



December 2018

A frustrating year – but “character is destiny”

A frustrating year

2018 is finally over, closing without having bounced back from months of declining market and commodity prices. Immensely frustrating to us, especially for the metals in which we are involved, as fundamentals point to coming shortages that will only be remedied through higher prices to incentivize new production.

This general decline in prices started this last June as on June 15 the US imposed its first set of tariffs specifically on China (the previously imposed worldwide tariffs on steel and aluminum date back to March 2018). But two years of threats, escalating rhetoric and not obviously thought-through pronouncements in the US had probably already brought the market to a place where it was becoming more and more difficult to believe unconditionally that the current administration is “good for business” – the state of mind that seemed to have prevailed until then.

There might be a parallel with the travails of Brexit in the UK. When the UK voted to exit the European Union in 2016 many (including the UK Treasury) predicted an immediate recession, a weaker pound and other catastrophes. Others had explained this was unlikely for now, as voting “yes” had had no immediate consequences in the physical economy. And effectively, nothing much happened immediately.

It is only now, as a better understanding of the extent of the consequences emerge, as businesses start to prepare, as investments decisions take Brexit into account that the consequences of that vote start to visibly accumulate. Two years after this vote, what had been forecast is only now becoming obvious: a weaker

currency, slowing growth, lower GDP, postponed investments, workers and business operations transferring to the EU, and difficulties in attracting qualified foreign workers.

It might be the same in the US: after the election of an “unconventional” president who brought with him unconventional aides (unconventional having here many potential meanings), nothing immediately changed. But after two years of turmoil without clearly understandable policies or objectives, wreaking havoc on established conventions and weakening government agencies, the consequences are bound to begin to appear.

Business executives are probably the first ones to experience them. As US businesses benefited from generous tax breaks and a weakening of regulatory constraints on their activities (weakened labour, environment, and production standards), they and the market cheered. But now with a much larger deficit, higher interest rates, higher steel and aluminum prices (tariffs), additional uncertainties at all levels and finally a “trade war” with China that is becoming real a recognition may have occurred: if unchecked, this might not end well.

In mid-December there was a Yale CEO Summit in New York. The New York Times reports that while the summit was strictly off the record a survey of the 134 business leaders who were there showed that “*three in four C.E.O.s said they often apologized to their international business partners about the president’s messages. Eighty-seven percent said Mr. Trump’s negotiating style had cost the nation the trust of its allies, and three-quarters felt he wasn’t leading effectively on issues critical to U.S. national security. [...] Almost half of the*



respondents thought the U.S. could wind up in a recession by the end of 2019. The greatest threats to U.S. markets, 67 percent said, are U.S. political instability and trade negotiations.”

So, while the general decline in prices started at the time the US enacted trade tariffs against China, we suspect the extent of the decline reflects not only these tariffs but also the realization that the additional levels of uncertainty accumulated over the last two years are starting to take a toll. And unsurprisingly this lack of confidence extends beyond the US to all the countries with whom the US is dealing.

In some sectors, positive fundamentals

While world economies may suffer for a while from self-inflicted wounds, or from an economic cooling down more pronounced than it could have been, it remains that fundamentally the world economy is still growing at a decent pace. China's growth, with its 1.4 billion inhabitants most of whom still live in poverty, is far from over and very likely unstoppable whatever the US does. India, with a similar population, is overtaking the UK as the world's fifth largest economy while still being rather poorly organized. Their populations keep moving to cities, demanding always more and more metals and other resources.

And then there is that matter of climate change that will keep pushing governments to favor electrification and minimize the usage of fossil fuels. In this the US is a world laggard – old habits die hard.

Electrification demands batteries, which will accelerate the demand for a number of metals; with nickel, cobalt and copper likely to be the biggest beneficiaries. Regarding electric vehicles and their supporting infrastructure, recent figures show that while US\$ 150 bn has been committed downstream toward their

development, US\$ 110 bn needs to be committed to creating the infrastructure to produce the required metals: US\$ 70 bn for nickel and US\$ 40 bn for copper (cobalt being a by-product of some copper and nickel mining, its availability depends on sufficient nickel and copper prices). However, at current nickel and copper prices, there is still no appetite to finance their development. It will take significantly higher prices.

Character is destiny

The above saying from Heraclitus seems appropriate to our current circumstances.

Regarding the current US administration, the character of its principals will likely determine how they end, with consequences to be borne by all.

Regarding developing countries, it is not only character but also demography that are destiny. At four times the US population each, China and India have demographic power on their side. Africa will follow. This means that what happens there will become more important than what happens in North America – a change of perspective that would be wise for us all to adjust to, and which can provide a useful perspective on what is happening in the US.

As for investors, character is certainly destiny. In turbulent times, the ability to keep one's perspective and dismiss short-term market shenanigans for what they are will remain the best key to long-term success.

As usual, please call if you have any questions.

From us all, wishing you an excellent New Year,

J-Dominique Sellier

December 28, 2018

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