

Miners offer deep value in a changing world

“Cheap” and “Change” are key for investors as the green revolution gains pace

Baker Steel Capital Managers LLP

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Jim Rogers became famous for travelling around China on his motorbike in the 1990’s and in doing so witnessed the massive building boom the Chinese were about to unleash. The first ensuing commodity super cycle was clearly identifiable from such a vantage point and Jim talked about seeking assets which were both ‘cheap’ and would benefit from the coming “changes” he foresaw.

Today we prefer to avoid terms such as “super cycle”, yet we do consider that a similar transformation is underway for the commodities sector, driven by the dual secular trends of the green technology revolution and transition towards sustainability, and the debasement of fiat currencies and financial repression by policymakers in the aftermath of the COVID-19 crisis. Against this positive backdrop for change, we consider miners to be historically undervalued and see a multitude of opportunities for an active investment manager such as Baker Steel.

An undervalued sector

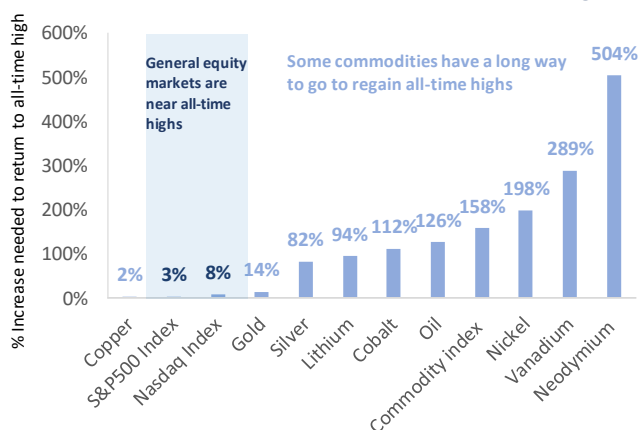
1. **Commodity prices have largely lagged** general equity markets’ gains in recent years.
2. **Miners appear historically undervalued** on a fundamental and relative basis.
3. **The sector’s recovery has begun.**

Change is underway

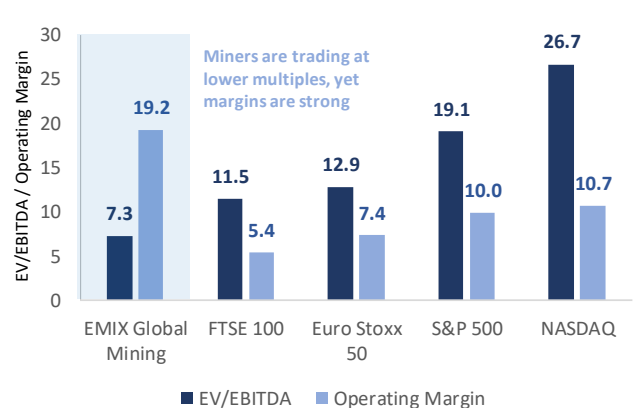
1. **The green revolution is gaining pace** and demand forecasts for speciality metals are surging.
2. **The debasement of fiat currencies** caused by rising inflationary pressure and financial repression favours precious metals.

While the past year has been an encouraging period for several sub-sectors of the mining industry, amid economic recovery supported by stimulus of an unprecedented scale, the mining sector continues to appear historically undervalued on a relative basis. Commodities have lagged general equity markets in recent years and prices largely remain far from their historic highs. Meanwhile a range of miners show substantial upside potential when screened using Baker Steel’s in-house proprietary research tools.

Commodities are far from their historic highs



Miners are undervalued relative to general equities



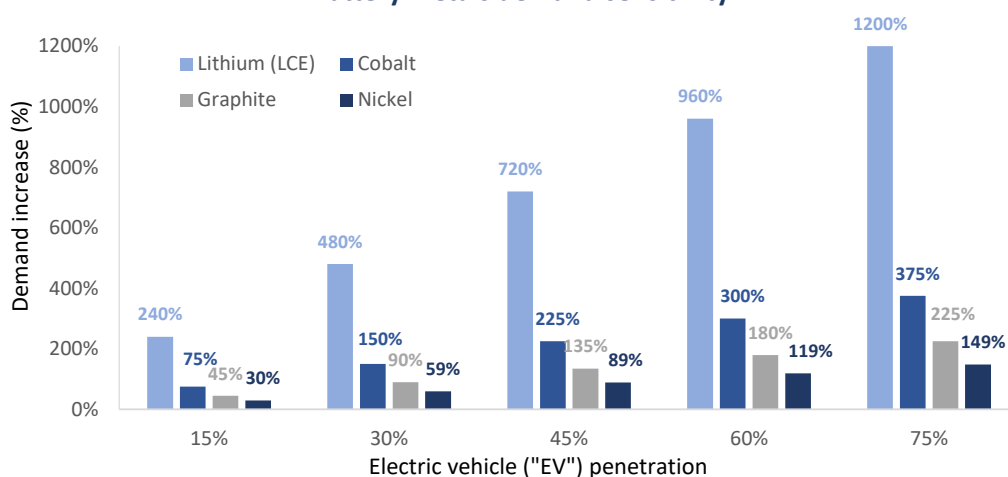
Source: Bloomberg. Data at 14 May 2021.

If identifying value is the first step, then the second must be to identify the catalysts for change. To determine this, we must look at the commodities sector on a more granular level and in the context of the two major secular trends which are set to drive change in commodity markets: the green revolution and the debasement of fiat currencies.

The “green revolution” is driving a surge in demand forecasts for speciality metals

While the green revolution covers a multitude of areas of industry and technology related to the transition towards sustainability, of particular significance for miners is the theme of decarbonisation. The road to net zero is generally considered a 30-year undertaking and will likely have several phases of specific focus. We would argue the first stage is for Electric Vehicles (“EVs”) to gain acceptance as the most desirable form of automotive transportation and achieving a penetration rate of c.25%. This goal appears achievable by the end of the decade. With regards to the batteries alone, the level of demand for battery-related metals would transform the industry.

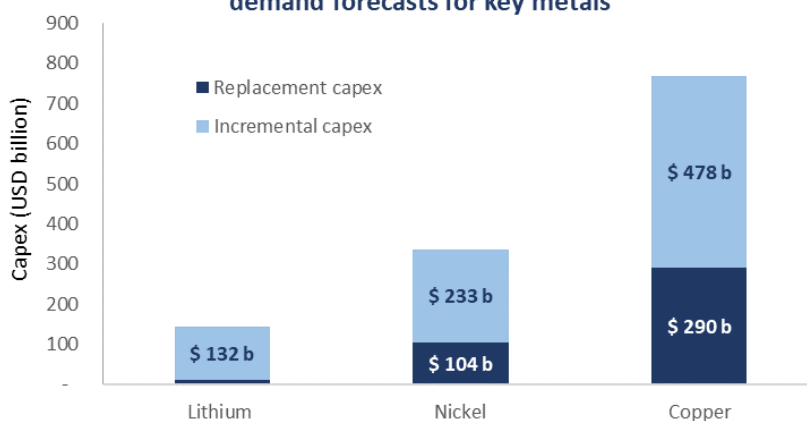
Battery metals demand sensitivity



Source: Baker Steel Capital Managers LLP. Note, based on 100M vehicles sold annually. EVs assumed to have an average of 60kWh battery packs and a mix of cathode chemistries.

The second stage, once EVs have become established as the future in the eyes of the consumer (and urban populations start to enjoy the cleaner air), is for governments to proceed with upgrading the methods of power generation and associated infrastructure needed for 100% EV sales. Decarbonisation requires renewables to power the grid so economies will need substantially more solar panels, wind farms, geothermal and possibly nuclear power capacity. It is likely that these first and second stages will cross over, and concurrently there will be a need for the western world, and the US in particular, to invest heavily in upgrading its electricity transmission lines as well as the industrial scale storage of renewable energy. The demand implications here are more difficult to gauge accurately but even with conservative demand estimates there is a huge need for capital investment in the sector.

A substantial increase in capex is needed to meet 2050 demand forecasts for key metals



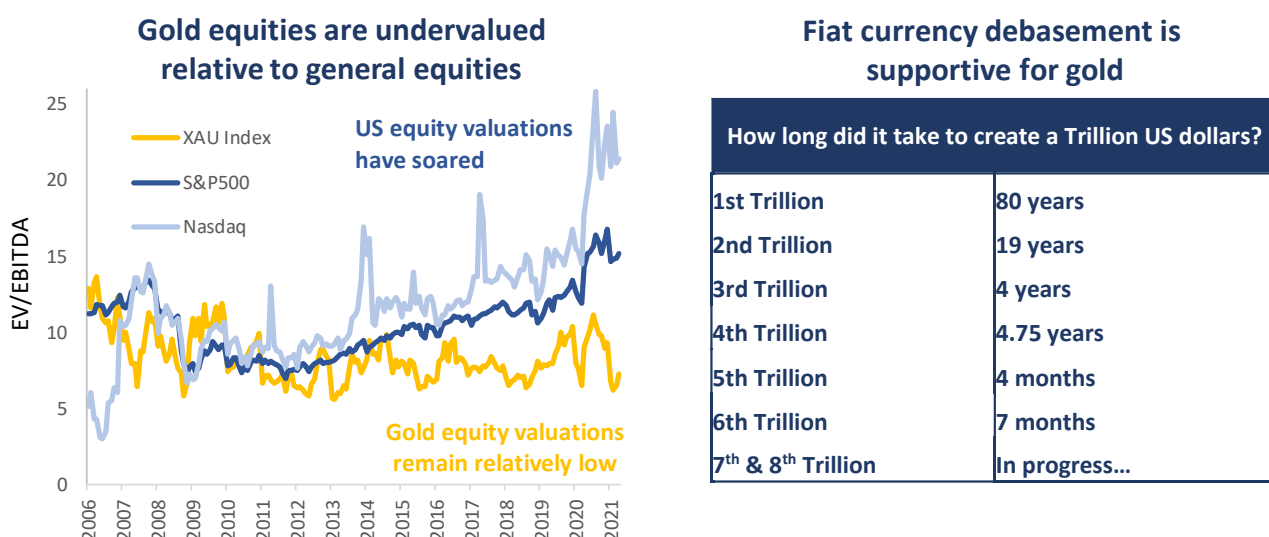
Source: Baker Steel Capital Managers LLP, BMO, Canaccord, BNEF. Note, growth rates assumed to 2050: copper 3.3% pa, Nickel 4%, Lithium 9%.

Importantly, production must take place in a sustainable way (as covered in our [recent article](#)) and with a much better understanding of the potential fragility of global supply chains. Financial markets also need to consider the timelines for building large scale base metals projects, which can typically take over ten years and be highly expensive (>\$14K/t capex intensity for large greenfield copper as an example). Achieving net zero by 2050 will require over a trillion dollars in capital expenditure on the mining side alone.

Fiat currency debasement presents a key driver for precious metals

The fact that a trillion dollars no longer seems a shockingly high number highlights the second catalyst we identify for the metals and mining sector; the impact of widespread money printing that has occurred since the COVID-19 crisis. Money printing has resulted in unprecedented money supply growth and acceleration of public debt growth.

The depreciation of the US dollar over time is illustrated below by the time taken to create USD 1 trillion. This trend seems unlikely to be reversed in the years ahead, as government spending and a focus on stimulus continue to dominate policy.



Source: Bloomberg, Goldchartsrus.com, Incrementum. Note, based on M1, in USD trillion, 1913-2020

A likely consequence of these policies is rising inflationary pressure. While inflation has remained low for most major economies over the past three decades, the global economic response to the COVID-19 crisis presents a potential turning point as inflationary pressures are unleashed. Money printing, heightened government spending on infrastructure and the “green deal” fuelled by debt, increased bank lending and pent-up consumer demand, alongside supply-side factors including “reshoring” and the impact of lengthy economic shutdowns, all indicate that a sustained rise in consumer prices is likely imminent.

Gold has historically thrived as an inflation hedge during periods of rising prices. We address the impact of rising inflation pressure in more detail in our [recent article](#), highlighting that the return of inflation presents a strong potential catalyst for the next leg higher for gold prices. Currency debasement, the return of inflation and heightened risk present key drivers for gold and gold miners have never looked more undervalued.

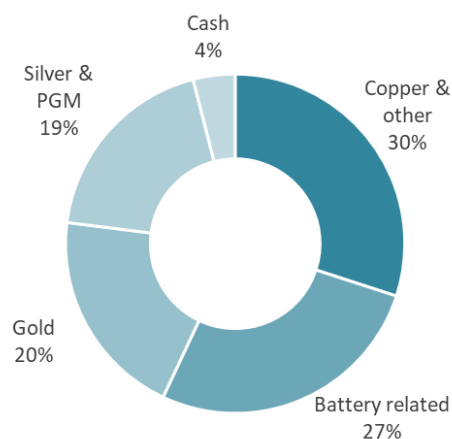
“Cheap” and “change” – An undervalued sector with change underway

As active investment managers focused on the natural resources sector, our team allocates strategically across sub-sectors of the mining industry, offering investors exposure to the long-term themes which drive metals and mining. Firstly, our gold equities UCITS funds (**BAKERSTEEL Precious Metals Fund** and **ES Baker Steel Gold**

& Precious Metals Fund) offer pure long-only, value-driven exposure to gold and silver miners. Secondly, our speciality and precious metals equities UCITS fund (**BAKERSTEEL Electrum Fund**) is focused on producers of “future facing metals” equities, including battery metals such as lithium producers, as well as broader industrial metals, most notably copper and precious metals miners (see chart to the right). Thirdly our LSE-listed investment company (**Baker Steel Resources Trust**) offers exposure to the pre-IPO portion of the mining sector, seeking deep value in earlier stage miners across a diverse range of commodities.

In summary the path to net zero is a challenging one but the COVID-19 crisis has presented the world with a unique opportunity to address these longer-term issues and “build back better”. As long-term mining investors, we consider that the transformation underway for miners has created the most compelling investment rationale in recent memory for the sector. We believe the fast-changing nature of the market, coupled with the substantial level of undervaluation which we identify across the mining sector, has created an environment ripe with investment opportunities for active investors seeking exposure to the momentum of the “green revolution”.

BAKERSTEEL Electrum Fund – Sub-sector breakdown



Source: Baker Steel Capital Managers LLP. Data at 31 March 2021.

About Baker Steel Capital Managers LLP

*Baker Steel has a strong track record of outperformance relative to its peers and relative to a passive holding in gold or gold equities. Fund Managers Mark Burridge and David Baker have been awarded **two Sauren Gold Medals for 2020** and were awarded **Fund Manager of the Year at the 2020 & 2019 Mines & Money Awards**.*

*BAKERSTEEL Precious Metals Fund is a **2021 winner** for the fourth year running of the **Lipper Fund Awards** while Baker Steel Resources Trust has been named **Investment Company of the Year 2020 & 2019, Natural Resources**, by Investment Week.*

*Baker Steel Capital Managers LLP manages the **ES Baker Steel Gold & Precious Metals Fund, Baker Steel Gold Fund, BAKERSTEEL Precious Metals Fund, BAKERSTEEL Electrum Fund, and Baker Steel Resources Trust**.*

Important

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