Aug 21 2017 at 11:00 PM | Updated Aug 21 2017 at 11:00 PM

Getting on board the lithium train

Buying shares of Tesla is one way to gain exposure to lithium. **Tesla**

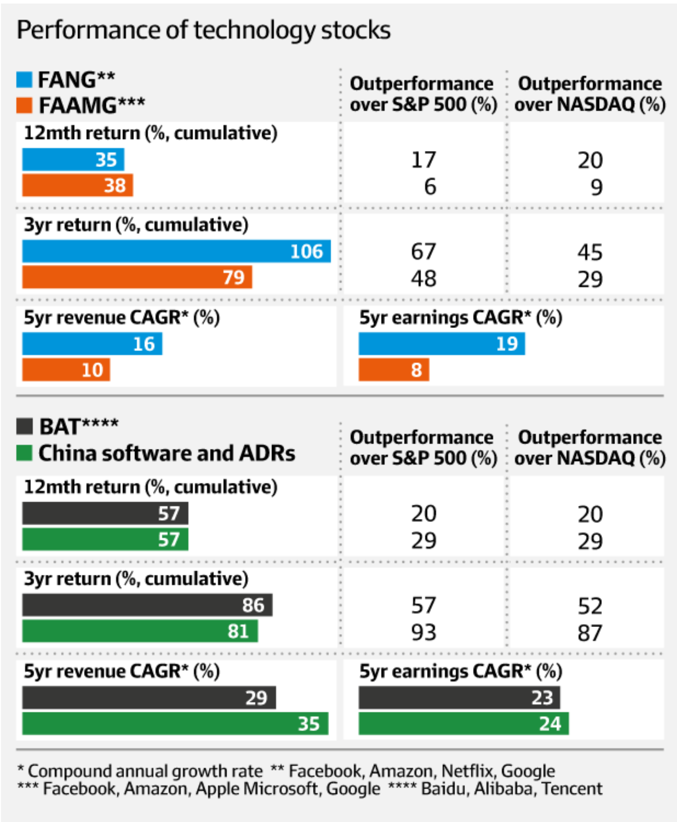
by **Stirling Larkin**

One of the very few things that we know for certain about markets is that they always rally before crashing. They have never plateaued and then collapsed. Ever.

It is therefore logical to assume that global bourses led by the S&P500 in the US will "rip" higher from here, even though current levels already feel lofty.

But when markets do collapse, which is known as retracing, the gravity of that momentum will pull down both "deep value" – which purports to maintain longer term value throughout shorter term movements – and highly volatile investments indiscriminately.

Accepting that there will be few places to hide, the savvy global investor needs to identify strong investment themes that will be resilient to broader market forces.



Related articles

Global stock pick: Scout24

How the short sellers are affecting your portfolio

Is Warren Buffett losing his mojo?

'Move on': time to sell Telstra?

Pay attention to companies' power costs

Latest Stories

Markets Live: Profit misses crimp ASX gains
LIVE

What Goldman is really doing in Washington
5 mins ago

Woolworths net profit slips 3.6pc to $1.42b
7 mins ago

More

SOURCE: AUSTRALIAN STANDFIRST

Among Australian ultra high net worth investors, several themes have either been resurrected or freshly originated which purport to provide all-weather resilience.

One interesting theme which has been revisited in mid-2017 is lithium.

It is no secret that thanks to the electric car and mobile device industries, the demand for lithium is set to rise further. What has been intriguing to observe during this recent interest in lithium is that it is not the commodity itself which is in play, but rather the industrial sector which surrounds it.

'Pocket' allocations

This is because although lithium composites abound plentifully around the world, conversion of the metal into either lithium hydroxide or carbonate is not only difficult but suffers the classic precious-metals Catch-22, which is that there are not enough experienced chemical engineers and related specialists to bring greenfield sites to plentiful commercial production.

Australian hard rock lithium, for which ready-to-go capacity to produce battery-grade lithium can take up to three years, accounts for approximately a third of total world supply, with Deutsche Bank estimating that it could rise to half by 2018-19.

Within UHNW circles, this theme has been invested in through what are referred to as "pocket" allocations, or additional standalone portfolios which do not form part of the classic hub and spoke core portfolio.

As an aside, another recent popular pocket investment theme for Australian and Asian UHNW investors was Manhattan tier-one domestic real estate purchases. These were predominantly made between early 2014 and March 2016.

Australian purchases of apartments in Zaha Hadid's 520 W. 28th Street highline marvel are a great example of this trend (and one this author aspires to buy too!).

Above and beyond direct investments in Tesla, whose listed shares ,have risen by about 60 per cent year-to-date, or Tesla's recent $US1.8 billion unsecured note offering, which was filled within less than one minute, according to insiders, savvy global investors have been bifurcating their exposure to lithium through two complementary but different approaches.

Gathered steam

The first has been via hedge funds, UCITS, or even publicly quoted exchange traded fund products which invest across lithium composite miners and battery manufacturers simultaneously.

A nice example of this has been the Global X Lithium & Battery Tech ETF, which has returned less than a direct play on Tesla alone but, unlike the renegade innovator, has been able to stabilise its return profile over the past three years with a return of 7.33 per cent.

The ETF's constituents include Japan's Panasonic Group, Taiwan's Simplo Technology, and the US juggernaut FMC Corp, alongside a sub-allocation to Tesla, which accounts for 6⅓ per cent of the vehicle.

A new UHNW pocket thematic which has gathered steam, but is questionable as to whether it provides all-weather resilience, has been dubbed "BAT", standing for Baidu, Alibaba, and Tencent.

Beyond the obvious China and Trumponomics hedge, which these Sino technology juggernauts represent, this investment theme becomes interesting because it provides identifiable liquidity provisioning.

The stocks are quoted on US and Hong Kong regulated exchanges, where liquidity provisioning is a requirement for quotation. This is welcomed by investors who may continue to question redemption rights on direct investments on mainland Chinese exchanges.

According to Goldman Sachs, the rise of FANG [Facebook, Amazon, Netflix, and Google (now Alphabet)] or FAAMG [Facebook, Amazon, Apple Microsoft and Google] in the US has spurred investor interest in their counterparts in China.

As investing in these businesses has become difficult for UHNW wealth advisers, such as the private bank arms of investment banks and managers sitting in family offices who have specific and narrow investment remits, individual UHNW investors who have been pursuing these trends have had to turn to pocket allocation approaches.

Historical peaks

Goldman believes that the BAT valuation looks inexpensive on price-earnings, price-earnings to growth and price-to-sales ratio versus historical averages and vis-a-vis FANG.

Even though the tech sector's domination (it accounts for 37 per cent of MSCI China index) is approaching historical peaks, it mainly reflects structural macro shifts rather than market euphoria. "China Tech" has gained 115 per cent since 2013.

However, their attraction as a hedge against an overall market fall arguably comes under scrutiny. While their growth potential has made them relatively insensitive to China macro/policy cycles, they are directly correlated with US rates through valuations and flows, and to RMB weakness.

This would threaten their liquidity on US exchanges by short selling acting via these Chinese companies' American Depository Receipts.

Whether considering pocket or core investments, dangerous times such as these require variegated thinking and actions because when the "Great Retracement" does hit, the only colour seen will be red.

Stirling Larkin is chief investment officer of Australian Standfirst, www.australianstandfirst.com

AFR Contributor