



## IS THIS AN INFLECTION POINT FOR PASSIVE MANAGEMENT?

Most people only know Branch Rickey as the general manager of the Brooklyn Dodgers, whose promotion of Jackie Robinson into the Major Leagues broke the color barrier. This act of courage and historic vision was one of many that characterized Rickey's 50 years of sustained success running Major League teams. Those of us who follow baseball know that having a strong farm (Minor League) system is key to the prolonged success of a Major League team. Rickey created this system in the early 1920s when he was the general manager of the St. Louis Cardinals. The Cardinals were a small market team incapable of spending large sums of money to acquire talent like the big, bad Yankees. So, they had to be different. Rickey realized that if he could acquire many players at a young age before they reached their potential, some of them would inevitably become superstars, producing huge returns on his investments. The creation of tryout camps all over the country with Minor League teams serving as local liaisons was a quick and inexpensive means of finding young promising players. Success came very quickly; the Cardinals won many pennants and the World Series during Rickey's time. But Rickey's active decision making did not stop there. As he developed many players internally, always keeping new and exciting prospects in the pipeline, he also, quite controversially, traded or sold superstars as they finished their prime and offered diminishing returns. "Trade a player a year too early rather than a year too late," was his motto. Hall of Famers Dizzy Dean and Johnny Mize are examples of players developed internally who were traded or sold just prior to a rapid decline in performance. While most teams were engaging in a kind of passive management, keeping the superstars until after their prime and receiving little value during the latter part of their careers, Rickey's bold active style led to his success. Rickey's innovation of recruiting players for prices below their potential and releasing them when they reached it resembles the active management principles that we employ at Kopernik Global Investors.

We are possibly at an inflection point in the growth of passive investing and of "closet indexers" (active managers who end up being passive-like due to their sheer size). According to ETFGI, a London-based group that provides analysis and research on the global ETF/ETP industry, there were 7,927 ETFs/ETPs globally at the end of December 2019, managing \$6.35 trillion dollars.<sup>1</sup> It is a top-heavy marketplace in which the 4 largest ETF firms account for more than three-quarters of available ETFs.<sup>2</sup> On the active management side, consolidation pushed by the low-cost offerings of passive managers, as well as survivorship bias, has led to the majority of the industry being controlled by a few large actors. As a result, large active managers lose the ability to invest in small companies as they grow ever-larger and have no choice but to allocate large positions in index-heavy stocks. This causes a problem for the client, who ends up getting the same package with different wrapping from passive ETFs and many large money managers.

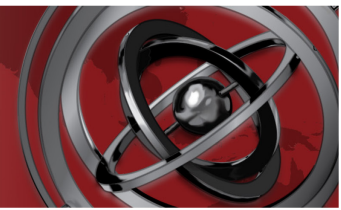
Our goal is to illustrate that we are at a point in the cycle where passive investing has become well overdone. Conversely, small, disciplined, active managers now have a distinct competitive advantage over their larger, index-shackled brethren. While arguing for active managers in general, we will feature our model portfolio due to convenience and familiarity. Kopernik's value philosophy, long-term investment horizon, disciplined process, and smaller size has resulted in a portfolio that looks very different from the benchmark. For Kopernik's Global All-Cap Strategy, the active share is 99.6% and the tracking error is 26.7% annualized.<sup>3</sup> Active fees, however, can be double the cost of many ETFs, or more. Do active managers deserve these fees? Is it possible to replicate their portfolios given the plentitude of industry and country-specific ETFs available to the average investor today? This white paper demonstrates that active strategies cannot be effectively replicated using passive vehicles, and that an active management approach adds a layer of benefit not present in passive investing.

Comparing Kopernik to the commonly used benchmark, the MSCI ACWI ("ACWI"), the differences in sector and country weights are clear, making it easy to conclude that simply buying the broad indices such as the ACWI or ACWI-ex US (since Kopernik has so little in the US currently) would not replicate our portfolio.

<sup>1</sup> ETFGI reports assets in the global ETFs and ETPs industry which will turn 30 years old in March started the new decade with a record 6.35 trillion US dollars, January 16, 2020, [etfgi.com](https://etfgi.com).

<sup>2</sup> S. Ross, *The five biggest ETF companies*, <https://www.investopedia.com/articles/investing/080415/5-biggest-etf-companies.asp>

<sup>3</sup> This number represents the annualized tracking error of Kopernik's representative account vs. the MSCI ACWI for the 6 months immediately preceding June 5, 2020.



Industry and Country Weight <sup>4</sup>	Representative MSCI ACWI ETF	Kopernik Global All-Cap Rep Portfolio
United States	56%	5%
Financials	17%	6%
Information Technology	17%	1%
Materials	5%	25%

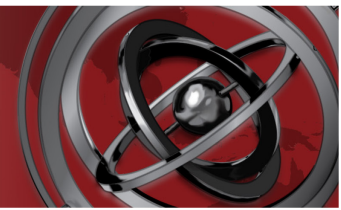
The same holds true when we compare our portfolio to a representative value ETF, as is shown in the table below.

Regional Allocation	Representative Value ETF	Kopernik Global All-Cap Rep Portfolio
Japan	27%	6%
Europe	56%	6%
Emerging Markets	11%	36%

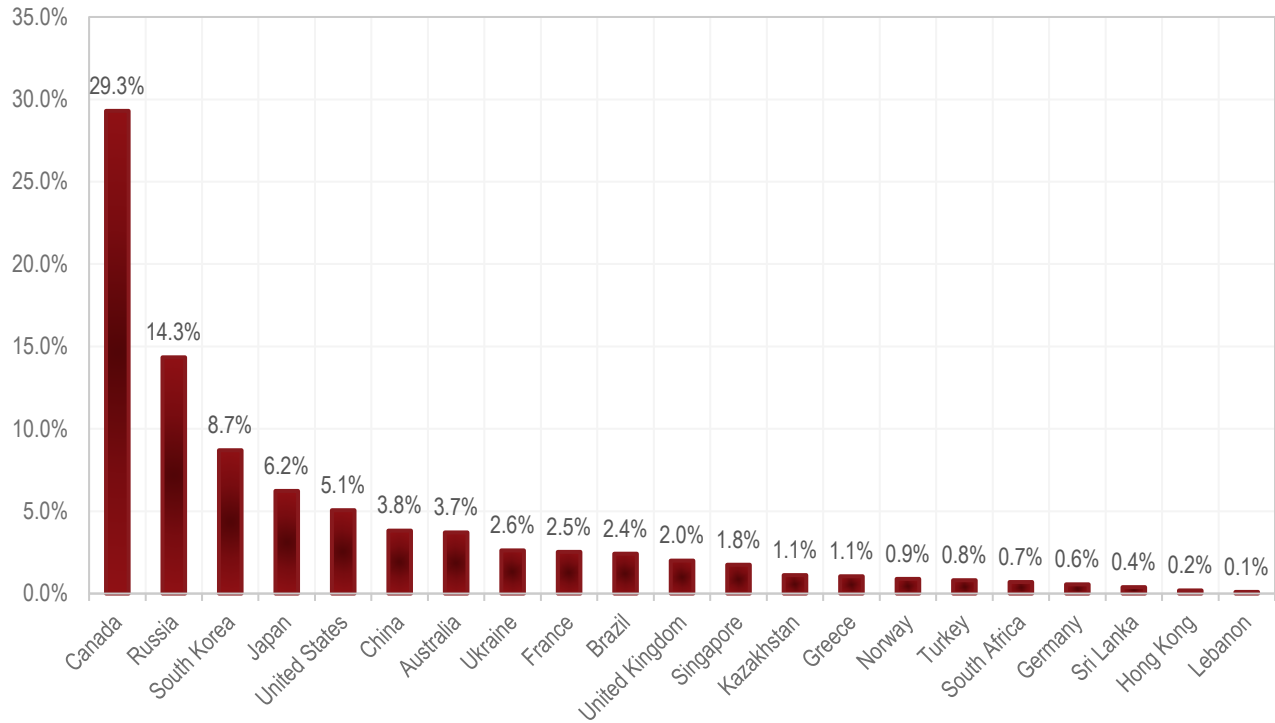
Perhaps using more country and sector-specific ETFs could better replicate Kopernik's strategy. We are finding valuations in emerging markets significantly more attractive than the United States. As such, Kopernik's strategy has close to 40% of the portfolio invested in emerging markets. Could this portion of the portfolio be replicated using a large emerging market ETF? Comparing Kopernik's country allocation to a representative Emerging Market ETF illustrates the differences. The top country exposure for this EM ETF is China, at 40%, while Kopernik's strategy has only 4% in China. Russia, while representing only 3% in the EM ETF, makes up 15% of Kopernik's strategy. The top sector in the EM ETF is financials at 21%, while Kopernik's strategy has only 5% exposure in financials. Again we see that a more specific (yet still broad) ETF has trouble replicating Kopernik.

One might counter that surely it would be possible to put 15% into a Russian ETF and 4% into a China ETF and so on and so forth, following the allocation in the bar graph below, which represents the country exposure in our strategy.

<sup>4</sup> All of the data used in this white paper is as of March 31, 2020.



## KOPERNIK GLOBAL ALL-CAP REP PORTFOLIO



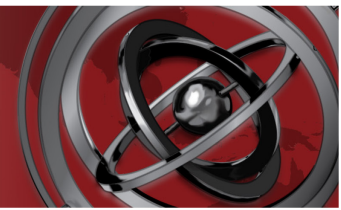
As you can see, Canada and Russia combined make up nearly 50% of our country exposure. Further analysis shows that our top ten Canadian and Russian holdings are considerably different from representative ETFs. Using a representative ETF for Canada and one for Russia, we note that only three of our Russia holdings - Gazprom PJSC (“Gazprom”), Sberbank of Russia PJSC (“Sberbank”), and Polyus PJSC (“Polyus”) – are held in the ETF. None of our Canadian holdings are in the top 10 of the representative ETF.

Kopernik Global All-Cap Rep Portfolio	
<b>Canada</b>	<b>29.3%</b>
Cameco Corp	4.8%
Centerra Gold Inc	3.8%
Gabriel Resources Ltd	2.6%
Wheaton Precious Metals Corp	2.2%
Seabridge Gold Inc	2.0%
Uranium Participation Corp	1.8%
Cenovus Energy Inc	1.7%
Turquoise Hill Resources Ltd	1.3%
Sprott Inc	1.2%
New Gold Inc	1.1%
<i>Other</i>	6.9%

Representative Canadian ETF	
<b>Canada</b>	<b>100.0%</b>
Royal Bank of Canada	7.9%
Toronto Dominion	6.9%
Brookfield Asset Management Inc	5.3%
Enbridge Inc	5.3%
Bank of Nova Scotia	4.4%
Canadian National Railway	4.2%
Shopify Subordinate Voting Inc	3.9%
TC Energy Corp	3.9%
Barrick Gold Corp	2.9%
Bank of Montreal	2.9%
<i>Other</i>	52.4%

# Kopernik

Global Investors, LLC



Kopernik Global All-Cap Rep Portfolio	
<b>Russia</b>	<b>14.3%</b>
Gazprom PJSC	3.2%
RusHydro PJSC	2.8%
Polyus PJSC	2.0%
Federal Grid Co. Unified Energy	1.7%
Sberbank of Russia PJSC	1.4%
Lenta PLC	1.2%
Etalon Group PLC	1.2%
Moscow Exchange MICEX-RTS PJSC	0.8%
LSR Group PJSC	0.2%

Representative Russia ETF	
<b>Russia</b>	<b>100.0%</b>
Lukoil	14.6%
Gazprom PJSC	14.2%
Sberbank of Russia PJSC	14.0%
Norilsk Nickel	5.1%
Novatek PJSC GDR	4.6%
TATNEFT	4.2%
Polyus PJSC	4.4%
Polymetal	4.3%
Mobile Teles ADR	3.9%
Magnit PJSC	3.3%
<i>Other</i>	33.6%

Moving from exposure by country to exposure by sector, we observe additional benefits of our active management approach. Our strategy's largest sector exposure is currently basic materials at 23%, with 100% of that in precious metals. If you were to purchase a representative basic materials ETF, only 10% would be invested in precious metals. Using our 23% current allocation to precious metals as your anchor, this gives you only 2.3% in precious metals (10%\*23%). To better compare Kopernik's strategy to a more passive method, it would be useful to use a representative gold miners ETF as the vehicle to replicate Kopernik's precious metal exposure.

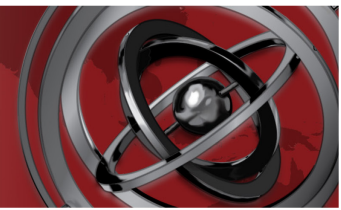
This is what that gold miner allocation would look like compared to ours:

Kopernik Global All-Cap Rep Portfolio	
<b>Materials</b>	<b>22.9%</b>
Centerra Gold Inc	3.8%
Newcrest Mining Ltd	3.7%
Gabriel Resources Ltd	2.6%
Wheaton Precious Metals Corp	2.2%
Polyus PJSC	2.0%
Seabridge Gold Inc	2.0%
Turquoise Hill Resources Ltd	1.3%
New Gold Inc	1.1%
Fresnillo PLC	1.1%
Novagold Resources Inc	1.0%
Other	3.9%

Representative Gold Miners ETF	
<b>Materials</b>	<b>100.0%</b>
Newmont Corp	15.4%
Barrick Gold Corp	13.4%
Franco-Nevada Corp	7.8%
Wheaton Precious Metals Corp	5.7%
Kirkland Lake Gold	5.0%
Newcrest Mining Ltd	4.5%
Anglogold Ashanti Ltd	4.2%
Agnico Eagle Mines Ltd.	3.9%
Royal Gold Inc	3.5%
Kinross Gold Corp	3.0%
Other	33.6%

The top 3 in the ETF, which represent 35% of the total, are not owned in our portfolios. For various reasons, we view them as having less upside than our holdings. There are only 5 companies that we own that are in the top 20 of the ETF: Wheaton, Newcrest, Gold Fields, Pan American, and Centerra. In addition, the ETF does not include some non-producing gold companies with massive gold reserves such as Novagold, Northern Dynasty, and Seabridge. Kopernik's portfolio does include these, believing that all of them have huge optionality (5-10x) to higher gold prices. Even when we get specific by sector and country, trying to replicate Kopernik's portfolio is impossible.

Active management of position sizes, we believe, should add alpha over the long term. Like many other value managers, we do not believe that volatility is risk. Actually, volatility is opportunity to take advantage of inefficiencies in the market. Risk is the possibility of permanent loss of capital, which increases as the price of a company increases. As a result, as the market



cap of a company grows, barring some large fundamental change to the business, we actively reduce the weighting of that company in our portfolio. It is in this way that passive investing is most dissimilar to our strategy. If the market cap of Apple, for example, were to increase, the weighting of Apple within the ETF would also increase. The ability to trim outperforming companies and reinvest in the companies that have yet to perform differentiates us from passive investment vehicles.

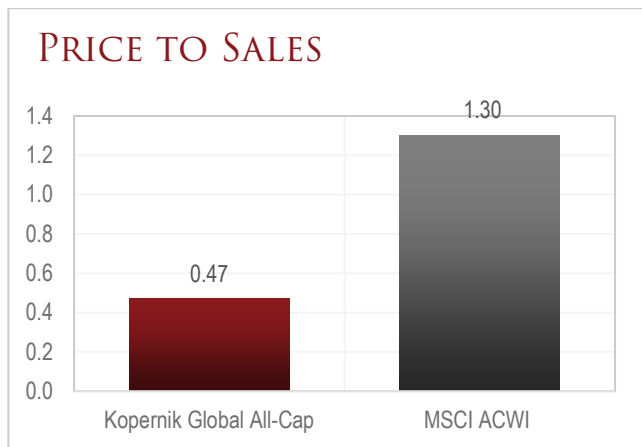
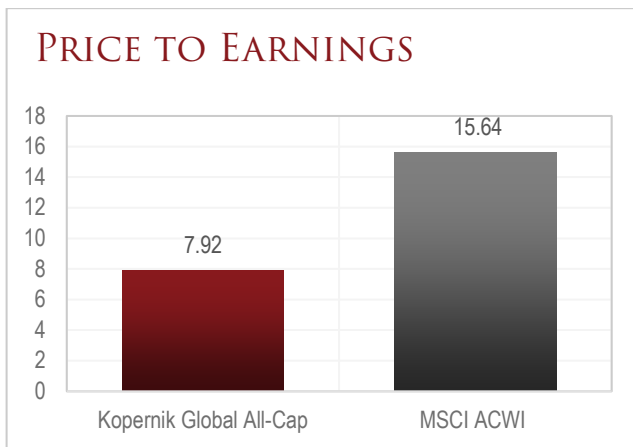
Below we show our sector performance compared to a liquid, representative ETF. Since its inception in 2013, Kopernik has outperformed the passive indexes associated with gold miners, Russia, and emerging markets as a whole. Unfortunately, our active management within energy has led to significant underperformance versus the representative ETF. This has resulted in some of the more attractively valued securities in our portfolios; therefore we are hopeful that this too will revert back to our estimated intrinsic value. The charts below illustrate our performance vs. representative ETFs from inception through Q12020.

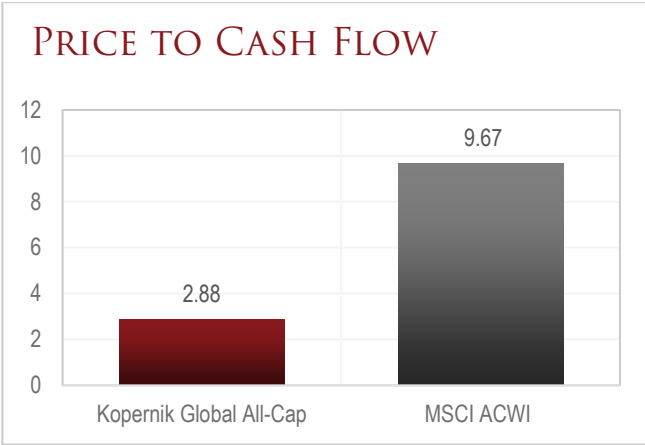
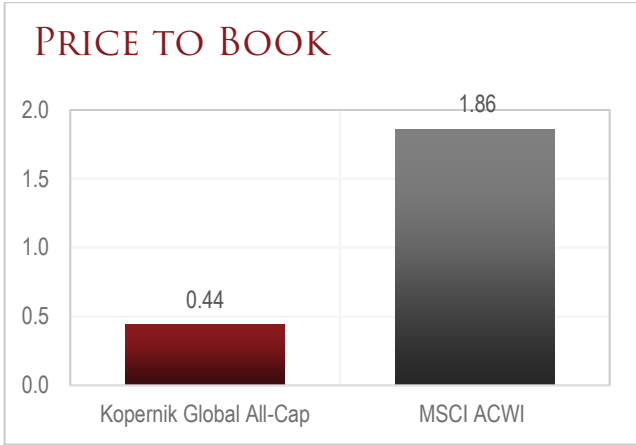
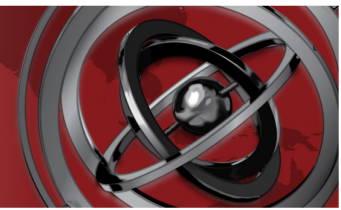
Kopernik Rep Portfolio		Representative ETFs	
Miners	51.05%	Miners*	-4.61%
Russia	1.28%	Russia	-9.27%
EM	24.00%	EM	8.98%
Energy	-68.5%	Energy	-42.5%

\*Jr. Miners -20.40%

Undoubtedly security selection is one component of both the outperformance and underperformance. However, taking advantage of volatility in individual names has also contributed. By nature, we like things less as they increase in price and more when they decrease, and are able to be very opportunistic in utilizing periods of volatility in the market. Almost every single day provides the opportunity to add value by trimming and adding to positions throughout the portfolios.

Looking forward, those who still believe that valuation is a major predictor of future performance will appreciate the distinct valuation discount that can accrue to those who analyze and select stocks. For example:

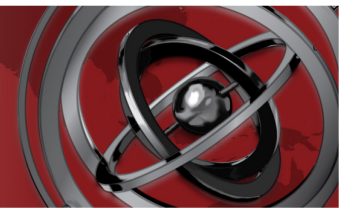




Tim Ferris notes that “the collective insecurity of the world makes it easy for people to hit home runs while everyone is aiming for base hits.” Branch Rickey understood this, and so do we. It has been a tough market for active managers, especially those who care about valuation. Those who continue to believe that cycles still exist should strongly consider allocating to actively managed strategies. We remain committed to our mandate to stay small and construct portfolios that stay true to our value philosophy and disciplined process.

Taylor McKenna, CFA  
Kopernik Global Investors, LLC  
July 2020





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Investing involves risk, including possible loss of principal. There can be no assurance that a fund will achieve its stated objectives. Equity funds are subject generally to market, market sector, market liquidity, issuer, and investment style risks, among other factors, to varying degrees, all of which are more fully described in the fund's prospectus. Investments in foreign securities may underperform and may be more volatile than comparable U.S. securities because of the risks involving foreign economies and markets, foreign political systems, foreign regulatory standards, foreign currencies and taxes. Investments in foreign and emerging markets present additional risks, such as increased volatility and lower trading volume.

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