. Current annual production of about 25 million tons of refined copper causes almost 100 million tons of greenhouse gas (GHG) emissions (0.2% of global emissions) but the short-term environmental cost of these GHG emissions, will make an enormous contribution to enabling and help reduce an estimated 2/3rds of global greenhouse gas emissions.

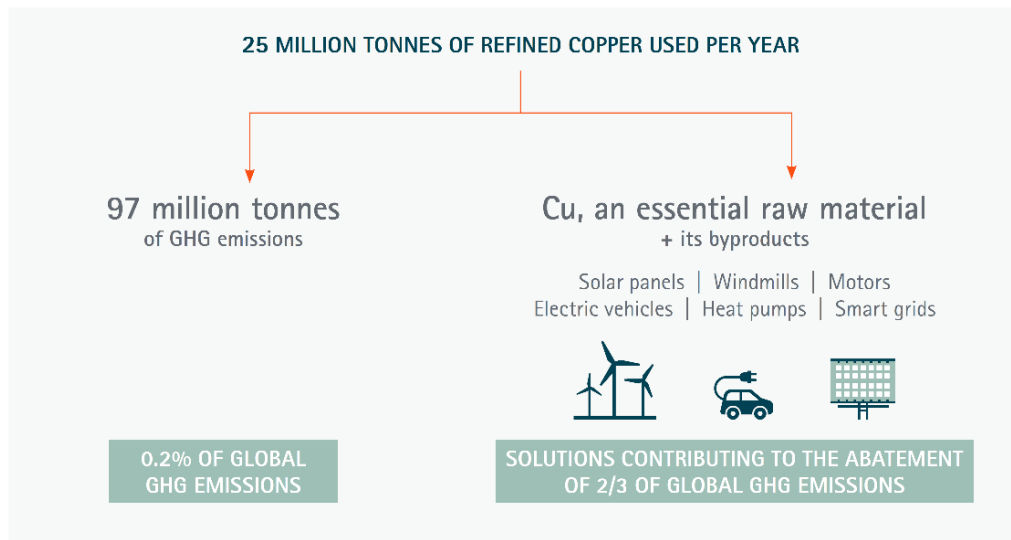


Figure 10 – Cost-Benefit Analysis of Copper GHG Emissions

Conclusion for SUNARES Fund Advisors:

The medium and long-term prospects for copper prompt us to pay even more attention to this sector in the future, and to seek out the most promising and sustainable copper producers, suppliers and recycling companies for the fund. With major mining companies increasingly diversifying their commodity portfolios into copper, such as BHP (purchase of OZ Minerals), and gold producers, like Barrick Gold Corp. (expressed an interest in buying First Quantum), we will look to increase our copper mining exposure, especially in those companies that might be vulnerable to takeovers by their larger rivals, and we aim to implement this faster than global commodity companies.

The current weighting of copper producers is circa 13% of the fund volume, but it is quite possible that this share will increase further in the coming months. We evaluate the holdings on the basis of the quality and size of the ore body, sustainability and ESG factors in production, quality and skills of the management, resource and water consumption, as well as maintaining the appropriate country and continental diversification, These, and other factors, are continuously taken into account.

Udo Sutterlüty & Colin Moor

Sources:

Red metal, green demand – October 2022 (Wood Mackenzie – Research)
New copper supply offset by multiple hits to existing operations (Rick Mills – www.mining.com)
Copper – The Pathway to Net Zero (<https://copperalliance.org>)
Own Research & www.stockcharts.com
Bloomberg

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