First State Investments

Global Resources

Quarterly Review and Outlook

As at September 2014

Key Highlights

- Global Resources stocks were not immune from the significant downward pressure on global equities in the September quarter. The First State Global Resources strategy declined in value by approximately 10% during the quarter.
- Question marks over the sustainability of economic activity in China had a particular influence on commodity prices and, in turn, sentiment towards mining stocks.
- Long-term drivers remain positive, benefiting from the growing consumer demand on commodities and ongoing industrialisation of emerging regions.

In this environment, we believe investors will continue to favour more 'defensive' names in the mining and energy sectors. Companies with solid balance sheets and low cost production are likely to be able to withstand commodity price volatility more effectively than some of their peers.

The Global Resources team continues to favour companies at the higher end of the quality spectrum, which should help the portfolio navigate the current turbulence we are seeing in resources markets, however the more growth-oriented juniors are likely to experience greater volatility.

Sector and country contributions

Diamonds sparkled relative to other sectors

Diamond exploration companies were among the few which performed well during the quarter. Demand for diamond jewellery continues to increase in emerging markets such as China and India. The US market also remains buoyant, helping to support diamond prices.

The strategy has exposure to several stocks in the sector. One of the holdings, Petra Diamonds, performed particularly well after the company discovered a 232 carat diamond of exceptional quality, which could command at least US$20 million. This was the second significant discovery at Petra's Cullinan mine in South Africa in the past few months.

Gold mining stocks lose their shine

Investments in selected gold stocks weighed on performance. Sentiment towards gold mining stocks has been dominated this year by the strength of economic indicators and, recently, the growing expectation of the US interest rates rise and appreciation of the US dollar. Recent geopolitical tensions have not had a significant influence on the gold price. We remain comfortable with the strategy's exposures to the gold sector. We added to the holding in Detour Gold, for example, following a meeting with the company during September at the Denver Gold Conference.

Iron ore has been under pressure, but long-term demand drivers remain intact

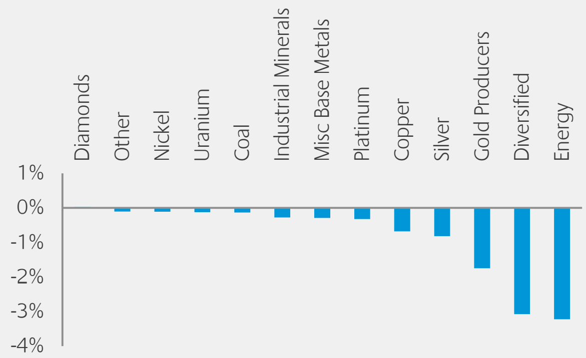
There have been concerns over the slowing pace of property construction in China as a result of high inventory levels. This weighed on the iron ore price during the quarter and was compounded by seasonal weakness in demand. Supply has also been growing rapidly as low cost Australian producers have pushed ahead with expansion projects. Investors appear to be ignoring the fact that absolute demand levels remain at record highs as emerging economies continue to industrialise.

Oil prices were affected by rising supply

The oil price was also weakened, with both WTI and Brent crude closing the period lower. Geopolitical tensions in Iraq were not sufficient to offset recent reports suggesting oil prices may soften as the US supply continues to grow. The increase in the US supply may not be countered by a reduction in OPEC production.

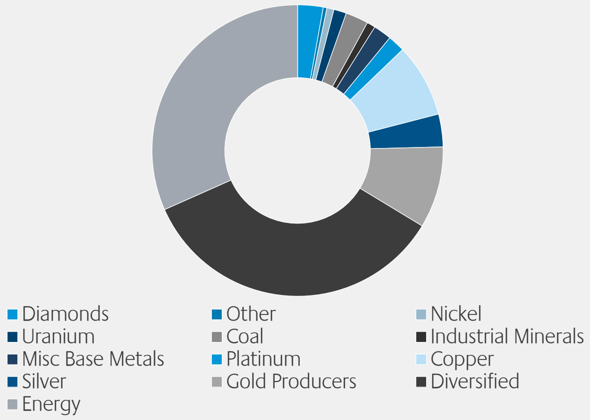
The charts on next page show the contribution by sector and country for the First State Global Resources strategy for the three months to 30 September 2014.

Sector contributions



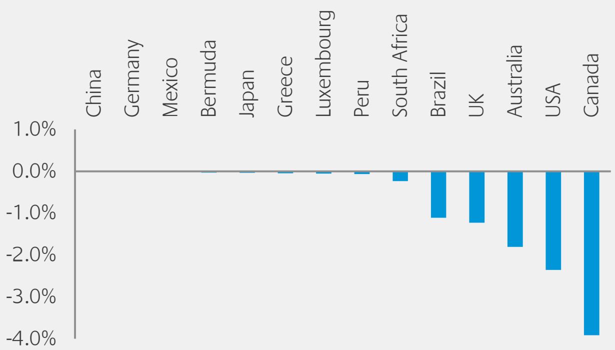
Source: First State Investments.

The strategy remains well-diversified by sector in order to minimise risk. A portfolio that is well diversified across a wide number of commodity types, geographies, market capitalisations and along the value chain reduces risk. Rarely do all commodities reach their highs and lows simultaneously. As at 30 September 2014, the strategy was invested in the following sub-sectors of the mining and energy markets.



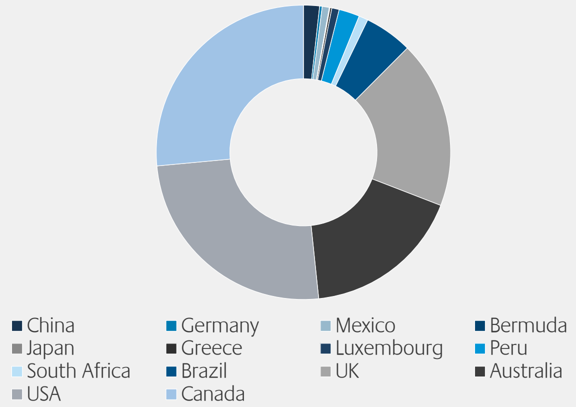
Source: First State Investments.

Country contributions



Source: First State Investments.

The strategy's mining and energy exposures in North America had the greatest influence on performance, as expected. More than half of the strategy's assets are invested in Canada and the US.



Source: First State Investments

At all times, the strategy remains well-diversified geographically.

Sector Outlook and Portfolio Positioning

The September quarter was a challenging period for global resources, but the sector continues to offer appeal for investors as reductions in investment and exploration will eventually result in a more balanced market medium term and supply constraints in the longer term. Market movements mean share prices have re-based to lower investor expectations for earnings in the near term.

Reduced capital expenditure among the major miners is expected to support free cash flow generation, despite lower revenues. Company boards remain focused on the delivery of strong shareholder returns over time and continue to focus their growth options on a limited number of mostly brownfield projects which have the greatest potential returns.

Whilst short-term indicators remain mixed, we believe long-term demand drivers remain positive, especially for later cycle commodities geared towards growing consumer demand and ongoing industrialisation of emerging regions.

As commodity prices weaken we are seeing production cuts and mine closures, most notably in coking coal and iron ore, where lower prices are making some operations uneconomic. This reinforces our investment philosophy of buying low cost producers with strong balance sheets that can weather the downturns in the cycle.

We believe the mining sector is close to the bottom of the current cycle but it will require an improvement in the global economic outlook to drive a re-rating. Valuations in the sector are reflective of this, and we believe are appealing for long-term investors.

Quality performs through the cycle

The Global Resources team's investment philosophy and process remain unchanged over years and the portfolio maintains a quality bias. We look for companies with long life assets that operate in the bottom half of the cost curve and which have built-in growth options. Strong balance sheets and management teams with proven track records are also key investment criteria. We invest in companies that we believe can outperform their peers throughout the full mining cycle.

We also look for the most promising early stage exploration and development companies that can create value through discovery and development. The best junior explorers and developers become the merger and acquisition targets for the mid-range and senior companies and can be meaningful contributors to performance over time. We believe that our approach of investing in 'oak trees, saplings and acorns' provides a mix of quality characteristics with enhanced growth that should generate superior returns through the cycle, without taking excessive risks.

We also remain committed to a program of visits to the operations of mining and energy companies globally. Seeing these operations firsthand provides valuable insights on current share price drivers and is always relevant to portfolio positioning.