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Betting on winners won't work

Don't expect the best performing stocks in 2019 to be at the upper end of returns in 2020.

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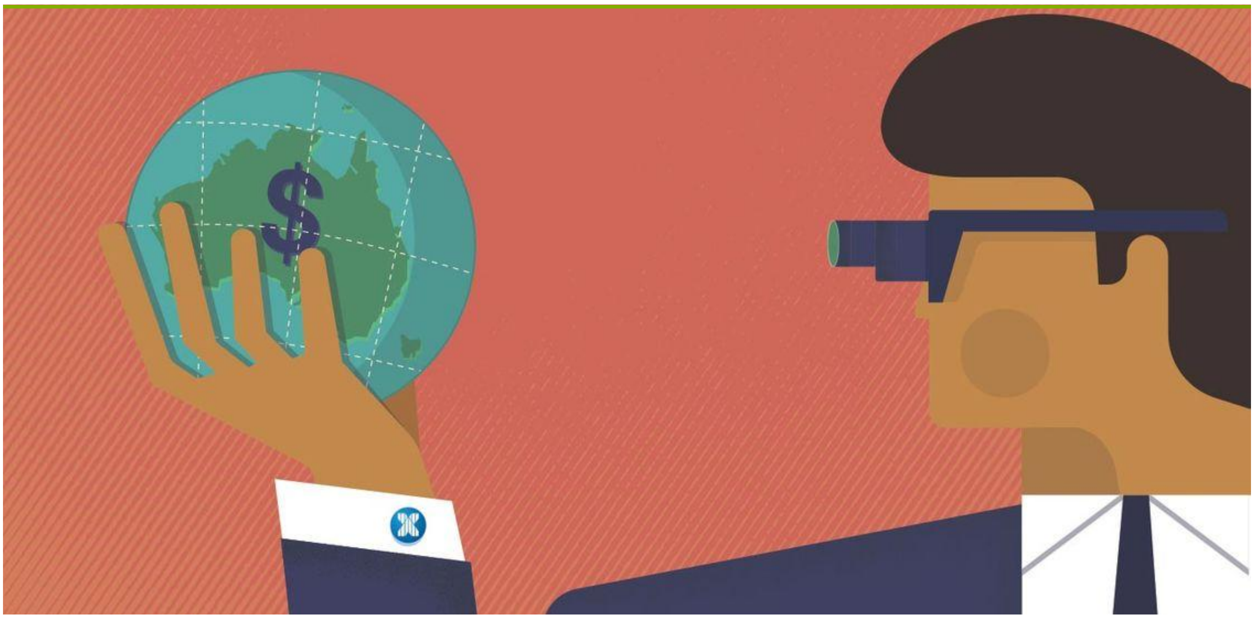

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The 10 highest-returning ASX-listed mining stocks in 2019 produced share-price gains of between 1,400% and 282%. Spectrum Metals headed the list followed by Andromeda Metals, Magmatic Resources, MRG Metals and Celamin Holdings. Each of the top five added more than 400%.

Stavely Minerals, the sixth best-performing stock in the sector with a 370% return, would have been the best investment, despite others having the higher share-price appreciation.

The stocks topping Stavely's 2019 return all came off sizeable losses in 2018, averaging 57%. Worse still, there was only one instance of a positive annual return in any of the three years prior to 2019 among the top five.

Five years on from its ASX listing in May 2014 as a copper-gold explorer in western Victoria, Stavely Minerals had managed a remarkable feat. Without a discovery, it was still trading above its IPO price, even while the median sector return over the same period was -50%.

Shortly after, in early September 2019, the Chris Cairns-led explorer excited investors with some outstanding assay results. The initial announcement sparked a near immediate sevenfold share-price rise before profit taking trimmed the gains in the latter part of the year.

Stavely was the odd one out among the sector leaders. Its shareholders did not have to suffer outsized losses as a precursor to its recent strong gains. Stavely aside, an objective observer could easily conclude that this is a sector in which you have to do poorly before having a chance of doing well.

The strongest performing stocks in 2019 typically produced their qualifying returns in the latter part of the year. The correlation in the timing of returns did not reflect market conditions. Rather, strongly performing stocks in the sector tend to give up a large proportion of gains quite quickly following an initial surge in investor interest.

> **Prior performance was, once again, no guide to future performance**

The best performing stocks in the first part of a year will have had more time before the year end in which to lose momentum. Stocks with strong investment returns occurring late in 2019 could still experience similar retracements in performance given the passage of sufficient time.

Liontown Resources (+650%), Meteoric Resources (+618%), Fenix Resources (+465%), Laneway Resources (+433%) and Hot Chili (+420%) all made initially stronger gains than those among the top five stocks but lost momentum as the year went on. They, too, were generally loss makers in 2018. Losses among this group averaging 55% in 2018 were bigger than the sector median in a weak year.

Multi-year consistency in resource sector returns is rare. Only 13 miners and three oil and gas explorers have produced positive returns over each of the past four years, according to my database covering some 800 ASX-listed mining and oil and gas enterprises.

Unsurprisingly, two of the 13 miners were BHP and Rio Tinto. They were propelled to gains of 118% and 125%, respectively, by outstanding global equity market conditions and few, if any, institutionally qualified substitutes.

Two other companies among the 13 - Evolution Mining and Northern Star Resources - benefitted from a combination of rising gold prices, active asset management and index presence.

Several others were lucky to get into the group. Beacon Minerals, for example, did not make any net gain between February 2017 and June 2019 but managed positive yearly results largely through the quirk of propitiously timed share-price fluctuations. Others similarly blessed were Cassini Resources and Gullewa.

The chance of an investor latching onto a stock with multi-year positive performance is depressingly low.

The failure of buy and hold strategies to add value for sector investors has previously been highlighted in January 18, 2018, and January 15, 2015, 'From the Capital' columns. Both drew attention to data that showed how the best-returning stocks in any one year were no better than a random sample of stocks from the prior year. Similarly, the worst-performing stocks in any year were only randomly connected with outcomes a year earlier, as were stocks in every decile in between.

The 2019 results replicated the return pattern evident in those earlier years. Consistent with the historical randomness of outcomes, two of the 20 best-performing stocks in 2019 were among the 10% of best-performing stocks in 2018. Similarly, two came from among the 10% of stocks with the weakest share-price performance in 2018. Three stocks in the top 20 in 2019 (rather than two) had sixth-decile returns in 2018 but, to compensate, only one came from the fifth decile.

The latest year-to-year outcomes have been remarkably consistent with warnings implicit in prior years about the futility of buy and hold strategies. Prior performance was, once again, no guide to future performance.

The 2019 results also added evidence that investors are being force fed overpriced stocks in initial offerings. Among those listed in 2017, declining stocks outstripped advancing stocks by 20 to nine by the end of 2019. Their median return was -69%.

Among stocks listed in 2018, losers outstripped winners by 25 to seven. Their median return has been -47%. Among the far fewer 2019 IPO stocks, post-listing declines exceeded advances by a five-to-one margin, with most dropping more than 20% within a few months of listing.

Momentum loss is typical. Carry-through buying from a year earlier is statistically random. IPOs are most likely overpriced. These repeatedly displayed price patterns, again evident in 2019, are a heavy burden on investor confidence and interest.

Looking for something different to happen to sector stock returns in 2020 is an understandable desire but an analytical stretch based on the data.

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