RESOURCES THROUGH 2019. CONSIDERING TRUMP, TRADE WARS, TARRIFS AND TAX

March 2019 White Paper prepared by Lowell Resources Funds Management Limited, Investment Manager of the Lowell Resources Fund

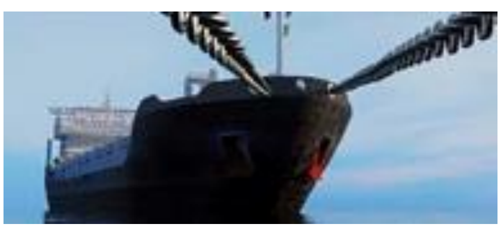
Overview

Global markets are in a state of flux, with the major equity indices showing little regard for fundamentals. The sharemarket is currently a twilight zone, a battered and bruised bystander to fights on a higher level and massive changes in public policy. The market is hoping for an end to this situation when President Trump produces a trade deal with China, however it may be a case of buy on the rumour and sell on the fact.

Mineral and energy prices have been buffeted by political sea changes, primarily the monumental restructuring of global trade agreements.

Forces present in the market today including Trump, growing trade wars, tariffs & taxes will increasingly impact global markets and Australian resource companies.

An incipient resurgence in the junior resource sector through the first half of 2018 was nipped in the bud by events in the US, as well as in Europe/UK and China. Consequently, resource prices, particularly oil, fluctuated over the second half of 2018 and, apart from gold, ended the period down significantly.



Reflecting the flight of risk capital out of the microcap sector in general, through the second half of 2018 there was minimal interest in the mineral exploration sector. On the other hand, mid-tier and major producers have been amassing large cash piles, which are being selectively deployed into emerging opportunities through equity investments, joint ventures and acquisitions.

Central Banks

We are bullish regarding the prospects for resources in the longer term, but the short-term outlook remains uncertain, weighed down by international trade tariffs, debt, a slowing world economy, and reduced global liquidity, all adding to the climate of uncertainty. On the positive side of the coin for juniors, and for gold, has been the US Fed's recent change to a more dovish stance on interest rates.

Central banks, and governments in general, are playing a key role in stimulating economies globally, through interest rate standstills or even potential cuts in key economies such as the US and Europe, as well as Australia. Government sector stimulus is also increasing in China, with a massive credit boost to SME's announced in January. We believe that Central Banks will continue to find it hard, if not impossible, to remove the prop of 'cheap money' to which equity markets have become addicted. That difficulty is not eased when Trump bombards the Fed with tweets demanding a weak dollar and low interest rates.

Central Banks have also resumed a key role in gold, a market which is pivotal to the junior resources sector. In 2018, central banks globally purchased a total of 652 tonnes of gold, the second largest in any year in history (the largest being in 1971 when Richard Nixon ended the gold standard). In 2019, the Chinese central bank has renewed its gold buying program, futher diversifying away from US dollar assets.

The End of the Risk Off Trend?

2018 saw an exodus of capital from most risk sectors. The S&P/ASX Emerging Companies Index fell over 25% across the calendar year, a period which can be broadly correlated with expectations of higher interest rates.

Resulting from the dearth of more speculative capital globally, the lacklustre junior exploration sector was at odds with local cashflow-generating mineral producers, whose profits were boosted in the 2nd half of 2018 by Australian dollar weakness, and recent gold price strength. Such divergence is typical of the early stages in the commodity cycle, and we expect this to evolve over time to the advantage of the junior explorers who offer the greatest potential for capital appreciation.

Since Christmas, the market has reversed its views of interest rate rises, and more speculative capital has been edging back into sectors such as resources exploration and development.

US Trade and Budget Deficits

The US trade and budget deficits continue to blow out, with a trillion-dollar US budget deficit (which includes off-balance sheet items) forecast. This is expected to necessitate increased Treasury borrowing by more than 60% annually for years to come. Monetary creation on this massive scale to facilitate debt-service, along with increased social spending and defence commitments, and compounded by declining tax revenues, can be expected to ultimately degrade the US currency and increase the USD price of natural resources.

The China-USA Trade War

The American consumer and Chinese manufacturer are of fundamental importance to the Australian economy, given its reliance on exports. The deliberate unwinding of globalization by the Trump administration and its potentially detrimental impact on international trade is therefore of concern. History suggests that there are no winners from this nationalistic focus on protectionism.

According to the Federal Open Market Committee, US GDP growth rate will be 3% in 2018, slowing to 2.3% in 2019 and 2.0% in 2020, and 1.8 percent in 2021, with the FOMC attributing the slowdown to the trade war. The impact on China and other smaller economies may be more significant.

The 2018/19 financial year commenced with a strong US economy and a bull market in equities, supported by strong earnings, record low unemployment, tax cuts, deregulation, infrastructure spending, repatriation of overseas funds, and massive stock buybacks. Flight capital from around the world was attracted by the security and high returns of US stocks, which trended higher until collapsing in the 4th calendar quarter of 2018, down 8% for the year. Apart from tariff concerns, growth momentum declined in response to diminishing Treasury revenue and tightening monetary policy.

China, Australia's largest market for minerals and energy exports, has borne the brunt of the US tariff measures. China ended 2018 in a challenging situation, but the country has overcome far more difficult obstacles in years past. Large stimulus measures announced in January 2019 appear to be having the desired effect as the first calendar quarter draws to a close.

With a disruptive transition already underway from an export-driven economy to a focus on increased domestic consumption, China was poorly positioned to weather the US trade imposts. In challenging US hegemony in high-value manufacturing and technology, China's position today is broadly comparable to Japan in late 1980. China has already drawn ahead of the US in several transformational industry subsectors. As with Japan thirty years ago, China is now attracting punitive measures from the US, but on a more drastic scale.

The Chinese response to US tariffs has included devaluing the yuan, tax reductions, and other stimulus measures to promote infrastructure spending and domestic consumption. Along with stricter environmental regulations, these policies boosted demand for Australian LNG and high-quality bulk commodities coal and iron ore. By promoting domestic demand and productivity growth along with transformational technologies involving robotics, electric cars and biotechnology, China is moving up the industrial value chain to compete more effectively with the US, Japan and Germany.

Furthermore, China is establishing production supply networks in neighbouring South East Asian countries, thereby lessening the tariff impact. Frontier economies such as Vietnam have been major beneficiaries of this trend. The Belt & Road strategy is focused initially on the 2,750 km China-Pakistan Economic Corridor which would connect China to the Indian Ocean. China therefore continues to expand the process of globalization, even with declining US participation.

Europe

Europe is in dire straits, with the cultural and economic disparity between the prosperous northern nations and relatively weak southern regions exerting mounting pressure on the fragile union. The Italian budget deficit appears to be beyond redemption, while escalating unrest in France centred on widespread rejection of Macron's policies further jeopardizes the already overburdened economy. Chronic banking distress in Greece and Italy endangers creditor nations such as Germany, putting Deutsche Bank, among others, at risk. The International Monetary Fund (IMF) has voiced concern that Germany's positive trade imbalance and large current account surplus threaten stability. Brexit issues further compound the problems.

Announcements by the European Central Bank that it would end its bond purchases, at the same time as reducing its growth forecasts, proved most inopportune. As a result, Mario Draghi has been forced to quickly backtrack. The ECB is reinstating its program to lend to commercial banks at zero interest rates, and has confirmed that there will be no interest rates changes until at least 2020.

The Resource Sector

The Wall Street Journal of November 25, 2018 reported that of the 70 different asset classes comprising stocks, bonds, commodities, real estate, and other less conventional assets, 90% showed negative returns for the year to date, a situation not seen in the past 100 years. The attraction of safe-haven dollar-denominated assets and the depth, liquidity and initially strong performance of the US sharemarket acted as a magnet as momentum trading of major technology stocks proved so rewarding. Interest in the resource sector declined, especially in junior oil & mining stocks.

US markets have therefore dominated global trends. The "Buffet indicator" based on the market capitalization of US stocks relative to GDP was at the highest point ever prior to a late-year decline. Commodities, in contrast, were at their lowest level in 50 years relative to US share prices. Such extreme departures from the norm tend to be relatively short-lived as prices revert to the longer-term mean, often overshooting in compensation. For example, the relatively depressed commodity prices in the late-1960s and late-1990s shown below were followed by a sustained rise in commodity prices. A similar response was observed in the 1940s.

Following the late 2018 sharemarket reversal, the forward P/E ratio below 15% was at its lowest level in four years. US industrial output had declined, with the Philadelphia Manufacturing Index the weakest since mid-2016.

Gold, in contrast, rose significantly in December and January. This may set the stage for a broader revival in the resource sector in 2019, as implied by the chart pattern below.

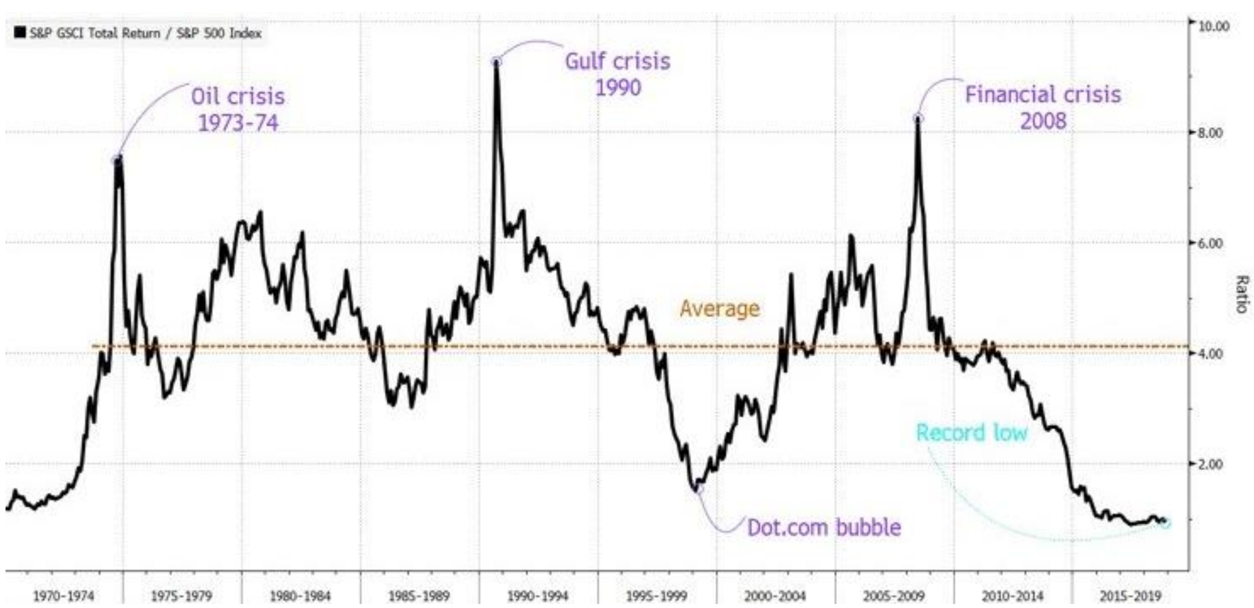


Chart: Commodity index relative to the S&P 500 share price index showing periods of drastic underperformance by commodities, including the present, followed by resurgence in the early 1970s and late 1990s-early 2000s. From Bloomberg.

Crude oil ended the year weak, but gold showed encouraging signs of revival as a hedge against weakness in equity markets, posting gains on days of massive declines in major US share indices. Oil prices had been strengthening until 3Q and then experienced a precipitous decline, partly as a result of phenomenal growth in US oil output and OPEC oversupply. Base metal prices fluctuated, most were down 15-25% for the year. The bellwether copper price has increased in 2019, correlating to a sharp fall in metals exchange stockpiles – copper stockpiles on the LME, Comex and SHFE fell by more than 50% from March 2018 to January 2019. In 2019, this drawdown may accelerate due to the world's second largest copper mine cutting its production by 85%. Indonesia's Grasberg, which produces 4% of world total copper output, has cut its estimated copper concentrate output in 2019 from 1.2mt to 0.2mt, as it is transitioning from depleting open cut mining to underground.

A broadly-based upturn in the resource sector which is anticipated by several prominent market commentators faces hurdles, foremost of which are Trump's protectionist policy, global debt levels, and indifferent economic outlook.

Salient Global Risks

Protectionist policy

Elevated geopolitical risk, fluctuating commodity prices, and a more challenging exploration environment continue to bedevil the resource sector. Nationalistic fervour and the imposition of US trade tariffs on China have impacted global markets, and the post-globalization scenarios remain clouded.

The process of globalization, currently being dismantled, gave rise to an era of international trade equilibrium which boosted prosperity worldwide and raised perhaps a billion people from poverty. Geopolitical Futures report of December 5, 2018 foresees an "ugly process of economic disintegration" that will impact the structure of the world economy.

The Smoot-Hawley precedent in 1930 and its contribution to the Great Depression warns of potentially far-reaching implications. To date, the Chinese economy has borne the brunt of Trump's pronouncements, with slowing growth and a massive sharemarket decline. The US economy, on the other hand, is in a relatively powerful position, sustained by prodigious bond issues, tax cuts, deregulation, and the torrent of foreign capital seeking refuge in the depth, liquidity and security of US markets.

Developed Countries' Debt and Interest Rates

As pointed out by the Economist, among others, the developed world is ill-prepared for the next recession, with already bloated balance sheets and lacking the traditional tool of significant interest rate reductions. A report from the OECD in November 2018 predicted a “fragile soft landing” as global growth declines to around 3.5% in 2019-2020 with China slowing to its lowest rate in 30 years.

The strong selloff in global markets during late October and persisting through November 2019 was ascribed to trade tensions, mixed US earnings, monetary tightening, Eurozone instability, Brexit tensions, and the untenable positions of small overleveraged export-reliant emerging economies.

In response to the global financial crisis of 2007-09, zero interest rate policies in the major economies coupled with prodigious money creation helped avoid a depression, but also triggered speculative bubbles in financial assets and unprecedented government debt. The US, Japan and several European countries are expected at some stage to be unable to meet debt-servicing costs, let alone repay.

Corporate and private-sector debt have also reached unsustainable levels. US corporate debt hit an all-time high of over 45 percent of GDP. There is a growing proportion of “zombie” companies in 14 developed economies. These are companies “that are unable to cover debt servicing costs from current profits over an extended period.” It is estimated that approximately 16% of US firms fall into this category. These overly leveraged companies are at risk of defaulting during

Emerging Markets

Emerging markets are in in a difficult situation. Saddled with debt, much of it denominated in US dollars which magnifies the burden as local currencies decline, and facing threats of reduced Chinese commodity demand, Turkey, Argentina and Brazil have proved particularly vulnerable. Many other relatively weak commodity export-dependent economies are at risk. Europe is vulnerable, given the limited scope of ECB intervention. The resilience of US equities relative to the collapse of most foreign ETFs reflects this dichotomy.

According to Jason Shapiro in Geopolitical Futures, dollar-denominated international debt soared to US$11.5 trillion 2018, while total global debt, excluding financial institutions is US$186 trillion (equating to 320% of global GDP). This compares to a pre-GFC global debt of US$113 trillion. Emerging market currencies have been depreciating, increasing the debt burden. Turkey has among the highest percentages of external debt to GDP, and South Africa, Mexico, Brazil and Argentina are heavily exposed too.

The US tried raising interest rates in 2018 and unwinding the bloated Federal Reserve Bank balance sheet. Central banks in Europe and Japan announced plans to follow suit, starting by curtailing their massive asset purchases. However, equity markets reacted negatively to these attempts, and as economic growth data softened Central Banks have been forced to rapidly change course so as not to deplete the ocean of liquidity that has been supporting global asset prices.

The mountain of debt is unlikely to be reduced by growth or default, leaving accelerated currency creation (inflation) the only viable option. This augurs well for future USD denominated commodity prices.

The Economic Cycle

Drawing on the Smoot-Hawley 1930's analogy, market research reports such as Edelson Wave, among others, recognize a similar pattern emerging in the current interplay of global politics, economics and debt.

Mutually reinforcing patterns in demographics, interest rates, debt, and human behaviour are culminating in a supercycle that commenced, as forecast by Edelson Wave, with soaring stock prices in the United States, government debt blowouts, political impasse, military confrontation and civil unrest in many parts of the world.

A period of asset destruction, already underway in Europe, may spread to other developed economies and eventually the US. This may be somewhat analogous to the period between 1932 and 1937 in the midst of the Great Depression when the Dow appreciated by 372% and gold stocks soared, even at the prevailing fixed price of bullion.

The enormous capital inflow in 2018 and a strengthening US dollar is reminiscent of the early 1980s where dollar appreciation in response to tax cuts and higher spending ultimately presented a headwind to economic growth. These concerns culminated in the 1985 Plaza Accord whereby the dollar was deliberately devalued. While we do not expect intervention on this scale in 2019, we have forecast the potential for a weaker US dollar in response to slowdown in interest rate hikes signaled by the Federal Reserve together with accelerated dollar printing to address spiraling deficits and monumental debt. This would be a positive for the resource sector as a whole.

The paucity of equity investment in resources, increased social and environmental burdens on the mining sector, and reduced exploration expenditure must eventuate in a shortfall in supply. This in turn should lead to significantly higher commodity prices as global growth picks up. As always, the smaller more speculative stocks offer the highest growth potential.

An impending recession is a certainty, but the timing is unknown. The Congressional Budget Office warns that mounting debt will ultimately trigger a more serious economic crisis as the deficit soars, government spending increases, and tax revenues plummet.

Commodities

Commodity cycles commence with protracted episodes of depressed prices followed by growing investor interest culminating in overblown price extremes preceding a renewed decline. Each cycle tends to be preceded by an asset bubble, monetary stimulus, and economic stress.

Bull markets in the resource sector take years to build up steam, and at the outset junior resource companies tend to lag the more mature mineral producers. The hesitant steps currently underway have been punctuated by false starts or sudden reversals, but the tempo may increase in 2019, perhaps starting with the stronger gold price seen since December 2018.

World mineral supply/demand fundamentals are strong, with restrained supply growth and the positive impact of China's environmental policy spurring high-grade imports.

Gold

Gold has represented an unsurpassed store of value for thousands of years but is subject to extreme fluctuations in investor interest. As mentioned above, Central Banks' strategies are currently supportive of the gold price – indirectly as real interest rates remain historically low, and directly as central banks continue to be major buyers of bullion. The US dollar gold price has remained fairly stable for the past 5 years, however, as a result of currency depreciation, in early 2019, the Australian Dollar gold price hit all-time highs above AUD$1,850/oz.

News of spectacular new discoveries such as in the Paterson Province of Western Australia, as well as in Ecuador and Bosnia, have elicited a share price response, but overall interest in junior gold exploration companies has been muted, in stark contrast to the strong performance of more mature gold producers. The build-up of cash in Australian mid-tier gold producers in particular, when viewed against their reserves growth, should result in increased M&A activity in 2019, of which junior gold developers will be the prime target.

Incrementum (2018) voiced the opinion that we are in the early stages of a bull market in gold which has been temporarily interrupted by the election of Donald Trump. Similarly, renowned gold investor Pierre Lassonde has recently opined that in 2019 the gold price will break out of its "seven year doldrums", a period during which the majority of portfolio managers have had no exposure to gold. Lassonde believes that these managers are now looking at gold. He stated that the USD is overvalued and 80% of the gold price is attributable to the value of the US dollar. Lassonde notes that the US administration is keen to see a lower dollar. Lassonde forecasts US$1,400/oz gold price in 2019, and US$1,500/oz the year after. He notes that the valuations of gold stocks are the lowest in 40 years and he has been investing heavily in them in the last 6-12 months.

These views should be borne out particularly if inflation starts to creep in, but at the same time the US Federal Reserve decreases its tightening bias. This would result in continued negative real Federal funds rate, which is historically positive for the gold price.

A further indicator is the peaking of the NasDaq technology stocks index. Following both peaks in the Nasdaq in 1971 (the Nixon shock) and 1999 (the Dotcom bubble), falls in the Nasdaq preceded large increases in the price of gold.

Oil

2018 saw a massive 85% price rise and subsequent collapse, the latter due to increased US shale oil production, OPEC overproduction forecasts and the ineffectiveness of Iranian sanctions.

US Shale Oil

With US oil production achieving a record of over 12 MMbod in March 2019, eclipsing Russia and Saudi Arabia, shale oil production contributed to a surfeit of new energy supply stemming largely from the Permian Basin of West Texas and New Mexico.

Unconventional shale oil production has soared to make the US now the largest producer and a net exporter of oil. For the US industry to maintain momentum it is likely to need another leg up in oil price but until then, many US unconventional producers appear to be break-even at best, with many companies reportedly heavily indebted and reliant on cheap financing, which may continue for the mid term if interest rate rises stay on hold.

Well production rates decline rapidly for shale oil, necessitating an ongoing high-cost drilling & completion program, greatly assisted by the low interest regime.

Recent data suggests the oil market will continue to tighten. As of February, with the announced OPEC cuts global supply is 99.7M barrels a day. Global demand in 2019 is forecast to rise in second half of year to over 100 mmbbls/d. Thus the forecast is for a deficit of 1M barrels a day by 2nd quarter 2019.

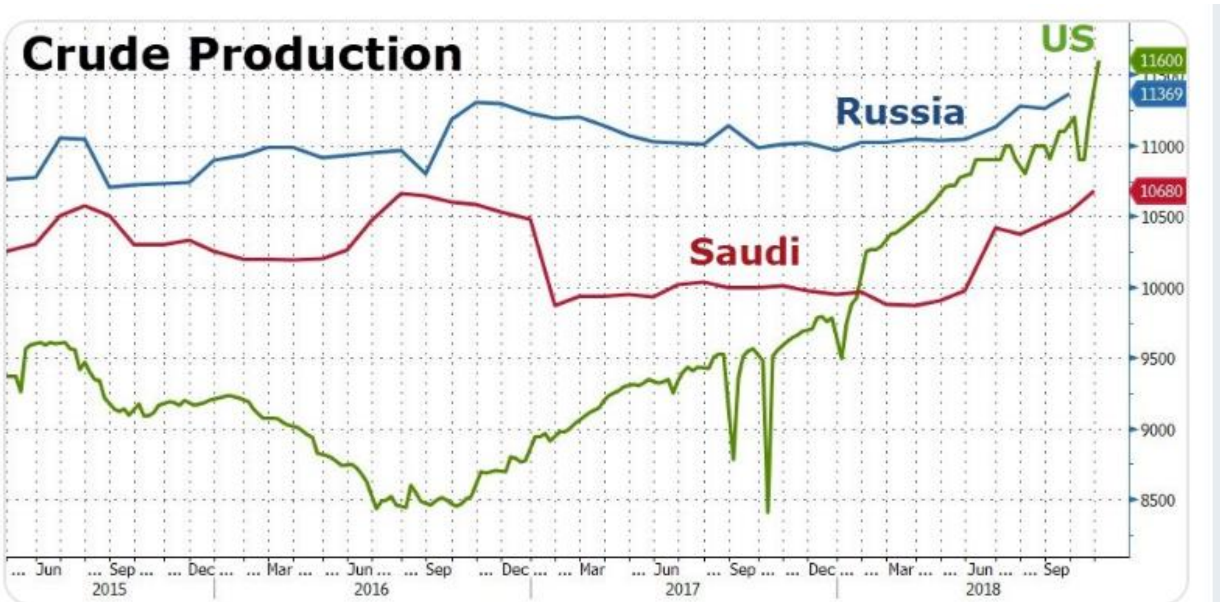


Chart: *The US becomes the world's largest crude oil producer, overtaking Saudi Arabia and Russia. The may prove to be a temporary phenomenon, based as it is on unconventional shale oil (Source Bloomberg).*

Oil Demand

Longer-term, much will depend on demand strength linked to economic growth and inroads from electric vehicles. Non-OPEC conventional oil reserves have plummeted. Reduced exploration expenditures have led to fewer and smaller conventional discoveries, to such an extent that the consumption vs replacement ratio is in deficit over the past five years of over 200 billion barrels.

Only Saudi Arabia has significant surplus capacity to service growing oil demand. China continues to dominate crude imports – February 2019 oil imports to China were up 22% year on year - and India's demand growth rate is even higher.

There is no question about demand growth, notwithstanding mainstream focus on impending obsolescence of fossil fuels. We are bullish on oil from the supply perspective. In due course electric vehicles will curtail oil demand, but this is too far into the future to be of immediate concern.

Natural gas

US natural gas supply continues to surge. The Energy Information Agency (EIA) reported that natural gas supply is now growing at rates exceeding 1 bcf/d per month, the fastest ever. Furthermore, gas is more than competitive with coal and renewable energy sources for electricity generation. Reflecting this strong gas demand growth, the Henry Hub price increased by around 20% in the fourth quarter of 2018 t0 $4.60/Mmbtu. However, the price has subsequently fallen back to below $3.00/Mmbtu as excess gas production from shale oil wells meets marginal demand.

Longer term in the US, LNG export projects may result in a situation similar to east coast Australia gas market i.e. a shortage of gas driven by export contract requirements. An additional 5-6 bcf/d is forecast to be required for new US LNG export capacity in 2019 alone.

The impending shortage of gas to supply domestic demand in eastern Australia provides a niche investment opportunity for both conventional gas and unconventional coal seam gas developers. Political obstruction is impeding exploration and commercial development of natural gas.

Increased efficiency of battery power storage may reduce the call on gas for flexible power generation, but even the most optimistic forecasts do not foresee renewable energy dominance in the next decade.

Base metals

Most base metals prices declined by 10-25% over the 2018 calendar year. However, across the base and industrial metals spectrum, a widespread theme has been reduction of domestic production in China as a result of environmental pressure. For example, China's copper mine production in 2018 decreased 9% yoy to 1.5Mt. This pressure is seen elsewhere, most prominently the 40Mtpa reduction in Brazilian iron ore production as a result of the Vale tailings dam failure(s). Increased regulation of tailings dams is expected to increase costs and decrease production at many new and existing mines globally, not just iron ore operations.

Copper

The performance of the bellwether industrial metal copper was disappointing in 2018, but the anticipated resurgence appears to have begun in the early months of 2019. On the demand side, rapid acceleration in copper demand is occurring in India (15% per annum) and China, as well as more widespread deployment in renewable energy installations around the world.

Forecasts indicate that demand for copper will not be met by supply from 2020, due to increasing copper requirement in power generation and electric vehicles. The current copper pipeline is the lowest seen this century, both in terms of numbers and capacity. Refined copper in LME, Comex and SHFE warehouses decreased from 875,000t in March 2018 to 400,00t in January 2019.

Increased demand for copper at a time when mine supply is becoming more constrained should result in a lengthy copper bull market. Given the multibillion-dollar capital costs involved, higher copper prices are inevitable.

In respect of copper supply, most of the largest copper mines are very old and many are depleting eg Grasberg, with new copper producers only capable of replacing existing production, without accommodating new demand.

Other Base Metals

A supply/demand imbalance is also forecast in other key base metals such as nickel and tin.

Nickel demand, long underpinned by use in stainless steel, is expected to be driven by increasing nickel battery usage, as lithium ion batteries progress from using metals in a 1:1:1 Ni:Mn:Co ratio towards a ratio of 8:1:1. The relatively small size of the nickel market, particularly sulphide nickel most amenable to battery metal production, and the traditional extreme volatility of the nickel price, may result in a significant spike in nickel prices.

Tin has been forecast by Rio Tinto as the metal most susceptible to shortage due to technology changes. The tin price has had an incremental rise of more than 15% since its 2018 low of US$18,145 per tonne in November, in the short term due to continued delays to exports from Indonesia, the world's second largest tin producer. The LME's depleting inventory sits at just over 1,300 tonnes on-warrant, which is less than 1-day's global demand. This has prompted a search for alternative supply, with the International Tin Association estimating as much as 30,000 tonnes of material sitting off-warrant in China.

Battery metals

Technological advance continues to adjust the focus on the niche metals required to optimize energy storage, both in electric vehicle (EV) and stationary applications. Of the key materials, graphite is abundantly found in East Africa, similarly cobalt from the Democratic Republic of Congo.

Lithium entered a period of oversupply during 2018, with a nearly 50% fall in price, but specifications have changed of late as battery design now favours lithium hydroxide, which can be produced directly from hard-rock lithium mines in locations like Western Australia, rather than from the vast evaporite deposits of South America where an intermediate processing stage comprising lithium carbonate is involved. However, new producers are encountering processing challenges, so the roll-out of additional production has not proved smooth. Lithium prices appear to have found a floor as a result.

Vanadium appears to have several advantages for large-scale energy storage from wind or solar sources. However, increased demand for vanadium in Chinese structural steel, coupled with reduced supply, pushed the vanadium price beyond battery economics in H2 2018. The vanadium price has fallen back from US$30/lb to under US$20/lb, but current prices are historically high still incentivize new production.

Key battery metal cobalt fell from $US95,000/t in late March to $US44,500/t in early November 2018, on demand concerns. Elon Musk said Telsa wanted to reduce the use of cobalt. Panasonic made a similar statement, and the largest lithium battery producer in China Contemporary Amperex Technology also plans to halve the amount of cobalt in its batteries. On the supply side, 60% of the global cobalt supply is sourced from the DRC, where political instability and increases in cobalt mining royalties are threatening supply.

Uranium

Nuclear power generation accounts for 10% of world electricity supply, and 18% in the US. Anti-nuclear sentiment is in a tug of war with environmental support over nuclear energy's status as an emissions-free source of power.

Chronic uranium oversupply and low prices have led major producers to shut down production, e.g. Cameco with its McArthur River mine, while Kazakhstan supply was also constrained. Uranium demand is increasing with new nuclear power installations under construction in Asia in particular. According to a Cameco report, 2018 demand has outstripped uranium production by some 60 million pounds, with the shortfall addressed by tapping into inventories. Demand forecasts foresee 800 million pounds of new supply required over the next ten years. Several Uranium ETF's entered the market in 2018 to capitalize on the forecast shortage of yellowcake.

The spot U_3O_8 price has recovered from sub-US$20/lb levels to circa US$27/lb, but almost all development projects require substantial further price increases to incentivize decisions to mine. The uranium supply/demand pipeline is opaque, so it is uncertain as to when large producers will reopen mothballed capacity and when end user stockpiles will be sufficiently depleted to motivate additional buying.

Bulk commodities

The iron ore price has been impacted in the short to medium term by the Vale tailings dam collapse at Brumadinho in Brazil, with some 40Mpta of production being shut. Coincidentally, the discount for lower grade iron ore has reduced. In the medium term, iron ore producers are now being asked to account for the CO_2 emissions resulting from steelmaking which uses their raw product. This is a growing trend which will impact the mining industry more broadly.

In 2018, China's environmental drive focused demand on higher quality coal, which benefitted producers in eastern Australia. However, import bans on Australian coal at some Chinese ports limited the benefit for exporters to China, while benefitting those miners which focused on other markets.

Conclusions and Navigating 2019

Because of their flexibility, risk tolerance and opportunism, junior resource companies make a disproportionately large contribution to new mineral discoveries around the world. Small Australian companies have been particularly adept in this regard. This junior mineral and energy subsector will rebound at some stage, with early signs of this beginning to occur in 2019, boosted by increased metal prices in particular.

Economic and geopolitical conditions in the US and China will determine the commodity focus and levels of demand, whether this be precious metals, industrial minerals or energy.

Budding signs of synchronous global growth earlier in 2018 failed to materialize, but growth may emerge in the coming year. The US economy has been re-supported by the Fed's extension of lower interest rates, despite the waning impact of Trump's tax cuts. Under these circumstances, a renewed rise in US share markets to new heights is possible. This in turn would probably revive inflation fears and boost commodities.

Escalating trade conflict would be an impediment to world economic growth and dampen international trade in industrial minerals, but the disruption that this might occasion would be expected to boost precious metal prices.

The impact of US trade barriers could perhaps be mitigated by expansionist efforts underway by China through the transnational Belt &Road infrastructure development program plus other Chinese stimulus in rail and EV sectors for example.

Potential Scenarios

We envisage four possible scenarios which are set out below.

Given the elevated climate of uncertainty and the inevitable "black swans" we assign more or less equal probability weighting to each case:

1. An evolving bull market in mineral resources in an expanding, moderate inflation world economy, a scenario favoured by some market commentators.

2. Inflationary world growth involving higher crude oil prices (e.g. from curtailed supply), currency degradation, and especially a lower US dollar.

3. A world beset with dysfunctional government, heightened trade conflict, military confrontations, European discord, a global debt crisis, and falling demand for Australian commodity exports.

4. Secular stagnation. An escalating trade war reminiscent of Smoot-Hawley. Tepid world growth, a return to quantitative easing, loan defaults, disinflation, falling bond yields, rising unemployment, failed pension programs, social unrest, and sideways trading markets.

Lowell Resources Funds Management expects 2019 to continue to be a year of surprises, many of which may impact commodities supplies and increase prices. Investors seeking to find potential investment opportunities while keeping an eye out to defend their resources exposure should consider these important points as they construct their portfolio and navigating the markets.

Time honoured recommendations towards this include:

1. Don't be too exposed to any individual stocks
2. Diversify
3. Consider outsourcing the smaller part to an investment professional
4. Stay close to your portfolio
5. Have stops set in place if you go direct