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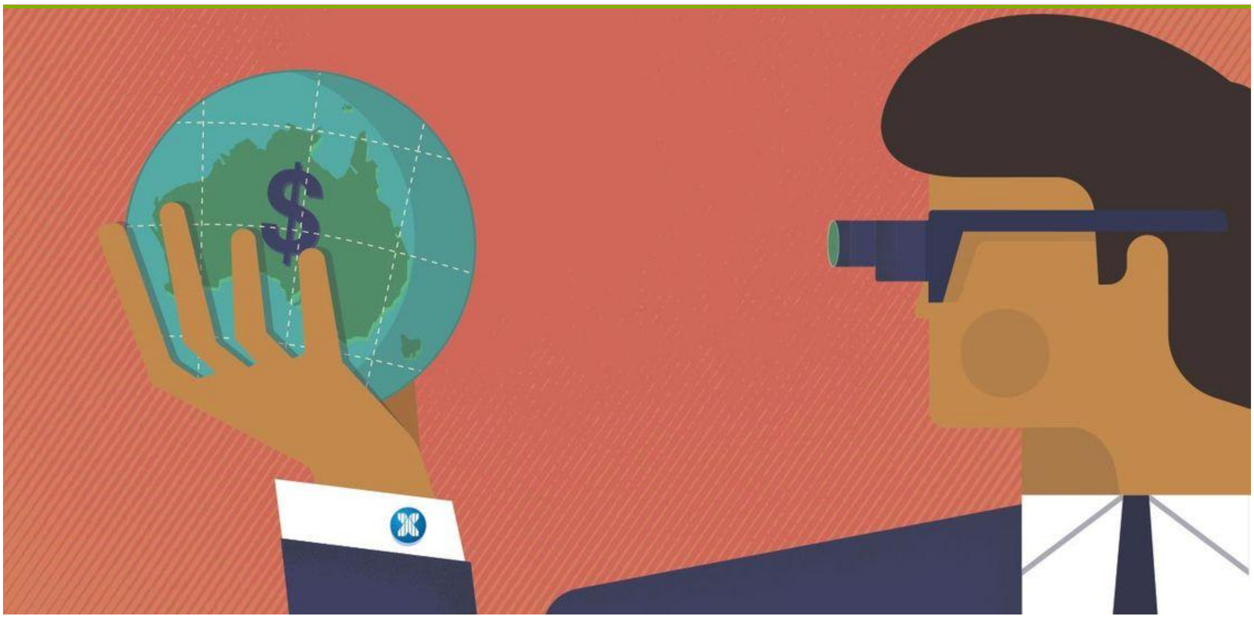
# Growth dictates investment returns

A global acceleration in economic activity will be necessary for any sustained mining industry investment recovery.

John Robertson*



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Among ASX-listed resources companies, stocks with rising prices outpaced the number with falling prices by 294 to 165 in the first three days of this week. Last week's 237-257 split was more evenly balanced but a considerable improvement over the 14-645 ratio over the prior four weeks.

Relative strength indicators point to improving short-term mining sector stock returns as markets deteriorate less quickly than they had been. Falling more slowly may not sound like much of an achievement but all recoveries must start that way.

Even so, more bad news about the progress of the coronavirus, or simply the fear of bad news, could spook equity prices into another downward spiral.

Importantly, though, markets have always made up their losses, eventually. The critical investment questions have always been how long recovery will take and when funds are best deployed to take advantage of an upcoming change in direction. The same two questions are pertinent today.

Over the past 50 years, the S&P 500 has fallen more than 30% five times. Of those falls, only two have been as precipitous as in the past few weeks, namely, in 1987 and 2009. Large falls, at other times, have sometimes extended over many months.

Many commentators are now drawing parallels with the global financial crisis of 2008-2009 in trying to understand the future trajectory of the current market.

By 2007, global GDP growth had averaged over 5% for four years. For several months after the S&P 500 had started to drift lower, metal prices and mining stocks had remained on the rise, driven by the supportive growth outcomes.

With the financial crisis, the GDP growth rate contracted by nearly six percentage points, nonferrous metal prices dropped an average 61% and the ASX sector equity benchmark shed as much as 58% in a highly correlated set of market adjustments that continued until March 2009.

> **"Previous experience raises hope that global growth could be noticeably stronger 12 months from now**

Subsequently, a six percentage point GDP growth acceleration during 2009 and 2010 contributed to historically high rates of growth in metal use. Metal prices started a two-year uptrend. So, too, did the share price of sector leader BHP. The ASX sector benchmark index followed a similar track higher.

The backdrop to the 1987 stock market crash was similar. Global GDP growth was accelerating through 1987 and 1988. The 1988 outcome was the best since 1976 and remained unmatched until 2000. Unsurprisingly, metal prices were on a largely upward trend until early 1989.

BHP, then the ASX market leader, and the Australian banks started their price recovery within weeks of the October share market rout. BHP, the Australian company with the broadest international investor following, had recouped all its October 1987 losses within seven months, as did the banks, and went on to post a 50% share-price gain over another year.

But the Australian economy was tottering on the edge of a recession. In mid 1989, both the mining sector benchmark and industrial share prices remained well below their September 1987 values even as average nonferrous metal price gains exceeded 50%.

Global GDP growth trends were also at the centre of the 2001 market slump. Growth, which had peaked at the strongest pace in a generation in 2000, halved in the following year. Metal consumption contracted. Stockpiles began to grow. The S&P 500 began a two-year slide lower.

Metal prices began to turn higher a year before the US equity indicator as miners caught the first wave of a surge in Chinese capital spending. BHP began a two-year 150% share price ascent. Although ASX mining benchmark gains trailed those of BHP by a wide margin, the Australian share-price indicator was beating the S&P 500 by 12 percentage points by mid 2004.

The world economy was growing faster in 1973 than at any time in the past 60 years. Raw material demand growth was exceptionally strong and nonferrous metal prices rose by more than 140% over 18 months.

Then, in 1974, the global economy slowed dramatically. Even as metal prices were hitting new heights, the ASX sector benchmark was following the S&P 500 lower. Both had lost over 40% within 12 months.

Metal prices also eventually dropped 40% but, by then, an acceleration in global economic activity had underpinned an equity-market turn and stabilised metal-price losses.

The 30%, 1969-1970 S&P 500 loss was the most modest in this history of large market losses. Global growth held above 5%, metal prices were on the rise and the sector equity benchmark was on an upswing until only the worst of the S&P losses late in the market cycle.

The S&P 500 subsequently moved higher for the best part of two years, while both BHP and the ASX sector benchmark lost ground as Australia's economy slipped into recession against the trend in the rest of the world.

From an investment perspective, Australia's miners need both the global and local economies to do well. That is normally the case but, as evident in these examples, not always.

Signs of lowered coronavirus infection rates followed by a return to work will help put a floor under financial markets but will not be sufficient for a sustained recovery in sector values. Evidence of improved global growth momentum, and economic recovery in Australia, will be critical for an ongoing improvement in sector values.

Previous experience raises hope that global growth could be noticeably stronger 12 months from now. In contrast to 2009, swift and dramatic government and central bank policy action, with little regard for the longer-term consequences, is keeping hope alive for a sharp turn in economic and market fortunes.

Recent production and income losses will never be recovered but a positive change in the pace of growth is likely to support a market uplift and, for the mining industry, promote the first stages of a demand rebalancing to help attract fresh funding potential.

**John Robertson is the chief investment strategist for PortfolioDirect, an Australia-based equity research and resource stock rating group. He has worked as a policy economist, business strategist and investment professional for nearly 30 years, after starting his career as a federal treasury economist in Canberra, Australia*