

Buy and hold? No thanks

Little benefit to be gained from long-term investing in mining sector, analysis shows

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Investment returns in 2014 once again showed buy-and-hold strategies failing to benefit mining investors.

Mining executives spend a good deal of their time trying to persuade potential investors to back them for the longer haul as they go about implementing plans to bring on new projects.

Financial advisers and investment researchers are also more likely to approve low-turnover investment funds. There is a good deal of pressure on investors to 'buy and hold'.

There is also a natural human tendency to buy or hold stocks with already proven investment performance.

Company presentations are more likely to highlight outstanding historical investment returns than previously mediocre or poor outcomes, hinting at past gains being a guide to the future.

If a buy-and-hold strategy was a source of additional value, inter-year returns would be positively correlated. Relatively high returns in one year would be followed by above average outcomes in subsequent years.

Reality runs contrary to this expectation. The correlation between return rankings in 2013 and 2014 for the universe of resources stocks listed on the ASX over those two years was a near perfect zero at -0.04.

In other words, there was next to nothing in the 2013 result that offered guidance about stronger performance in 2014. All we could have inferred is that a top-100 finish in the first year would have meant a 90%-plus chance that the same stock would finish outside the top 100 a year later.

Of the 100 best-performing stocks in 2013, only eight repeated a top-100 ranking in 2014. Of this group of 100 stocks, 53 were better than median performers in 2014, meaning 47 failed to beat the median result for the sector as a whole.

An almost identical pattern was evident at the bottom of the market. Of the 100 worst-performing stocks in 2013, eight retained that position in 2014. Even among this group, 54 did better than the median in the following year and 46 were worse.

It did not matter whether an investor retained a sample of stocks from among the best or worst performers. The result would have been the same.

This was no aberrant result. The same out-



comes are apparent in past years. This compelling empirical evidence not only runs counter to how companies present themselves, but also seems at odds with conventional thinking about how markets should behave.

In theory, as development projects move closer to completion, the attending risks should diminish and valuations should improve. Even among exploration companies, work programmes should add certainty, one way or another. Even a disappointing programme of work could result in correlated returns as underlying prospects fail to materialise.

The absence of return correlations suggests a tendency for one-off or relatively short duration excess returns resulting in stock re-pricing.

Atrum Coal, developing extensive anthracite resources in western Canada, topped the share price performance list in 2013. Between January and September 2013, the company's share price rose tenfold.

In 2014, the company's performance fell to the 39th percentile.

Evidence such as this suggests markets quickly assimilate new information about a company, including an assessment of its likelihood of success. Within a relatively brief period, companies move to the upper or lower ends of the return rankings to reflect these judgements.

Subsequently, returns drift back to the norm. Having already been re-priced, the longer a stock is held, the more likely an investment will display returns closer to the median for the sector.

Among some of the recent industry suc-

cess stories, the trends have been similar. Sandfire Resources, for example, dropped from the 33rd to 45th percentile in 2014. Sirius Resources fell only marginally from the 14th percentile to the 19th but, in prior years, both companies had been at or close to the very top of the investment rankings before making their way back toward the centre.

Orocobre was a company advancing toward first production in the latter part of 2014 and could have been the model for correlated returns as it moved closer to plant commissioning, but its return ranking slipped from the 3rd percentile in 2013 to the 19th.

A portfolio comprising some of the most successful miners in recent years would have lost ground against others in the sector even as each of the companies was achieving what it had set out to do.

The implications of the statistics for investment decisions depend on what an investor might be trying to achieve.

Getting average returns for the sector is straightforward, according to the numbers. Little effort needs to go into stock choice for investors happy enough with that outcome. In a sector comprising something approaching one thousand stocks, a random selection of 15-20 will probably be adequate for the purpose.

The tendency for returns to revert to the norm may not be of great consequence for some investors as long as they can take advantage of the original market re-pricing activity. For these, the data imply that stock selection and timing are the vital ingredients for success.

Similar outcomes would be less satisfactory for institutional or professional money managers, who need ongoing better-than-average performance to retain funds or qualify for performance bonuses. In their cases, a more aggressively traded portfolio perhaps made up of a smaller number of stocks would be necessary to avoid the gravitational pull back to the middle.

There is also an important message in the data for industry executives. If a company's investment return is already among the best in the sector, executives should normally be reconciling themselves to possibly several years of lesser performance no matter how deserved the past re-pricing might have been.

Even the slightest hints that past performance is a guide to future investment success should be discouraged. ▼