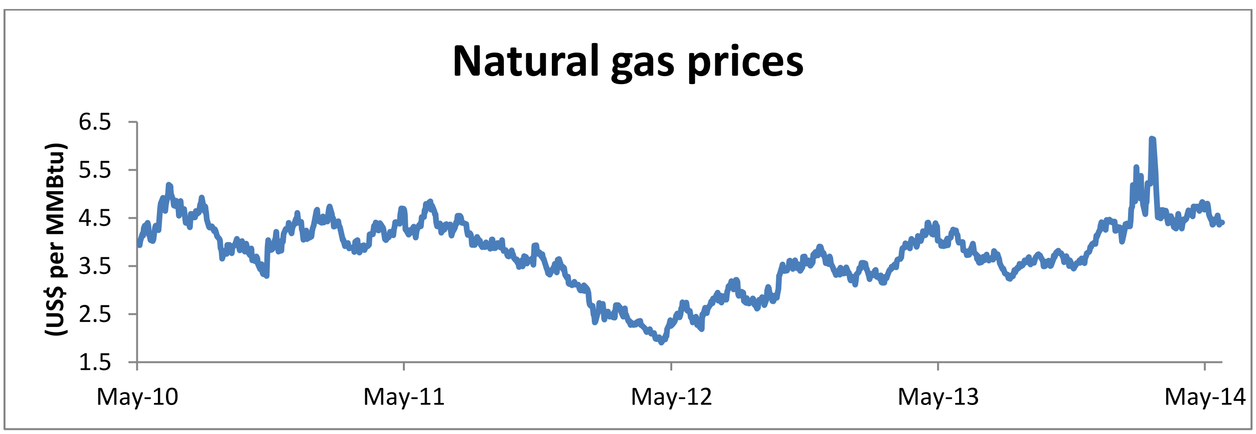
MAY 15, 2014

Global Natural Resources Update

Commodities have been somewhat mixed in recent quarters, with agricultural and oil and gas-related commodities generally performing well, while most mining-related commodities have lagged. Natural gas prices in North America have continued to rebound from previously depressed levels on the back of a severely cold winter in North America which drove very strong heating demand. Oil prices have remained very healthy in the US$100 per barrel range[1] due to generally solid fundamentals, very strong heating demand during the winter season and ongoing supply disruptions in Libya and Iran. The more lackluster performance of base metal commodities is largely attributable to slowing economic growth in China, which is the largest global mining consumer – accounting for more than 40% of global demand in several key commodities.

ENERGY OUTLOOK

Natural gas has risen sharply over the past several quarters to currently sit in the US$4.70 per million BTU (mmbtu) range[1]. A tightening supply/demand picture driven by a harsh North American winter has been the short-term driver of prices. We expect the impacts of this cold winter to positively influence natural gas markets for the next several quarters as companies strive to re-build inventories ahead of next winter. The longer-term picture is also shaping up well as demand from new petrochemical plants and LNG facilities are expected to increase sharply over the next few years. Even with the recent run-up in prices, North American natural gas sits well below global prices and retains a huge advantage over oil on an energy-equivalent basis. Companies positioned within key, low-cost basins should positively benefit from LNG opportunities that evolve in the coming years as North America moves to become a significant net exporter of natural gas to the rest of the world.

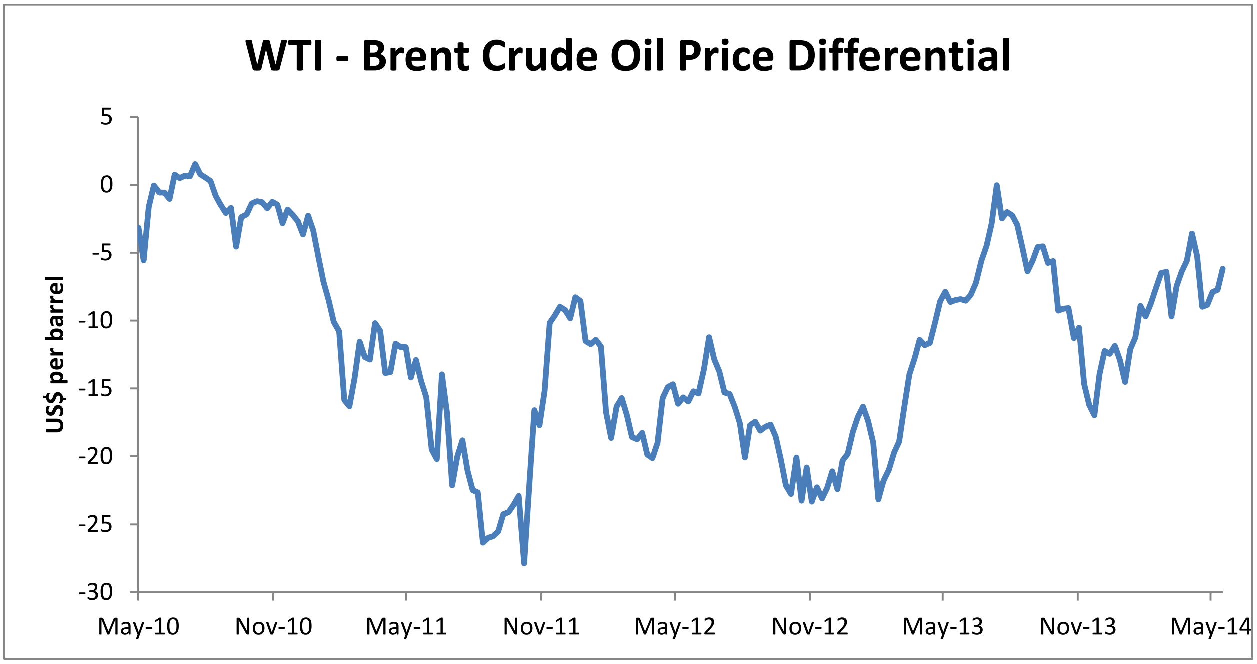


Source: Bloomberg, as of May 23, 2014

Energy producers have also benefited from the narrowing of oil price differentials in North America compared to the rest of the world. Over the past several years, as oil production rose quickly from

[1] Bloomberg, as of May 8, 2014

unconventional North American reservoirs such as the Bakken formation, bottlenecks developed in the transportation system. As a result, producers were unable to efficiently transport oil out of its producing basin, forcing them to receive discounted pricing for their products. More recently, as various pipelines have expanded or newly opened and crude-by-rail has expanded and become more efficient, these bottlenecks have lessened, allowing producers to capture more favourable prices for their oil. We expect differentials to remain volatile since additional pipelines and transportation solutions will be required to meet ongoing increases in supply from North America. However, we believe that the worst is behind us for differentials and producers will generally be able to capture better pricing for their product as compared to world prices.



Source: Bloomberg, as of May 23, 2014

In the Refining & Marketing sector, refining margins have pulled back over the past year as somewhat softer offshore product demand, combined with narrowing price differentials in North America, have squeezed profit margins. While margins still remain high by historical standards, they are somewhat softer than the lofty levels experienced during 2011 and 2012. We expect the current market dynamic to remain in place for the foreseeable future.

MATERIALS OUTLOOK

Materials equities indexes have been largely range bound but volatile year to date, as concerns regarding Chinese economic growth have tempered global growth outlooks.

One of the key themes of the broader industry has been a focus on capital discipline and returning capital to shareholders. Across many of the materials subsectors, capital expenditures are being both constrained and heavily scrutinized and dividends and share buybacks are gaining increased popularity. Over the medium term, this will have several effects. First, it will keep balance sheets efficient and reduce the tendency to become cash 'heavy.' In addition, the reduced rate of capex will result in slower capacity growth over the medium term, which should help to support prices.

In the mining space, base metal prices have been volatile and range bound, reflecting a combination of market fundamentals offset by economic and geopolitical uncertainty. The recent announcement by Indonesia of a ban on the export of unprocessed ores[2] has created an unforeseen limitation on supply to the nickel, copper and aluminum markets, which has prompted positive price responses (notably in the smaller nickel market).

Copper prices fell sharply entering the second quarter (on concerns of excess Chinese inventories and the unwinding of trade finance backed by copper) but rebounded as market fundamentals reasserted themselves. The copper market remains fundamentally tight, but reflects concerns of both potentially weaker demand and new supply scheduled to come on stream over the next couple of years.

Metallurgical coal prices have continued to weaken through the year as a combination of inventory destocking in Asia has met increasing low cost supply from Australia. This is forcing the higher cost U.S. exporters to curtail production, which should bring the market back into nominal balance and support improved pricing. At existing prices, many producers are cash negative.

After reaching a near term bottom in late December (at just under US$1,200/ounce[2]), gold prices recovered sharply through the first quarter before pulling back in the second quarter. With the contraction in prices, gold companies have had to reset mine plans, resulting in reduced mine lives but lowering cost structures. Additionally, most are aggressively implementing cost reduction exercises and reducing capital expenditures.

While we believe the gold price probably established a medium-term floor in December (largely based on the cost curve for the industry), we remain neutral on the sector, seeking companies with either strategic or cost advantaged positions, or strong "self-help" catalysts.

In the commodity chemicals sector, regional cost advantages continue to define distinct performance advantages. Consumers of low cost U.S. natural gas and its byproducts continue to hold a large cost advantage against their international peers, which is reflected in their share price performance.

SUMMARY

With rebounding economies in the developed world but slowing emerging market economies, we are in a somewhat bifurcated market for commodities – the days of 'a rising tide lifts all boats' are simply not here at the moment. The energy revolution in North America – driven by an abundant resource that can be captured through new drilling and completion technologies – still has a long way to go. Related to this, we believe chemical margins have entered a "stronger for longer" cycle that we believe will last for several more years. Pockets of strength remain in certain parts of the paper and forest and mining sectors. Even in the current tepid global economic environment, we continue to identify resource companies with solid balance sheets, advantaged cost structures or unrecognized growth. Stock selection remains paramount in equity performance.

For more information, contact your AGF representative.

[2] Bloomberg, as of May 8, 2014.

Publication Date: June 05, 2014