

## On Top Down Under

*Representing a story of supply and demand, the commodities market is highly cyclical. This time, however, we might be witnessing a major structural change in their pricing due to the huge demand from emerging economies and the ongoing supply problems, according to Elliott Rowton, the manager of the Australian Natural Resources Fund. Based in Perth, the resources heart of Australia, the fund offers exposure to natural resource focused companies.*

**Q: What are your core beliefs in managing this fund?**

**A:** The reason for creating the fund is our belief in the 'stronger for longer' commodities investment theme. We are big believers in the secular bull market occurring in developing economies and the associated secular bull market for commodities and natural resources.

The commodity story is one of supply and demand, and the demand is not going away for many, many years with the emergence of China, India, Asia and other developing economies like Brazil and Russia. On the other hand, the supply side has got many well documented problems that also contribute to creating tight markets in many commodities. In a nutshell, we are positive on resources because we believe that the world is in the infancy of a major structural change in their pricing.

Oceanic Asset Management and its first product, the Australian Natural Resources Fund, were created with the idea of providing UK investors with a regulated product that gives exposure to these growth markets. We are located in Perth, which is the resources heart of Australia. In only a couple of years, we have grown the Fund from \$1m at launch to around \$120 million.

**Q: How has that philosophy translates into an investment strategy and process?**

**A:** We focus on growth-orientated small to mid-cap resource companies and aim to capture the value of junior companies as they emerge from exploration into production. The typical resource story has two separate growth phases that we look to capture. It can be best described as an "N" curve, where the first uplift is driven by exploration and the excitement of discovery. Then, as the companies come out of that stage and try to develop the project, the lethargy of the market tends to hurt them and they typically pull back to lower levels. As they move into production and become cash flow/profit stories, there is another growth leg and a re-rating to the share price.

**Q: Do you focus on Australian companies only or you invest internationally?**

**A:** Although we call ourselves the Australian Natural Resources Fund, we also take positions in other markets, mainly on the TSX in Toronto. We like Toronto because it has a well-developed mining and oil and gas capital market. We are also developing relationships with some brokers in London and are looking at a number of companies there as well.



**ELLIOTT ROWTON** has over ten years experience in global financial markets specialising in equities trading and portfolio management. Prior to Oceanic Asset Management, Rowton was with Hartleys stockbrokers in Perth where he advised institutional funds and managed high net-worth private client portfolios, specialising in ASX-listed small to mid-cap resource stocks. Previous to this he worked for five years in both London and Zürich for Crédit Agricole Cheuvreux. Here Rowton worked in the Swiss and Pan-European equities sales trading teams advising UK and European institutional and hedge fund clients.

Rowton has a Bachelor of Business in Finance, a post graduate Diploma in Applied Finance and Investment majoring in Investment Analysis from the Securities Institute of Australia.

**Q: What's your definition of resource-related companies?**

**A:** It is a conventional definition, which includes oil, gas, gold, copper, zinc, and all the other base metals. But we also look at resources like mineral sands and rare earths. Rare earths are used in catalytic converters and environmentally friendly light bulbs amongst other uses so is a good play on the global warming reduction investment theme. We also look at platinum, coal, gas and geothermal thermal energy, and other types of renewable sources, such as bio fuels. We also play some port and logistics companies that are benefiting from the commodities boom at the moment but these are typically a small part of our portfolio. Of course, we also invest in uranium, which currently is a compelling investment theme for us.

**Q: What do you focus on as an investor? Does the resource and mining sector require a specific strategy because of its high capital requirements, long investment phase, and cyclicality?**

**A:** For us, an important element is evaluating the quality and the value of the assets that the company owns whether they be in exploration and/or production. The world continues to develop and we look up to our neighbors in India, China and Southeast Asia, which are consuming vast quantities of commodities as they continue to build cities and "Westernize".

We also pay special attention to the management because in the small

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to mid-cap area, the management expertise is very important. We need to make sure that the management driving these companies are well experienced and skilled to deal with developing these projects.

**Q: How large is your investment universe? Would a company like Lihir Gold fit in it, for example?**

**A:** We would look at it but it is probably a little bit too big for us. We had invested in this company a couple of years ago and it fulfilled our expectations. We exited that position and moved into other emerging companies. But the size of the companies in our portfolio varies from \$20 million to \$3.5 billion Australian dollars.

We look at a very large universe. In Australia alone it consists of about 1,800 companies. There are a lot of small to mid-cap mining and oil and gas companies in Australia.

**Q: The exploring companies that are just starting out do not have historic earnings to evaluate. How do you resolve that issue?**

**A:** Yes, the explorers don't have earnings so the value is estimated based on what's in the ground. For mining companies this is ascertained through a complex combination of drilling, trenching, geophysical, geochemical and other modern day exploration techniques. For oil and gas companies, obviously drilling results are important but seismic reprocessing techniques also play an important role in generating targets within oil and gas fields. When it comes to the producers, we mainly use cash flow models to ascertain the value.

**Q: How do you generate investment ideas? Would you describe your research process?**

**A:** Perth, where the fund is located, is very mining and oil and gas oriented. We are ex-stockbrokers, so we know all the stories very well from our days as stockbrokers. We have a number of strategic relationships with many local broker groups and research houses. So

we have a supply of quality research, but we also source our own ideas. After all, we live and breathe what we're doing here.

**Q: Could you give us some examples of specific investments that highlight your research process?**

**A:** The commodities space is quite diverse as there are many different types of commodities, and each individual commodity has its own supply and demand dynamics. We start with a macroeconomic layer to select commodities with more favorable dynamics, and then we look for the individual stock picks that would benefit from the positive macroeconomics.

For example, last year we were very positive on the outlook for nickel. After the release of some very bullish drilling results and discussion with the management, we selected a company called Sally Malay. Because many companies are located here in Perth, we can spend considerable time with the management. So we sat down with them to discuss the potential upside in their project, their strategy in terms of regional exploration, and the results of their geological work. We built a substantial position in that company, management kept on achieving its exploration and production milestones, and the nickel price kept going up. We offloaded the position last month after producing a handsome return for 12 months.

**Q: Why did you decide to sell it?**

**A:** We thought that it was getting a little bit beyond its valuation. Also, we were noticing in the nickel market that Chinese were looking to use cheaper substitutes to make stainless steel and we felt that would dampen nickel demand and sentiment in a fairly overbought market. They are not using nickel, they are using substitutes. So we made that decision again based on the macroeconomic overlay. Both the nickel price and the stock has pulled back already since we got out, so the process has been vindicated in this instance.

**Q: Could you give us another example?**

**A:** Lynas Corp. would be an example of rare earths play. Again, the initial interest was prompted by the big picture. In that market, 95% of rare earths come from China and the price was increasing. Looking for a way to play rare earths outside of China, we did research on Lynas Corp, which is based in Sydney. We arranged for the managing director to fly over to visit us. We had a very positive meeting and were taught a big lesson on the fundamentals and main drivers of the rare earths market.

The more we were researching the rare earths market, the more compelling the story became. There is large demand for end products - light bulbs, catalytic converters, plasma screens, iPods, etc, and China is almost the only source for the companies to get this material. At the same time, China was shutting down mines because of inefficiency, pollution and strategic reasons

All those ingredients of the story prompted us to build a big position in this company and to develop a good relationship with the management. It kept achieving its benchmarks as it moved towards production. Now it will mine the Mt Weld deposit here, in Western Australia, and is going to process the ore in Malaysia. It has a very favorable contract with the Malaysian government, including a tax-free status for 10 years. So there is a lot of value in this story to be unlocked as the management keeps achieving its milestones.

**Q: How do you approach the portfolio construction process? How many stocks do you have?**

**A:** At the moment we have 54 stocks in the portfolio. Within our macroeconomic overlay, we are currently quite favorable on the fundamentals in zinc and energy, including uranium. Our strategy is to overweight our higher conviction stocks, which can consist of say 5% to 6% of the portfolio and build a long diversified "tail" of investments that could range from 0.5% to 2% of the portfolio.

We keep a close eye on the position that comprise of the less weighted "tail" of the portfolio. As these stories develop and we see milestones being achieved, we look to build bigger positions in these companies to capture the potential growth in anticipated share price appreciation.


**Q: What types risk do you perceive and how do you try to mitigate them?**

**A:** Diversification is one way to mitigate risk. Although we are favorable towards certain commodities within the macro-economic overlay, we will not concentrate our holdings in one commodity. We do have a split across all the commodities within the diverse resources sector.

We also use cash tactically as a risk management tool. If we don't see value, or if we think that the market got ahead of itself, we tend to move to cash quite readily, particularly with the more liquid stocks. At the moment we have about 15.5% cash. We can use derivative instruments to hedge NAV when we feel that stocks in the portfolio have overshot their valuations.

Although we are big believers in the commodities secular bull market, we know that it's not going up in a straight line in perpetuity. We recognize that there are pullbacks and plenty of volatility along the way. We certainly embrace those opportunities and are comfortable holding cash positions and wait for the market to reach a level where we feel there is more appropriate value.

**Q: How do you handle the tax-related issues?**

**A:** We don't have any tax-related issues. The majority of our stockholders are fund of fund managers, and 20% of our stakeholders are smaller investors who came in through one of the platforms in the U.K. They deal with their own tax issues through their financial planners, so it is not a concern of ours. 

**Oceanic CF Australian Natural Resources Fund**

Symbol	<b>GB00B0D75910</b>
Fund Type	OEIC
Website	<a href="http://www.oceanicasset.com.au">www.oceanicasset.com.au</a>
Address	2 Hallside Park Knutsford Cheshire WA16 8NQ
Tel. No.	0044 (0)15 6563 1309
Inception	25/07/2005

<b>PORTFOLIO</b>	
Total Net Assets*	\$54

<b>INVESTMENT INFORMATION</b>	
New Investment	Open
Min Initial Investment	GBP 50,000
Min Subsequent Investment	GBP 10,000
Min Regular Investment	N/A
UK ISA	YES
CAT standard	No
UK PEP	YES

<b>RETURNS VS. LGC - EQUITY SECTOR NAT RES INDEX</b>		
	GB00B0D75910	Index
1 Year (Cum.)	28.04%	17.89%
3 Year (Ann.)	N/A	30.55%
5 Year (Ann.)	N/A	20.06%

<b>FEES AND EXPENSES</b>	
Initial charge	4.00%
Annual charge	0.65%
Exit charge	0.00%

<b>PORTFOLIO MANAGER</b>	
Elliott Rowton	25/07/2005
Stuart Bell	25/07/2005

\* millions  
Data through: 30/06/2007  
Source: Company Documents; Lipper

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