



FIRST QUARTER 2020

GLOBAL NATURAL RESOURCES

COMMENTARY | FIRST QUARTER 2020

COMMENTARY

"Everyone has a plan 'till they get punched in the mouth"

Mike Tyson

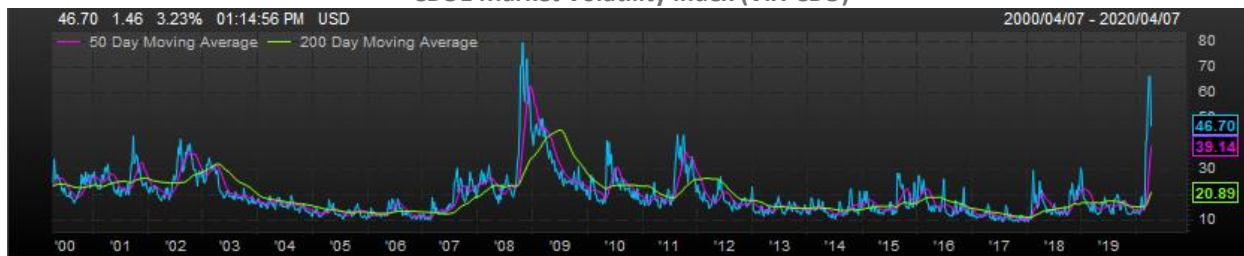
Each quarter, the Dallas Fed publishes a survey of U.S. E&P and oil service companies. While the data is informative, the "Comments" section is often more insightful. Amidst COVID-19 projections and calls for government intervention to "protect America's energy independence", two observations stood out as being particularly on-point in the just-released first quarter survey.

We have no clue what to say about oil and gas prices

...thinking that one was making money at \$50 per barrel was dreaming and public company accounting. However, it did not and does not work. At \$40 per barrel, you're in the hole; at \$30, it is hard to even keep producing existing wells.

It is difficult to imagine a "noisier" environment than the one we now find ourselves in. There are real human tragedies unfolding around the world, and the response thus far to COVID-19 has resulted in the most significant global economic shock since the Great Depression. Every day, we are inundated with news related to death rates, job losses, demand destruction, governmental responses and political grandstanding. As if that wasn't enough, OPEC+ has decided to flood the market with oil. Or maybe they haven't. The range of plausible outcomes, particularly over the short term, has expanded exponentially, causing volatility indices to spike and asset prices to plummet.

CBOE Market Volatility Index (VIX-CBO)



Source: Factset 2Q 2020

CBOE Crude Oil Volatility Index (OVX-CBO)



Source: Factset 2Q 2020

While no one can be certain about how this all unfolds – *we have no clue what to say about oil and gas prices* - in the commodity markets there are simple economic realities that serve to narrow the range of outcomes, particularly over the intermediate and longer term. In a period of heightened turmoil, simple is better.

There are two basic supply equations that must hold true over time:

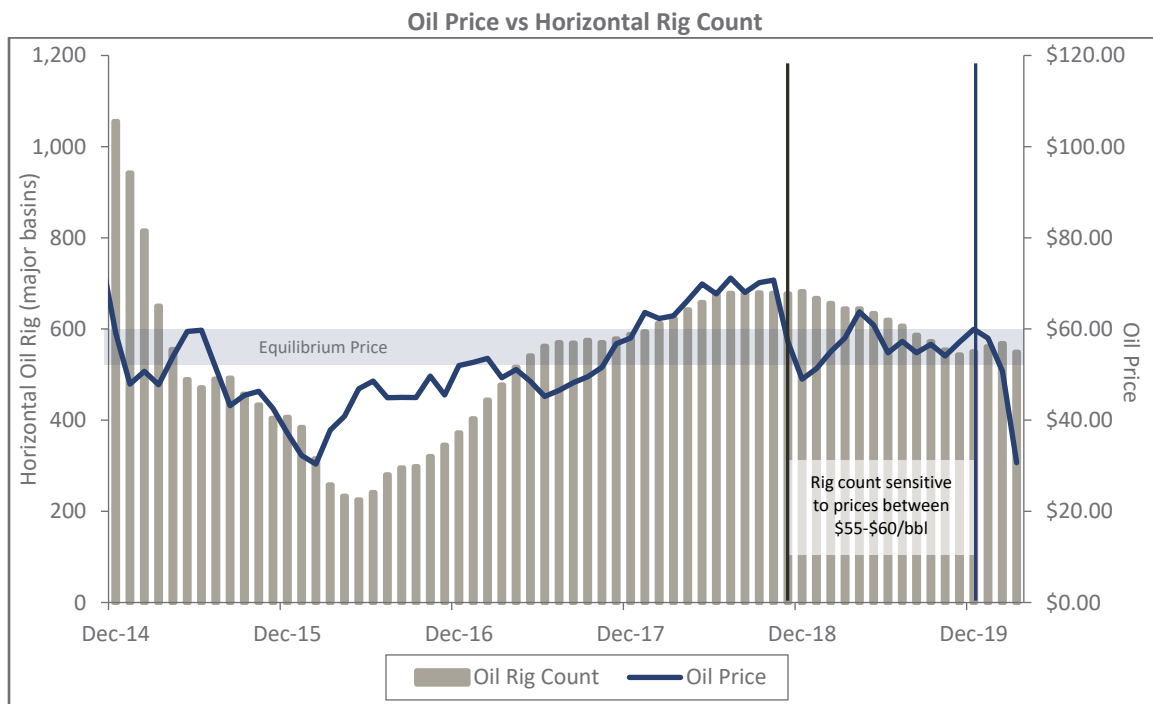
Gross Production Additions = Capital Invested ÷ Capital Intensity

Capital Invested = Revenues – Total Cash Costs + External Capital

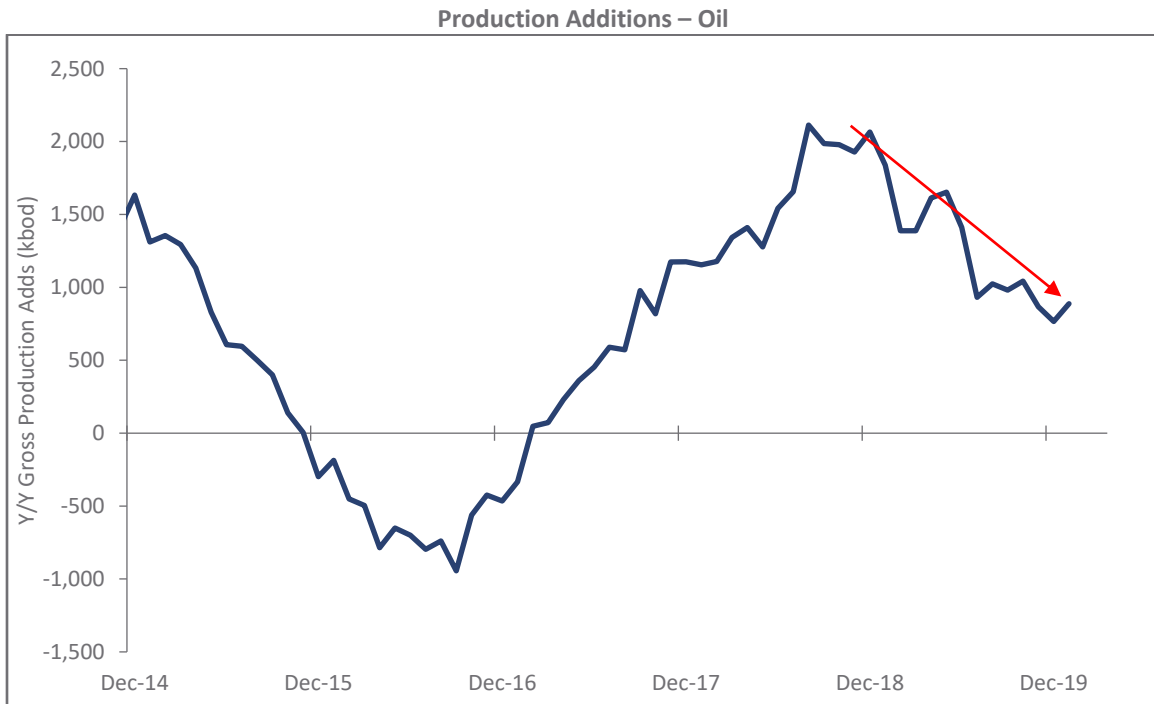
If there is excess capital to invest due to high commodity prices, overly accommodative capital markets, or, as has been the case until very recently, both, the market becomes oversupplied. Conversely, the only way to ration supply is for prices to fall, for third-party capital to be removed, or, as is the case today, both.

What has made the last five years so unique, particularly in U.S. unconventional oil, has been the massive amount of cheap, external capital made available to producers. Public equity investors funded uneconomic growth based on “dream(s) and public company accounting” (hellooooo SEC), levered with high yield bonds and bank revolvers. This enticed private equity investors to chase outsized returns predicated solely on the ability to flip debt-financed assets at exorbitant valuations to public companies who could “afford” them because the cost of capital was so low. It’s a virtuous circle, until it isn’t.

The reality is that left to operate within their own cashflows, most U.S. unconventional oil assets require prices north of \$55/bbl to yield sufficient cashflow to reinvest, cover corporate costs and generate an adequate return for their owners. This has been our conclusion for the last several years, based on well analysis as opposed to attending industry conferences or reading marketing materials. When producers review our work, we typically get the same feedback. “We agree with you. Just not for our projects.” Unfortunately, Lake Wobegon doesn’t exist in real life, and all the children can’t be above average.



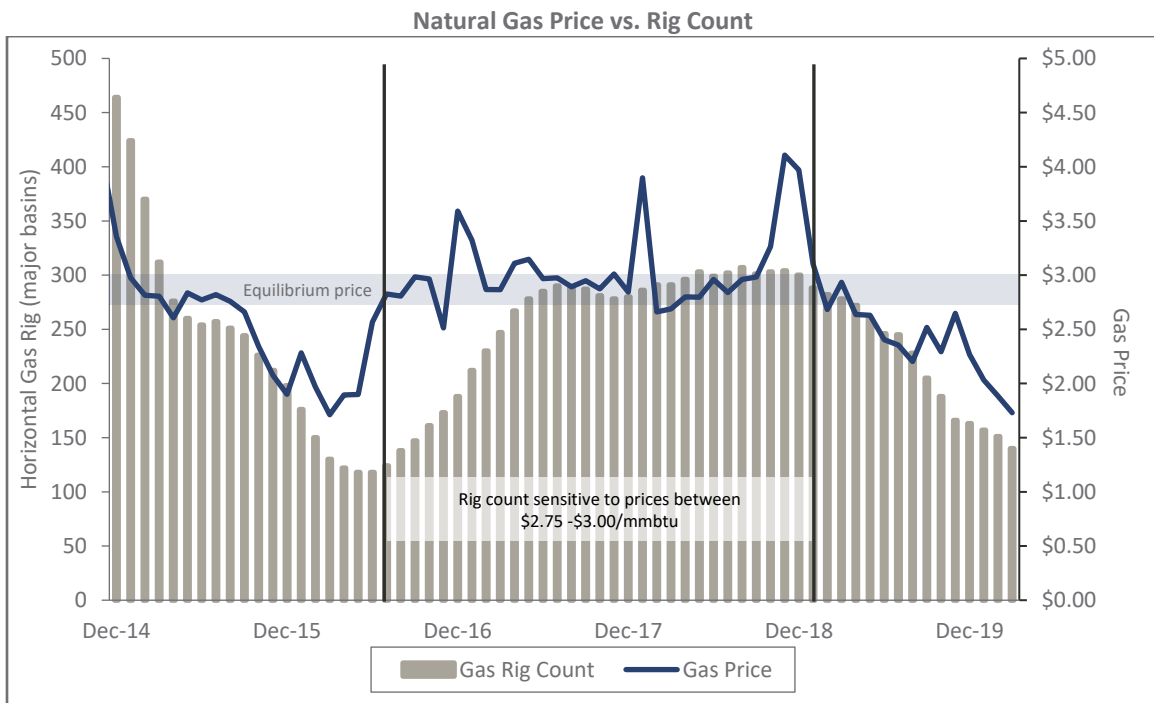
It’s clear that the rig count responds to prices around \$55-\$60/bbl, particularly when external capital isn’t available.



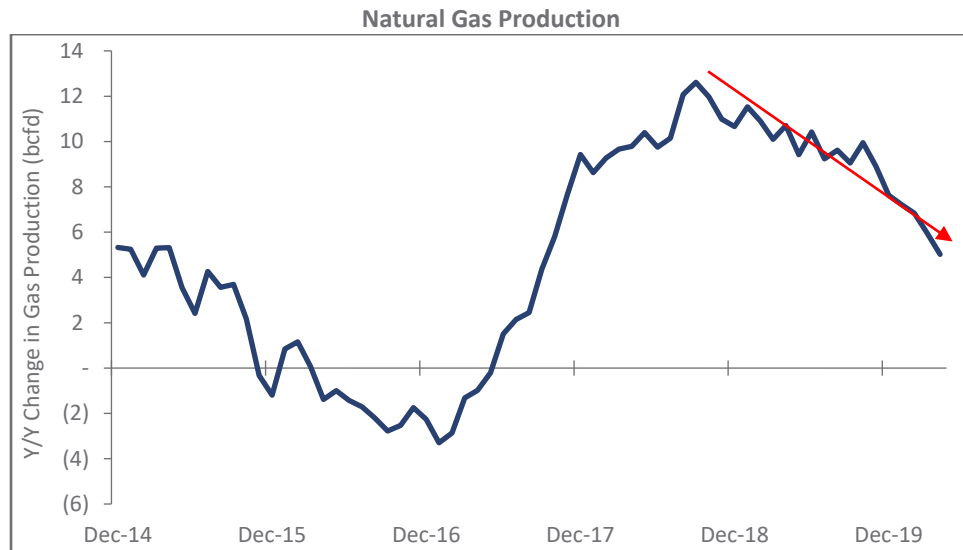
Source: SailingStone Capital Partners LLC, EIA and DrillingInfo, 2Q 2020

And when the rig count changes, production always follows.

Relative to shale oil, natural gas is farther along in the supply rationalization process as producers were forced to live within cash flows much earlier. We continue to see lots of commentary about “half-cycle breakeven prices” that are sub-\$2.50, but once again, the data tells a different story.



Source: SailingStone Capital Partners LLC, EIA and DrillingInfo, 2Q 2020



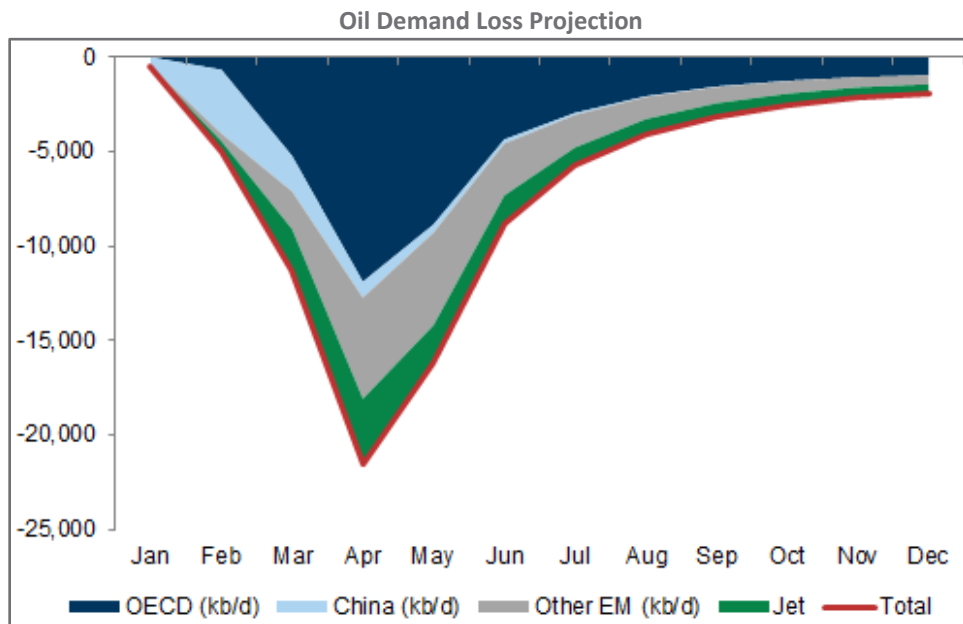
Source: SailingStone Capital Partners LLC, EIA and DrillingInfo, 2Q 2020

The natural gas rig count rolls-over once gas prices go below \$2.75/mcf, as does supply growth. What does that say about the price required to maintain natural gas production?

We're making these observations to drive home a point that largely has been lost in the furor of the past six weeks. ***The oil and gas markets were already rebalancing. The sudden drop in oil demand only accelerates the process.*** In natural gas, the "plan" was to generate free cash flows and let production moderate in order to manage through a period of weather-induced oversupply. In oil, the "plan" for most producers appeared to be hoping that OPEC+ would allow them to continue to take market share. The oil market just got punched in the mouth. From our perspective, it is just a wake-up call that serves to accelerate the return to economic reality.

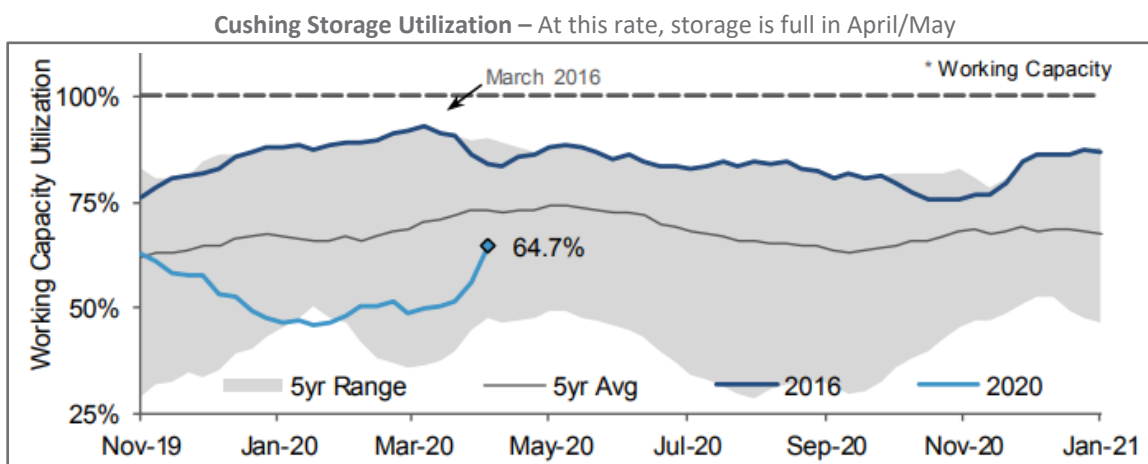
OIL

Oil is predominantly a transportation fuel, and in the current environment, demand is plummeting. The market is ~100mmbd, so the peak decline represents almost 25% of global consumption.

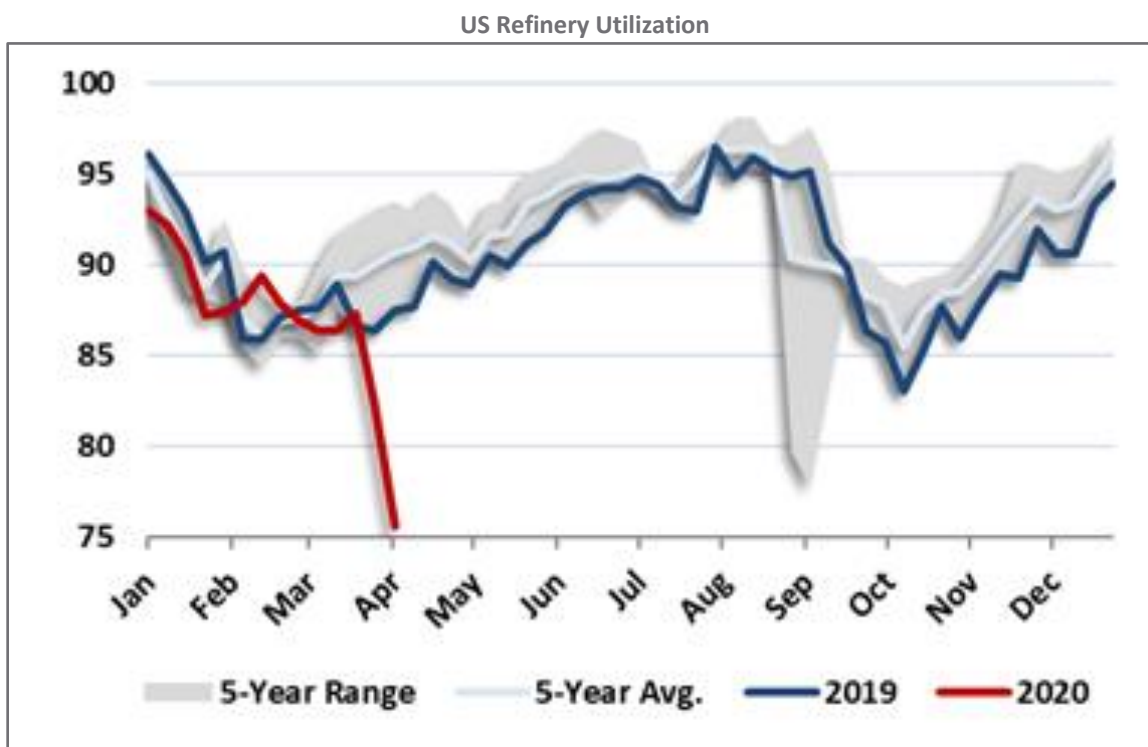


Source: Goldman Sachs Global Investment Research, IEA, OAG, 2Q 2020

The chart above forecasts a recovery, but no one knows what the severity and duration of the demand contraction will be, just as no one knows what, if anything, will come from attempts to coordinate a supply response. What we do know is that crude and product storage is filling, and refineries will either shut or meaningfully cut back utilization rates because there isn't enough end market demand. We know this because it is already occurring.



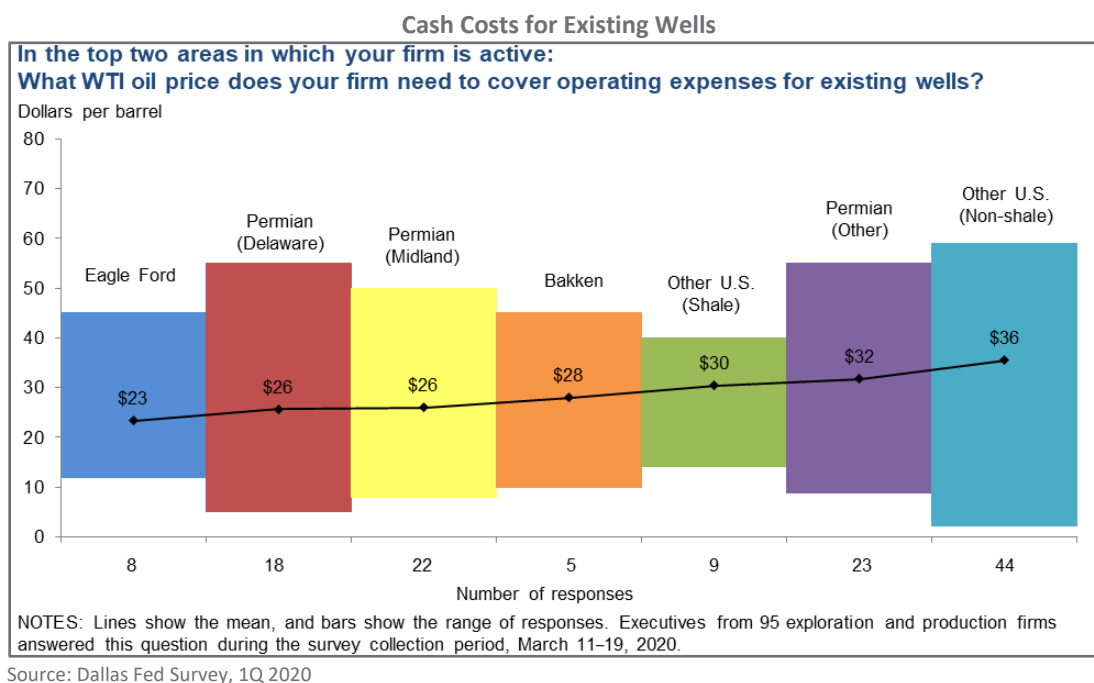
Source: DOE, EIA, Scotiabank Research, 2Q 2020



Source: EIA, USCA, 2Q 2020

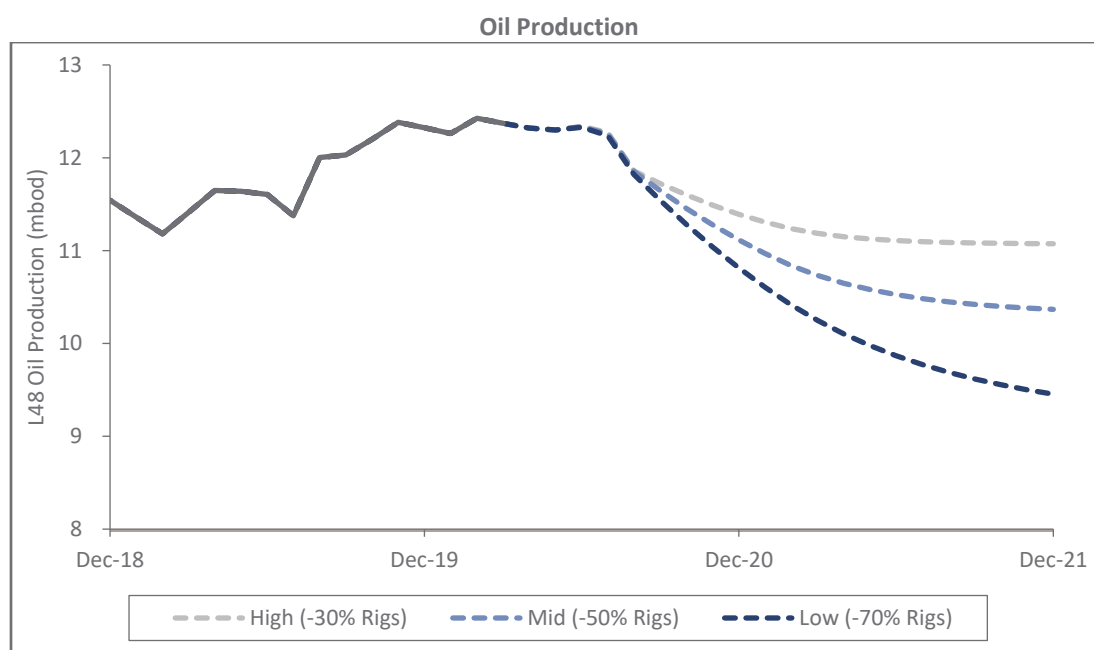
Once storage is full and/or refineries stop taking crude, prices will fall to cash costs in order to curtail supply. This has already happened in more landlocked basins such as the Bakken and will occur in other regions as well. When there is nowhere for oil to go, it must stay in the ground.

The price where shut-ins occur is an open debate. Producers and analysts have taught investors to think about operating costs on a per barrel basis, as if shale oil is a 100% variable cost business. Once again, we go back to the Dallas Fed survey to determine whether “at \$30, it’s hard to even keep producing existing wells.”



While this runs counter to producer claims of operating costs in the \$5-\$10/boe range, it more closely matches reported profitability for the sector. Our guess is that benchmark prices of around \$20/bbl less differentials will cause operators to shut-in production. Even a coordinated supply cut is unlikely to offset the contraction in demand. Thus, we expect prices to fall to these levels over the next few months.

Recall that the U.S. oil horizontal rig count dropped almost 30% exit-over-exit in 2019 and has declined another 25% so far in 2020. At current prices (or lower), and without access to external capital, the U.S. oil rig count will fall even more. The chart below shows the impact on U.S. oil production based on a range of incremental reductions to the rig count, excluding the impact of any voluntary shut-ins.

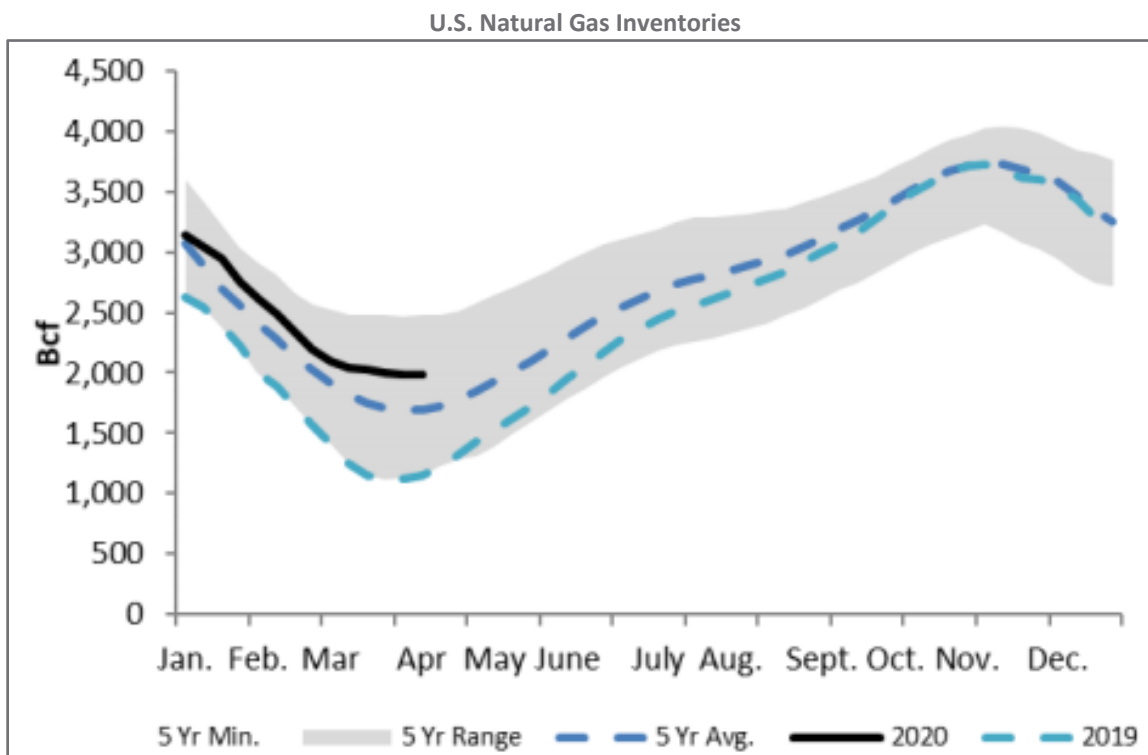


Source: SailingStone Capital Partners LLC, EIA and DrillingInfo, 2Q 2020

Even with a steep drop in supply, the next one to two years will be challenging for the oil markets, and we do not believe that anyone knows when the markets will balance. That is why our only meaningful oil exposure is to conventional producers with low decline rates, strong balance sheets and attractive free cash flow yields. Longer term, however, the outlook for oil is much more constructive than it was even a quarter ago. Capital providers are unlikely to rush back to the sector, meaning that prices will need to reflect marginal supply economics. Global demand will recover, and as first inventory and then low-cost spare capacity is worked down, the call on North American shale oil will increase. This will require prices in the mid-\$50's to low-\$60's, but the path from here is likely to be anything but linear.

NATURAL GAS

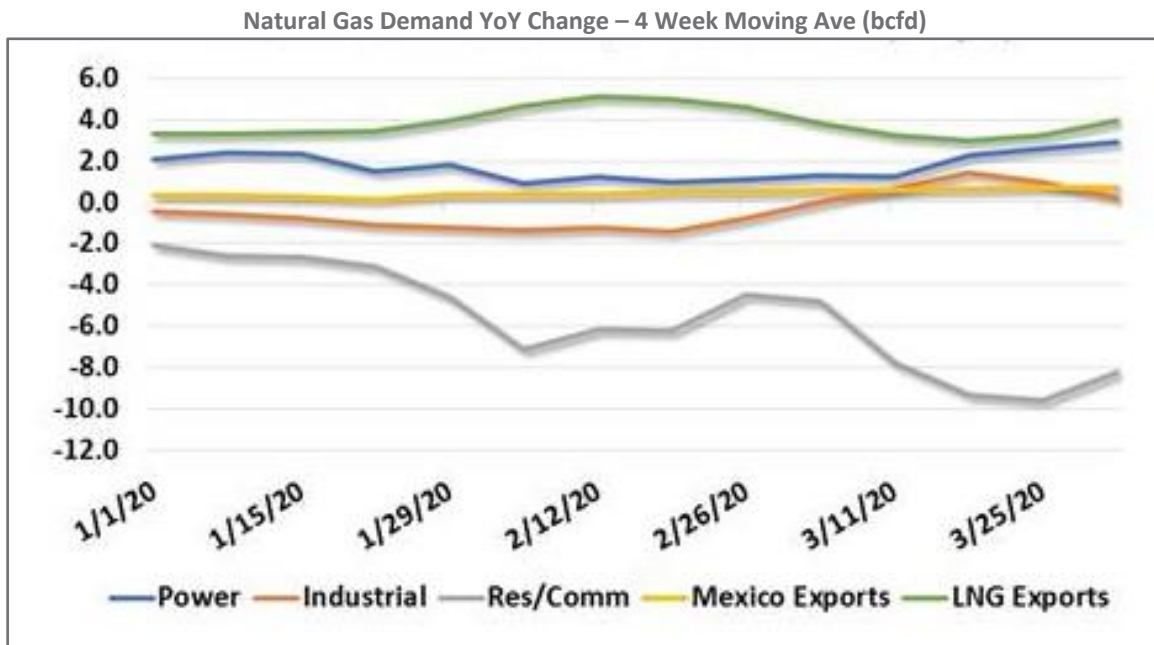
After suffering through one of the warmest winters on record, U.S. natural gas inventories remain above the five-year average.



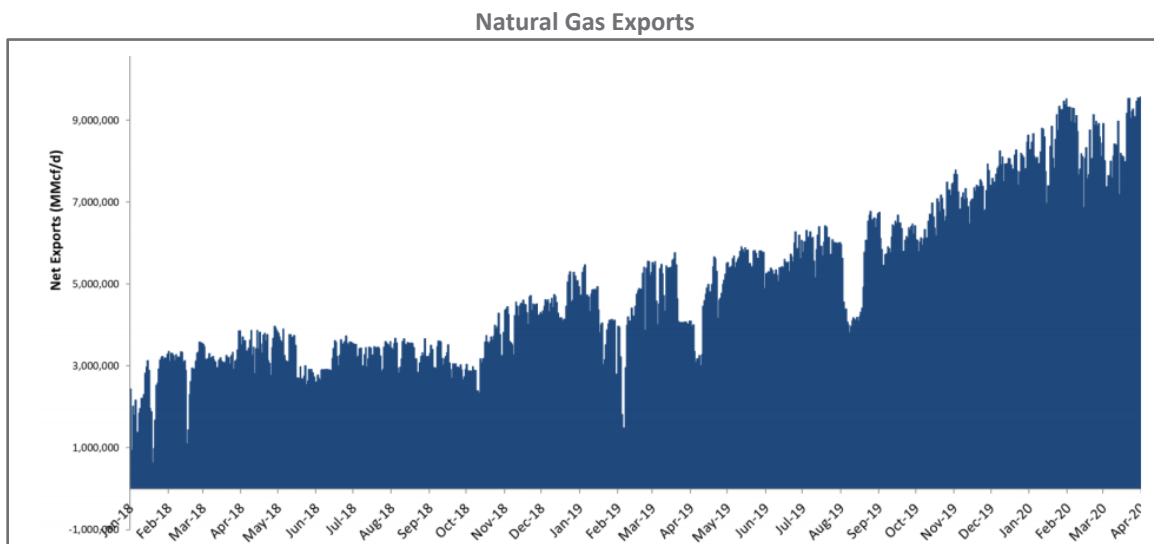
Source: EIA, Wolfe Research, 2Q 2020

Just as in oil, when natural gas storage is full, prices fall to incent a demand response (in this case coal-to-gas switching in the power stack) and to shut-in supply. The natural gas horizontal rig count fell more than 45% in 2019 exit-over-exit and has declined almost 30% already this year. Encouragingly, marginal but high growth plays such as the Haynesville (rig count down about 50% from the early 2019 peak), Utica (-50% from mid-2018) and SCOOP/STACK (-80% from late 2018) have seen a significant compression in activity. As we stated in our [recent white paper](#), the natural gas market was farther along in its evolution relative to shale oil because it had already been forced to live within its own means.

Unlike oil, recent developments unequivocally are net positive for natural gas and low-cost natural gas producers. Domestic natural gas demand is far less economically sensitive than oil, down about 1% (1bcfd) on a net basis relative to last year over the last four weeks. While that number almost certainly will decline going forward, it is a rounding error relative to the 25% drop in oil demand that we have witnessed thus far.

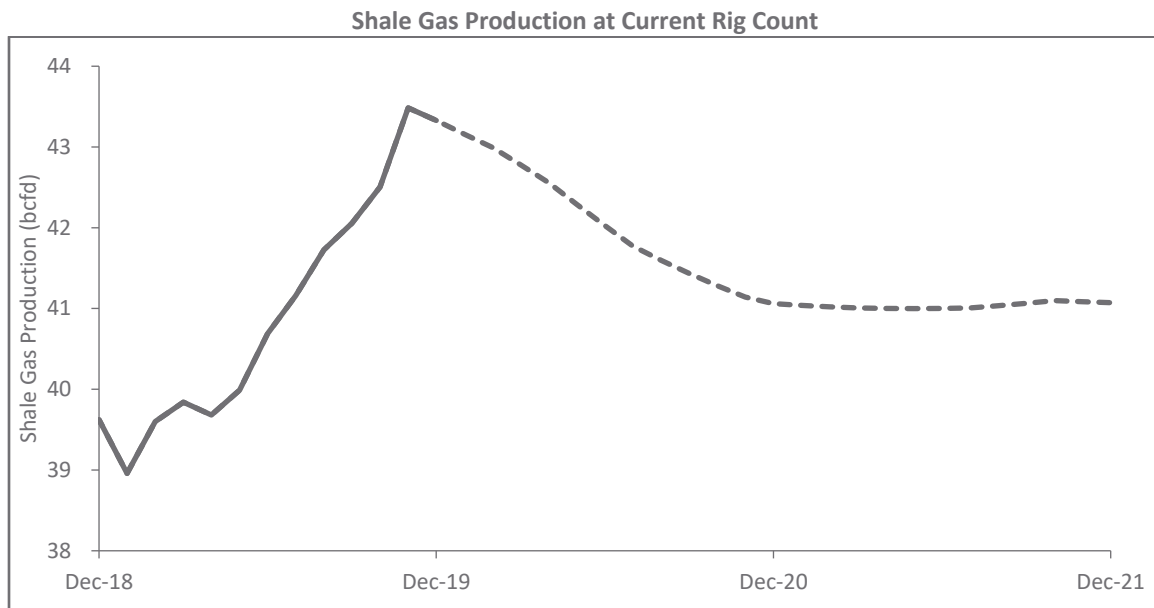


Furthermore, the US exports about 9% of natural gas production via LNG.



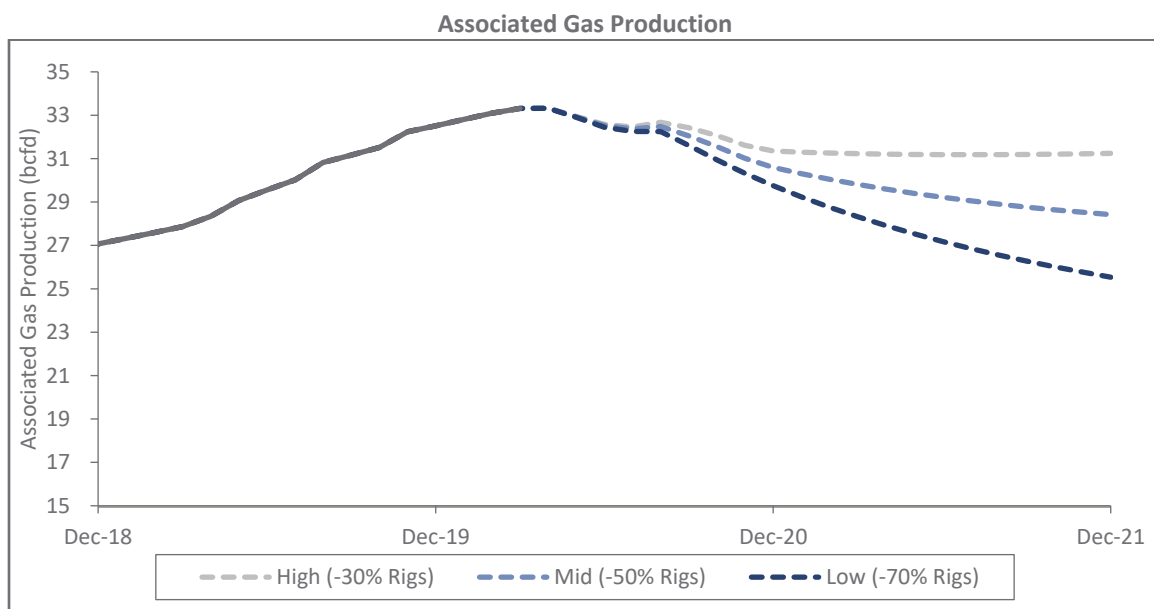
Volumes have stabilized over the past two months, although loadings could slow in the future, particularly if China's economic restart is derailed by a second Covid-19 outbreak or a weaker than expected export market.

From a supply perspective, however, the steep drop in oil prices, the resulting impact on drilling activity and the potential for further curtailments due to oil well shut-ins far outweigh the demand risks. Again, this is in addition to the reduction in supply that was already occurring due to the reduction in drilling activity in many higher cost natural gas regions. Starting here, the chart below is our forecast for production from those basins at the current rig count.



Source: SailingStone Capital Partners LLC, EIA and DrillingInfo, 2Q 2020

Production has already started to fall in response to low prices and fewer rigs. The more important variable, however, is the impact on associated gas as the oil rig count drops. The following chart shows the same scenarios that we ran for incremental reductions in oil drilling activity on associate gas production.



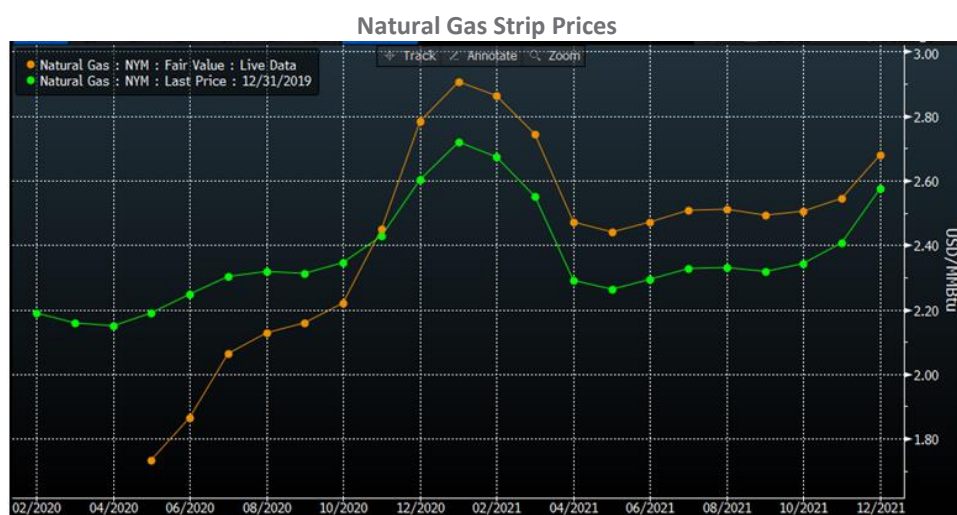
Source: SailingStone Capital Partners LLC, EIA and DrillingInfo, 2Q 2020

In addition, the rough math of the impact of potential oil shut-ins on associated gas volumes is as follows, courtesy of our friends at Tudor, Pickering, Holt & Co:

Oil Shut-ins = refinery run reductions. At 25% = 3mmbod oil curtailed. At an average Gas Oil Ratio of 3mcf/bbl, adjusted for a reduction in flaring, equates to 7bcfd of supply that will come out of the market.

With a net supply drop of 10-15 bcfd (11-20bcfd gross supply less liquids removal and some demand destruction), the natural gas market will balance and then likely revert to a deficit much more quickly than we had anticipated in a \$50-\$60 oil price environment.

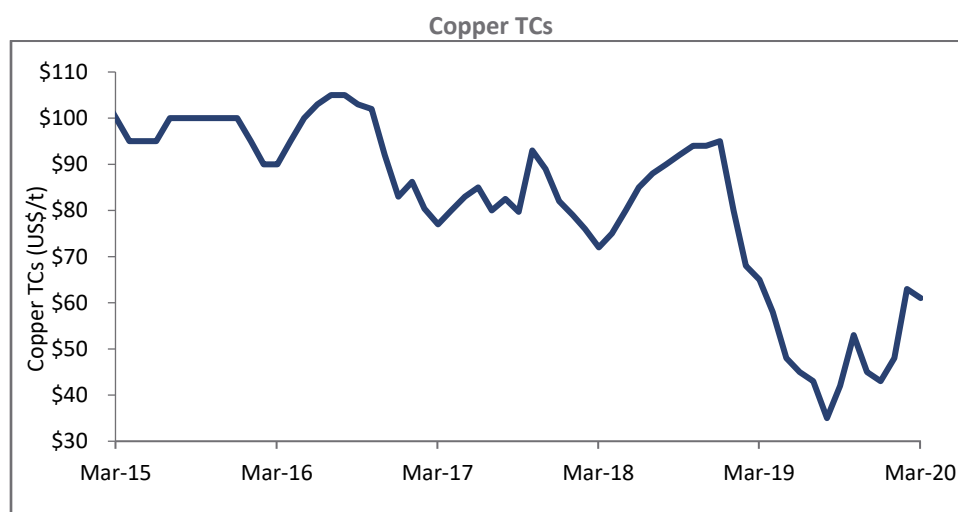
While spot prices could remain subdued through the summer, given existing excess inventories, the strip is already moving up to reflect these longer-term realities.



Many natural gas stocks are trading well below the value of their proved developed producing reserves at strip pricing. Much of this negative view is a function of a). investor confusion around the actual economics of natural gas, driven in part by the proliferation of what is turning out to be uneconomic associated gas volumes and b). a public equity market that is more driven by momentum than fundamental investing. As we have been saying for several years, low-cost natural gas producers generate attractive cash-on-cash returns, are long inventory and are well positioned to benefit from the on-going energy transition with its focus on lower carbon emissions and the “electrification of everything”. With the sudden removal of associated gas volumes and the likelihood of permanent changes to oil-related drilling activity going forward, the pure economics of natural gas are once again becoming apparent. Despite many natural gas stocks being up 40-80% in the last few weeks, we contend that companies with Tier I acreage, ample liquidity and long-duration inventory are worth multiples of their current value.

COPPER

The copper market was facing a small deficit this year, as pent-up demand from the U.S./China trade war overwhelmed supply. The rapid tightening of the market through 2019 is evident in the precipitous drop in TC/RC's, which are the prices producers pay smelters and refiners to take their concentrate. Lower prices = a tight market for concentrate.



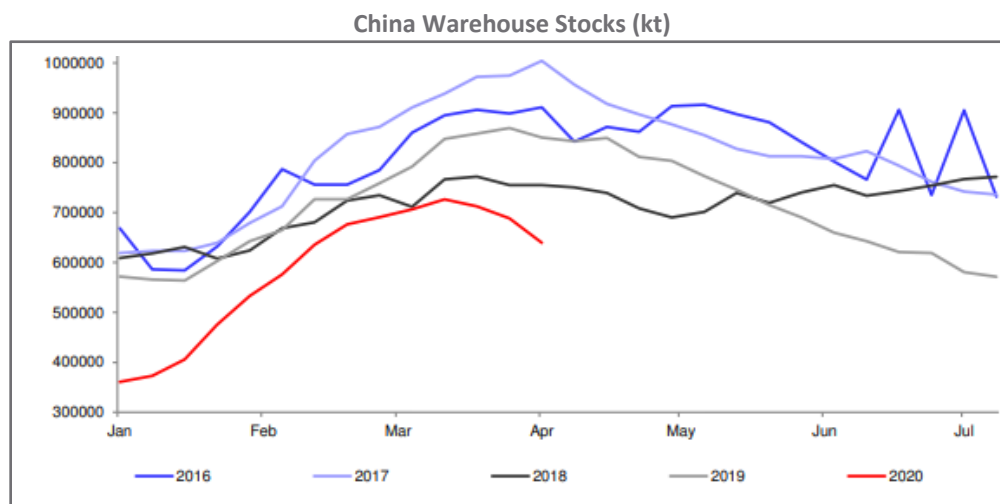
Of course, demand has been negatively impacted as first China and then OECD economies have ground to a halt. But, COVID-19 has also had a much more direct impact on copper supply than almost any other commodity. As of today, more than 11% of annualized supply is offline due to operations being curtailed or put on care and maintenance.

Total Cut Output by Commodity

Commodity	Capacity suspended	Volume loss-td	Disrup allowance filled %	Cap sus as % Glob demand
Copper	2.7Mty	133kt	6.7%	11.3%
Aluminium	3.9Mty	228kt	11.4%	6%
Zinc	2.5Mty	103kt	14.6%	16%
Iron Ore	72Mty	2.7Mt	4.5%	5%
Thermal Coal	73Mty	3.7Mt	7.4%	7%
Coking Coal	35Mty	800kt	5.1%	11%

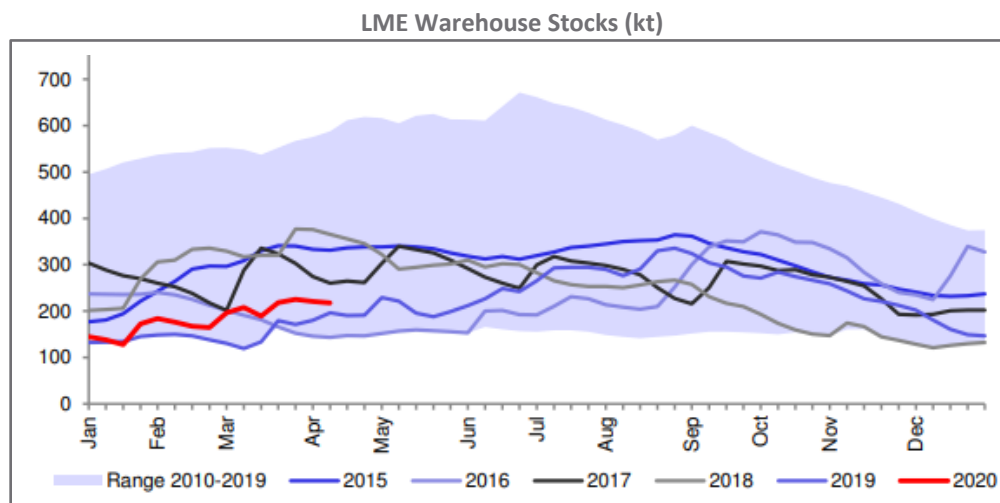
Source: Deutsche Bank, Company Reports, Bloomberg Finance LP, 2Q 2020

In addition, a number of development projects have been halted or slowed, making the 2021+ supply outlook even more challenged. Of course, the ultimate impact on supply/demand balances will be a function of how long different projects are offline vs. the pace of demand recovery, but it is interesting to note that Chinese warehouse inventories are following normal seasonal trends off a very low base.



Source: Deutsche Bank, WIND, 2Q 2020

Non-China inventories are low as well, with both SHFE and LME exhibiting signs of destocking in 2019.



Source: Deutsche Bank, WIND, Bloomberg Finance LP, 2Q 2020

As with oil and to a lesser extent natural gas, the near-term outlook for copper is difficult to forecast. But, over the short to intermediate term, copper prices will need to move meaningfully higher just to meet current demand. Similar to natural gas, copper is integral to the energy transition, meaning that copper demand growth may accelerate going forward.

Copper versus Other Metals in NextGen Applications

	Cobalt	Copper	Dysprosium	Gallium	Indium	Lithium	Neodymium	Nickel	Platinum	Selenium	Silver	Tellurium
Reserve (ton)	7,100,000	790,000,000	55,000	5,200	47,100	16,000,000	4,100,000	74,000,000	44,100	100,000	530,000	31,000
Mining (ton/year)	110,000	19,700,000	1,350	555	720	43,000	21,000	2,100,000	200	3,300	25,000	420
Recycling rate (current)	40%	60%	15%	15%	40%	10%	15%	60%	70%	5%	80%	0%
Metal intensity (ton/GW)												
Wind power (induction)		4,982						377				
Wind power (PM)		4,700	13				200	377				
Solar PV (Si)		884									10	
Solar PV (aSiGe)		1,005			5.32							
Solar PV (CdTe)		5,181										70
Solar PV (CIGS)		450		4	13					41		
CSP (parabolic)		3,200						940			13	
CSP (central power)		1,400						1,800			16	
Metal intensity end use												
Motor PM (kg/kW)		0.19835	0.0000516				0.0038					
Motor induction (kg/kW)		0.48105										
Battery (kg/kWh)	0.4	0.4				0.2		0.6				
Fuel cell (kg/kW)									0.00015			

Source: Manberger, Stenqvist, Energy Policy 119, 2018

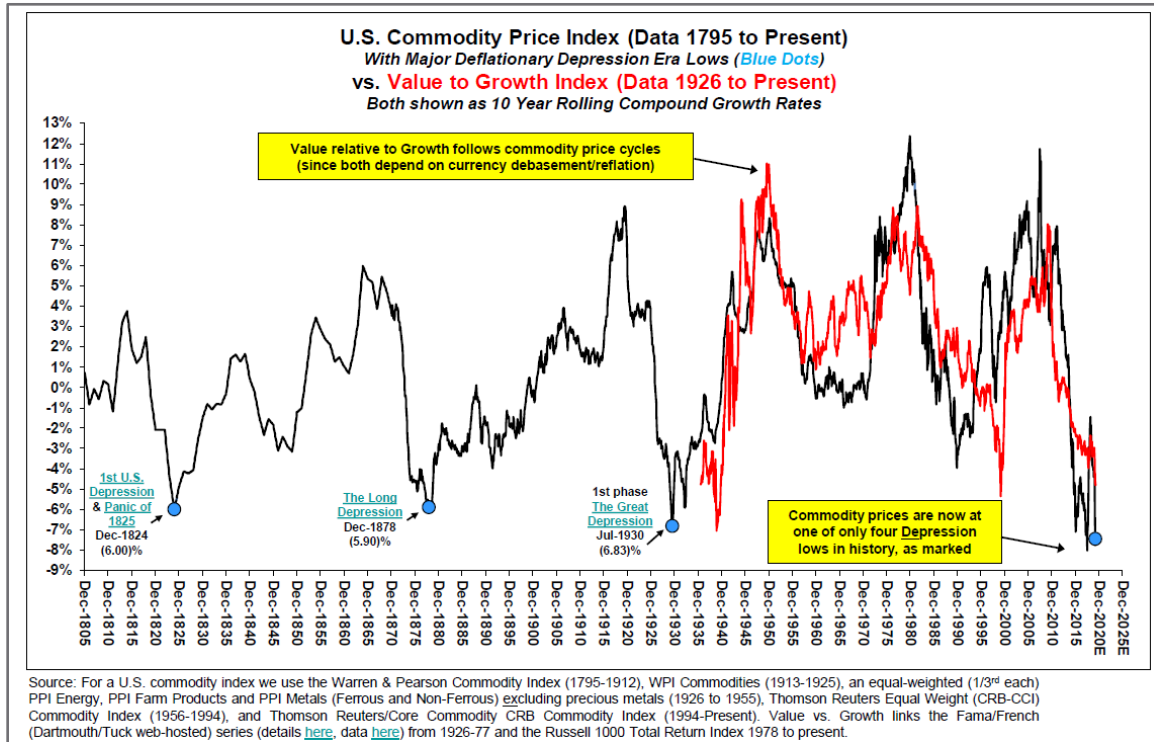
The copper industry has been living within cash flows since 2012-2013, substitution has largely run its course and scrap volumes are almost entirely pro-cyclical. The various demand shocks over the past few years (U.S./China trade war, COVID-19), and the resulting low copper price have forced companies to rationalize costs, limit capital reinvestment and defer growth projects. From here, there are three options to keep the copper market in balance: demand falls, investors open up their pocketbooks, or prices rise. Given the critical role that copper plays in virtually all low-carbon scenarios, the rapidly maturing supply base and the lessons learned from the 2000's era chase for growth, option #3 seems like the most probable outcome.

INFLATION IMPLICATIONS

As value-based natural resource investors, our objective is to find companies which can generate attractive project-level returns that translate into economic value creation for their owners. Over time, we assume that commodity prices mean revert around the marginal cost of supply due to underlying depletion rates and the rational allocation of capital (this was a big mistake the last few years). Typically, investment opportunities arise when commodity price expectations are so low that assets become mispriced relative to intrinsic value, but we have always believed that higher future commodity prices are the “cherry on top”.

Having said that, it's a whole lot easier running with the wind at your back than a gale in your face. The last decade has been largely deflationary, including for commodity prices. As shown in the chart below, the 10-year rolling compound growth rate for commodity prices went from +10% to -8% between 2009-2019, the largest and one of the fastest drawdowns over the last 200 years.

U.S. Commodity Price Index

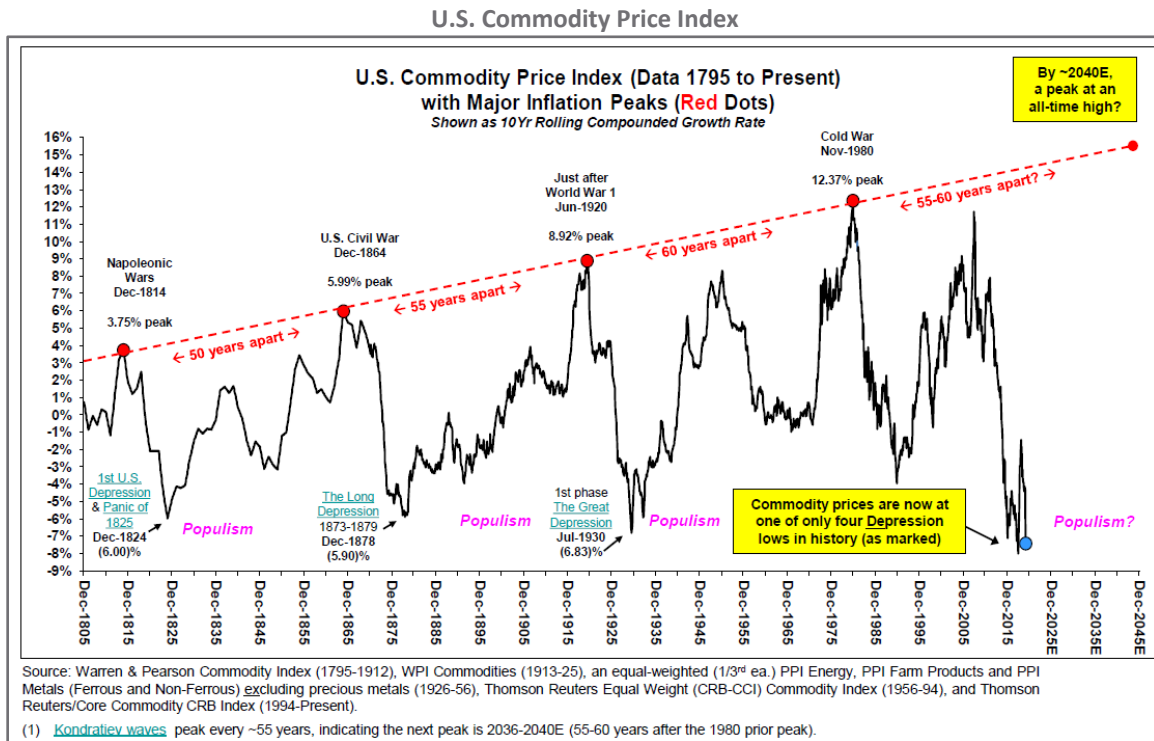


Source: Stifel, 2Q 2020

The fact that commodity prices and value investing appear to be so highly correlated has made the gale occasionally feel like a hurricane.

No one would argue that the current environment is inflationary. Quite the opposite, in fact. However, after a decade of deflation and with capital markets largely shut to commodity producers, “what’s next” becomes a much more provocative question than it was even a few months ago. It’s possible that commodity prices fall from here, but it would require either a seismic, permanent drop in demand for supply to clear at current levels, or for investors to finance uneconomic projects. Neither option seems particularly likely.

The alternative is that we are approaching a cyclical turning point, similar to what occurred in the late 1990’s. It’s possible, and perhaps probable, that commodity inflation is more prevalent going forward than it was over the last decade. More structurally, it seems almost guaranteed that global supply chains will regionalize in a post-COVID-19 world, reversing years of efficiency gains that were passed through in prices. And, the emergence of strong nationalistic and now populist policies in countries around the world over the last several years have, in the past, tended to be reflationary. For reference, here is the same chart as above, with some different historical context.



Source: Stifel, 2Q 2020

We aren't making a forecast, but instead raise the issue as one worth considering, particularly since it doesn't seem to be on many people's radar. Along a similar vein, we paraphrase recent comments from Darius Dale, the senior macro analyst at Hedgeye who is far more versed and succinct on big picture topics than we are.

Thought piece for investors with (longer) investment horizons:

- a. The last time the US dollar was this high on a broad, trade-weighted basis (e.g. at the turn of the century), investors could only pile into "Secular Growers" in the US Tech Sector. You couldn't touch EM or Energy with a 10-foot pole then. Sound familiar?
- b. What outperformed the then-Secular Growers over the next decade? Levered plays on a falling USD (e.g. China/EM, natural resources). While I doubt the next decade will perfectly resemble the 2000-11 period ...I suspect it'll look different enough from the 2009-19 period to warrant using...market volatility to build long-term equity and credit positions in the natural resources sector.
- c. The re-shoring of domestic manufacturing capacity and building up of supply chain redundancies is likely to be a big theme over the next 3-5yrs as well.
- d. **Key Takeaway:** The risk of the US and global economies transitioning to a persistent...stagflationary regime from a secular perspective in a post-COVID19-de-globalization-fiscally-profligate world is likely an underpriced risk... Just something for your mind...to the extent you are afforded longer investment horizons within your mandate(s).

An interesting perspective, and hopefully thought-provoking for investors implementing a plan that allows them to avoid the next punch in the mouth.

VALUATIONS AND OUTLOOK

Over the last few years, the natural resource space has become increasingly irrelevant for many investors. A period of cheap, abundant capital and a series of exogenous demand shocks led to supply/demand imbalances and poor investment returns which, when combined with ESG concerns has made the space easy to overlook. Recent events certainly haven't helped near-term performance, but they are accelerating a rebalancing which will create a much more constructive outlook for natural resource investing going forward. Call it a "return to fundamentals".

Excess Capital Removed. While mining and natural gas producers have been operating within cash flows for the last few years, U.S. oil companies have had relatively easy access to capital. This led to uneconomic supply additions which depressed both commodity price expectations and project returns. Finally, though, it appears as if the artificial support of third-party financing has been removed.

At lower commodity prices and with limited access to external funds, the underlying economics of U.S. shale oil are becoming clear. While the reconciliation of balance sheet and operating leverage with lower commodity prices undoubtedly will be painful for the industry, the implications are very positive longer term. Uneconomic supply will fall for both U.S. shale oil and associated gas. This will allow the few low-cost oil producers to thrive operationally and strategically, as their competitive advantage should translate into a lower cost of capital. More importantly, it will remove a source of natural gas supply which has become the bogeyman for investors, with many forecasting that incremental associated gas supply would overwhelm all future demand growth. That doesn't appear to be the case today, which means gas prices will need to rise in the short- to intermediate-term.

Cost Structures Will Determine Price. With OPEC+ signaling a desire to return to something like full capacity utilization going forward, the price umbrella has been removed for oil. This will accelerate the rebalancing process already started by the rationalization of capital. While it may take a year or two for the oil markets to clear, ultimately shale oil will be required to meet demand. When it does investors should expect oil prices to be in the \$55-\$60 range.

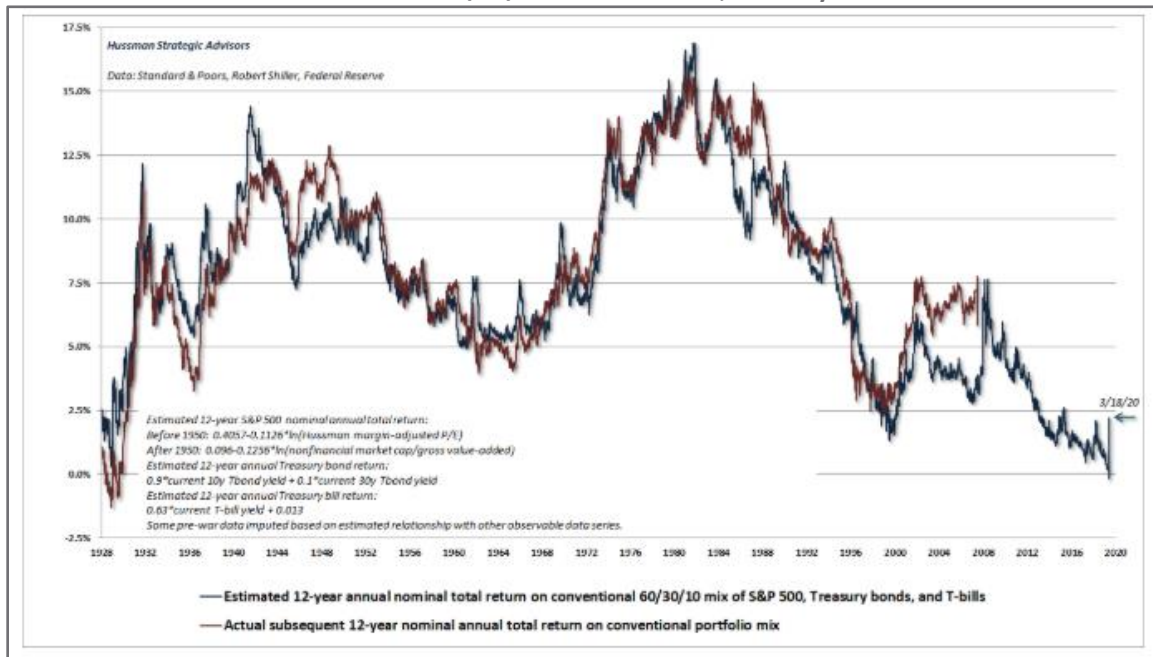
Unlike oil, the natural gas market recalibrates each year because largely it is a closed system. This was already occurring, but the sudden removal of associated gas volumes means a more rapid and potentially violent equalization process. In fact, it may require a price spike to ration demand, just as we witnessed a price drop in 2019 to ration supply after an abnormally warm winter. Longer term, natural gas must average around \$2.75-\$3.00 (much as it did from 2016-2018) for dry gas producers to generate sufficient cash flows to cover their capital needs. We will be there sooner rather than later.

The copper market is reaching the end of its tether at a sub-\$3.25 price. Because mining assets have much lower depletion rates than unconventional oil and natural gas wells, they can weather longer periods of low prices. But the longer prices stay low, the more constrained supply becomes. At some point, prices will need to rise, as they did just prior to the commencement of the U.S./China trade war in 2018, and as they started to do in the fourth quarter of 2019 after trade relations began to thaw. COVID-19 demand is not just deferring the price response, but likely magnifying it as well.

Demand Characteristics – Commodities in a Decarbonized World. No one knows what the lasting implications of the current social and economic environment will be on commodity demand. Maybe we travel less. Maybe, after being cooped up alone or with our families for a few months, we travel a LOT more. Maybe vehicle miles fall permanently as we realize some of the benefits of remote working, which may also require a build-out of our networking infrastructure. But it is interesting to think about what, if any, lessons we can learn from the temporary but immediate decarbonization of the world's economy. Over the short term, it's clear that oil demand is much more economically sensitive than gas, and more economically sensitive than copper. Over the intermediate and long term, we reasonably can expect that oil demand is at risk as EV penetration increases and remote working habits become more entrenched. Conversely, natural gas and copper demand likely will increase due to the central role that each play in enabling the "electrification of everything" on a global basis. For investors who want to do more than pay lip service to ESG mandates, finding responsible ways to capitalize those upstream commodities necessary to achieve a universal good seems like a moral imperative. Fortunately, the return outlook appears to be pretty attractive as well.

Relative Valuation. Most non-commodity asset classes have enjoyed a strong run the last decade or so. The chart below shows one estimate of how future expected returns of a 60/40 U.S. stock and government debt portfolio compares versus the last ninety years.

Estimated Future Returns: 60/30/10 Mix of S&P 500, Treasury Bonds and T-Bills



Source: Hussman Market Comment, April 2020

As we illustrate in the chart at the beginning of this letter, resource equities are generally at the opposite end of the spectrum. This is particularly true for smaller and mid-cap stocks which have been hit disproportionately by the sharp reduction in liquidity that has occurred over the past few years as investors fled the space. Even including the various oil companies that are not able to navigate through the current demand shock, in aggregate the resource space is trading at multi-decade troughs compared to other asset classes which appear to be near century peaks. Historically, this has been fertile ground for contrarian investors.

Summary. Over the last two years, we have attempted to take advantage of the extraordinary volatility in the natural resource space by acquiring interests in companies which we believe are best positioned from an asset quality, inventory depth, commodity mix and balance sheet perspective to thrive in the years ahead. We have stress tested liquidity and are comfortable that the companies have ample flexibility to manage through a prolonged period of weak commodity prices. We have consciously avoided most U.S. oil shale plays because we do not believe that their economics are particularly attractive, and as a result question valuations as well. Instead, we have focused on more conventional oil producers with attractive cost structures, lower depletion rates and significant inventory. In natural gas, we remain targeted owners of Marcellus and Montney natural gas and liquids producers, and in copper we own stakes in what we contend are the two most attractive development projects in the world today.

We have made our share of mistakes, the most critical of which was underestimating the willingness of public and private markets to fund uneconomic shale oil projects, and for far longer than we expected. While this has created temporary headwinds for commodity prices and marks, we do not believe that we have suffered any material permanent asset impairments as a result. In fact, we expect that our second quarter review of 2019 drilling returns and project development will show further compounding of economic value.

Despite the challenges associated with COVID-19 for global economic growth, or perhaps in part because of them, we believe that commodity fundamentals are improving. This is truly the “cherry on top”, because even at something like strip prices, the outlook for equity returns is quite attractive. Today, you are being paid to hedge against future commodity price inflation risks.

Ronald Reagan’s 1984 maxim about Congress -


“We could say that they . . . spend like drunken sailors, but that would be unfair to drunken sailors since the sailors are spending their own money.”

certainly holds true for the natural resource space. Fortunately, folks are sobering up, which means we should be moving into a period where economic principles like value creation matter, and where commodity fundamentals become more of a tailwind than a headwind.

Best Regards,

A handwritten signature in black ink, appearing to read "MacKenzie Davis". The signature is fluid and cursive, with a long horizontal stroke at the end.

MacKenzie Davis, CFA

A handwritten signature in black ink, appearing to read "Ken Settles". The signature is fluid and cursive, with a long horizontal stroke at the end.

Ken Settles, CFA

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Performance presented is achieved by SSCP and, prior to June 1, 2014, that achieved at a prior firm unaffiliated with SSCP and at which the accounts were managed by MacKenzie Davis and Ken Settles. SSCP did not calculate the performance data prior to June 1, 2014 but believes such data to be accurate. The indices shown are broad-based securities market indices. They are not subject to management fees, transaction costs and expenses to which a managed fund or account is subject. You cannot invest directly in an index. Those indices that are not benchmarks for the strategy are not representative of the strategy and are shown solely as a comparison among asset classes. Certain indices have been selected as benchmarks because they represent the general asset class in which SSCP’s strategy invests; however, even such benchmarks will be materially different from portfolios in the strategy since SSCP is not constrained by the any particular index in managing the strategy.

The S&P North American Natural Resources Sector Index™ (S&P NANRSI) is an unmanaged modified-capitalization weighted index of companies in the Global Industry Classification Standard (GICS®) Energy and Materials sectors, excluding the Chemicals industry and Steel sub-industry. Index weights are float-adjusted and capped at 7.5%. Ordinary cash dividends are applied on the ex-date. As of

December 31, 2007, the strategy changed its benchmark from the Lipper Natural Resources Fund Index to the S&P North American Natural Resources Sector Index because the S&P North American Natural Resources Sector Index is composed of securities of companies in the natural resources sector while the Lipper Natural Resources Fund Index is composed of mutual funds that invest in the natural resources sector. The S&P Global Natural Resources Index includes 90 of companies in natural resources and commodities businesses that meet specific investability requirements whose market capitalization is greater than US\$100 million with a float-adjusted market cap of US\$100 million. Equity exposure is across 3 primary commodity-related sectors: agribusiness, energy, and metals & mining. Liquidity thresholds are the 3-month average daily value traded of US\$5 million. Stocks must be trading on a developed market exchange. Emerging market stocks are considered only if they have a developed market listing. The MSCI World Commodity Producers Index (MSCI-WCP) is an equity-based index designed to reflect the performance related to commodity producers' stocks. The MSCI World Commodity Producers Index is a free float-adjusted market capitalization-weighted index comprised of commodity producer companies based on the GICS. The S&P Global Natural Resources Index (S&P GNR) includes 90 companies in natural resources and commodities businesses that meet specific investability requirements whose market capitalization is greater than US\$100 million with a float-adjusted market cap of US\$100 million. Equity exposure is across three primary commodity-related sectors: agribusiness, energy, and metals and mining. Liquidity thresholds are the 3-month average daily value traded of US\$5 million. Stocks must be trading on a developed market exchange. Emerging markets stocks are considered only if they have a developed-market listing. The Bloomberg Commodity Index (formerly the Dow Jones-UBS Commodity Index) is calculated on an excess return basis and composed of futures contracts on 22 physical commodities. It reflects the return of underlying commodity futures price movements. The S&P 500 Index is a free-float adjusted market-capitalization-weighted index designed to measure the performance of 500 leading companies in leading industries of the U.S. economy. The stocks included have a market capitalization in excess of \$4 billion and cover over 75% of U.S. equities. The S&P GSCI® Crude Oil Index provides investors with a reliable and publicly available benchmark for investment performance in the crude oil market. The S&P GSCI® Natural Gas Index provides investors with a reliable and publicly available benchmark for investment performance in the natural gas market. The S&P GSCI® Copper Index, a sub-index of the S&P GSCI, provides investors with a reliable and publicly available benchmark for investment performance in the copper commodity market. The S&P GSCI® Gold Index, a sub-index of the S&P GSCI, provides investors with a reliable and publicly available benchmark tracking the COMEX gold future. The index is designed to be tradable, readily accessible to market participants, and cost efficient to implement. The S&P GSCI® Corn Index, a sub-index of the S&P GSCI, provides investors with a reliable and publicly available benchmark for investment performance in the corn commodity market. Net of fee returns are presented net of the actual management fees, trading costs, foreign exchange costs, foreign withholding taxes and other direct expenses (including commissions), but before custody charges and other indirect expenses. Gross performance results are net of trading costs, foreign exchange costs, foreign withholding taxes, and other direct expenses (including commissions) but before management fees, custody charges and other indirect expenses. All returns shown assume the reinvestment of dividends and other income. Benchmark returns are gross of withholding taxes. The performance shown is for the stated time period only; due to market volatility, each account's performance may be different. Returns are expressed in U.S. dollars.