Staying the Course in Turbulent Commodity Markets

By Shawn Reynolds, Portfolio Manager

VanEck Global Hard Assets Fund
GHAA X / GHAC X / GHA I X / GHAY X

Market Review

Commodity and natural resource equity markets were skittish during the third quarter. Concerns surrounding tariffs, trade and Brexit dragged on, overshadowing markets and infusing them with further uncertainty. Central banks around the world continued monetary easing measures as a way to address persistent concerns around slowing global growth.

Oil price reaction following a drone attack on Saudi Arabia’s largest oil-processing centers appeared relatively benign, even as the U.S. oil rig count continued to decline (down nearly 21% since the end of 2018).

Though falling rates were supportive of gold during the quarter, prices eventually consolidated in September, giving back some of their mid-year gains.

Base and industrial metals remained unsettled both as trade concerns continued unresolved and as copper demand sputtered. Nickel – one of the few bright spots in all of the metals and mining space over the past few months – gained on the heels of Indonesia’s effective ban on exports.

The performance of grains was also lackluster as, according to the U.S. Department of Agriculture, expectations of severe impacts to U.S. crops following unseasonably wet weather earlier in the planting season appeared to be more muted than first believed.

Performance & Positioning

On an absolute basis, our positions in gold and renewable energy (including semiconductor equipment, industrial REITs, electrical components and equipment, and renewable electricity subindustries) were the largest contributors and now account for approximately 7.6% of net assets as of quarter-end. The largest absolute detractors included our allocations to oil and gas exploration and diversified metals and mining.
In terms of portfolio positioning, the only notable change in the third quarter was within our energy allocations where we substantially reduced our exposure to oil and gas equipment and services companies including exiting Halliburton and Patterson-UTI. We established no new positions during the quarter.

Top Quarterly Contributors/Detractors

<table>
<thead>
<tr>
<th>Holding (% Weight)</th>
<th>Estimated Contribution (%)</th>
<th>Performance Drivers</th>
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<tbody>
<tr>
<td>SolarEdge (2.42%)</td>
<td>0.77</td>
<td>Strong global demand, particularly in Europe</td>
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<tr>
<td>Barrick (5.85%)</td>
<td>0.50</td>
<td>Elevated gold prices; Hit production and cost targets</td>
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<tr>
<td>Kinross (1.60%)</td>
<td>0.23</td>
<td>Elevated gold prices; Mauritania mine expansion announcement</td>
</tr>
<tr>
<td>ProPetro (0.56%)</td>
<td>-0.86</td>
<td>Concerns over accounting transparency issues</td>
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<tr>
<td>Teck (2.35%)</td>
<td>-1.34</td>
<td>Second quarter earnings miss</td>
</tr>
<tr>
<td>Concho (2.80%)</td>
<td>-0.90</td>
<td>Reaction to shift in focus on growth</td>
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Source: FactSet, VanEck. Data as of September 30, 2019. Weights denoted with “0.0%” indicate a position sold during the quarter. Contribution figures are gross of fees, non-transaction based and therefore estimates only. Figures may not correspond with published performance information based on NAV per share. Past performance is not indicative of future results. Portfolio holdings may change over time. These are not recommendations to buy or sell any security.

Outlook

A couple of things surprised us over the quarter:

- There appears to be absolutely little-to-no premium built into the price of oil. Relatively stable prices amid heightened geopolitical risks, of which the attacks on Saudi Arabia are only an extreme example, suggests to us that global markets are seemingly unfazed by the potential for any type of future supply shock. The safest barrel is likely the one sitting in the middle of West Texas, yet the market appears to be overlooking that fact.

- The resiliency of the U.S. economy and global commodity demand is underappreciated. While neither can be described as “doing great” – particularly considering the nearly $15 trillion worth of debt (globally) carrying a negative yield as of quarter-end – both appear to have withstood the brunt of these most recent trade wars and could even benefit from any type of further global easing measures.

Still, we remain encouraged by what we have seen from companies across the natural resource space over the last quarter.

Despite higher prices, gold miners are focused on stringent cost discipline. Most companies we follow expect to hold the line on costs by maintaining their ore grade cutoffs and using a conservative $1,200 gold price to plan future operations. Some are paying down debt while others have already shifted to “shareholder returns” mode and implemented dividend programs. Encouragingly, so far, priority also appears to be placed on organic growth through brownfield expansion and/or increasing reserve life, rather than through new, costly greenfield projects or heavily-financed M&A expansions. These two later factors were the main sources of value destruction in the last bull cycle when companies overpaid for acquisitions and developed properties that required too much capital.

While the global diversified mining sector has emphasized financial discipline and return of shareholder capital for the last several years, there is now clear evidence of widespread adoption in the U.S. oil and gas industry as virtually every energy company we own has made significant capital returns to shareholders in the form of dividends and/or share repurchases in 2019.
Manager Commentary  September 2019

Though share price performance of these names has been moderate at this point, we believe that at least some of this can be accounted for by the fact that many investors remain somewhat skeptical about the sustainability of a “return of capital” strategy. We have heard many times that investors want to see several years of consistent/improving behavior and financial results before meaningfully re-engaging in the sector. To that, we might just add we are encouraged by the fact that:

- E&P have demonstrated discipline despite, at times, higher commodity prices
- Share price performance of these E&Ps appears to be less susceptible to macroeconomic headwinds, which, in recent years, drove a more substantial negative impact
- Improvements have been made in the multi-year visibility for enhanced free cash flow yield in the space, even in a moderately depressed commodity environment

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