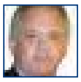
Global growth reset may boost mining interest

Higher economic growth expectations continue to rest on China's sagging shoulders



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For the first time in over three years, as 2014 begins, one of the preconditions for a recovery in resource sector values is finally becoming evident.

Since the end of 2010, raw material supplies have generally been adequate for the world's needs. Budding miners occasionally point enthusiastically to eventual shortages in their chosen commodities to whet the appetites of investors. One day perhaps, but, for now, many of those market opportunities appear sufficiently distant to leave today's investors looking elsewhere for encouragement.

Exploration success and timely project development will remain short-term investor priorities. Exploration success relies on adequate funding, but investors can assume this is the part of the industry least correlated with economic conditions.

Red Mountain Mining Ltd, a Philippines-based explorer, is illustrative of what keeps interest alive at this end of the market. Its 500% share price boost in the first week of 2014 came after announcing gold assays as high as 31.1g/t from relatively inexpensive trenching.

"Upward forecast revisions signal greater confidence about the outlook – a critical and hitherto missing ingredient required for stronger sectoral equity prices"

Meanwhile, of those developing new projects, Argentine lithium-deposit developer Orocobre Ltd topped the performance standings among the Australian S&P/ASX 300 resources stocks for 2013, with a 70% gain as it drew nearer to a production start slated for mid-2014.

But these are the rare exceptions. The vast bulk of a capital hungry sector will need something on the macro side to encourage even some of the most risk-friendly investors to re-establish a presence.

This will prove difficult insofar as specialist fund managers that have acted as a capital conduit historically have been losing funds to other market sectors where performance has been outstanding, by any historical standard.

Raising expectations … International Monetary Fund boss Christine Lagarde has indicated the IMF might increase its growth forecasts for this year

While miners were suffering the pain of some of the worst investment outcomes in decades, the 30% rise in the S&P 500 in 2013 was the strongest calendar year appreciation in the index since 1997.

Over the past two years, the Australian market produced a 119 percentage point performance gap between the banks, its largest single segment, and the median resources industry performer.

One source of potential joy for specialist sector fund managers and the industry's ability to source capital in 2014 is the possible narrowing of these yawning performance differentials. Once the elastic has been stretched as far as it can go, the corresponding spring back can bring dramatic investment results.

Few managers will actually be positioned to take advantage of the initial – and potentially career defining – move, but some reversion to more normal pricing relativities would help channel an improved flow of funds into the sector.

The asset allocators brave enough to initiate this swing will need a catalyst. That could come from the first global growth upgrades for the cycle.

Christine Lagarde, the head of the International Monetary Fund, foreshadowed a few days before Christmas that the fund would have to raise its 2014 output growth forecasts after earlier outcomes had repeatedly fallen short of expectations.

Upward forecast revisions signal greater confidence about the outlook – a critical and hitherto missing ingredient required for stronger sectoral equity prices.

With stronger output growth (and greater confidence about its future trajectory) should also come higher investment spending. Both are needed to tilt the balance of markets back toward deficit and for a genuine cyclical recovery to commence.

Investment spending in the USA, Europe and Japan relative to the size of these economies and current corporate financial capacity is close to rock bottom and capable of significant improvement. Policy settings are consistent with improved capital spending outcomes in 2014.

One fly in the ointment is China, on which so much of the resources industry depends. Credit availability continues to outpace Chinese output and investment growth rates creating policy headaches that will have to be addressed more emphatically during the year.

▶ *Continues on page 12*

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Insight: Society

Continues from page 11

Ideally, Chinese policymakers will weave their unique magic to slow credit growth and investment spending without impacting seriously overall output growth. The Chinese central bankers should not be underestimated but will have to show uncommon skill in being able to achieve this transition seamlessly.

Signs of success will add to investor confidence – not only about the sector, but also the growth prospects of developing economies in general.

China is not alone in its reliance on monetary policymaking skills. Central banks in the USA, Europe and Japan are all pivotal to a rising rate of economic growth in 2014. Speculation about their success (or potential failings) is likely to dominate judgements about the macro outcomes so critical to the investment fortunes of the world's miners.

A more solid macro foundation has been a long time in coming, hence an unusually prolonged sector downturn. While this will only be a necessary and not a sufficient condition for a cyclical revival in commodity prices, it will be vital for equity returns.

More often than not, equity markets anticipate three or four commodity price recoveries for every one that happens. Firmer macro conditions will encourage markets to start looking ahead during 2014 to better outcomes.

Those better outcomes could still be several years away, but the balance of risks will have tilted.

The precise timing of an eventual change in cyclical direction will depend on when the world can generate one or more years of demand for raw materials sufficient to swamp the flow of supplies and underwrite a subsequent change in market balances. There is not enough happening as yet to make this a likely event in 2014.

A bias toward companies completing new projects continues to make sense for investors with a three-to-five year investment horizon. Unsurprisingly, profits matter in this segment as in equity markets more generally.

Iron-ore producer BC Iron Ltd demonstrated in the past 18 months with a near doubling in its share price how a maiden profit and dividend are among the most alluring and convincing pieces of evidence for investors trying to wean themselves from banks, consumer discretionary investments and those other sectors that currently retain the eye of investment strategists. ▼

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Trust before gold

SLO and steady (and responsive) is usually the best policy

Dr Elizabeth Adey
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Two gold mines, two thousand miles apart: both shut down in 2006. One is still held back by the legacies of the past. One is set to reopen in 2014. What lessons can they teach us about a social license to operate (SLO) ?

A mining company's SLO can often feel like a fragile thing. The consequences of a project failing to win stakeholder approval and losing its SLO have been seen all too frequently.

No doubt this stems in part from the bad reputation that mining has in many parts of the world, caused by a poor environmental and social record and a legacy of accumulated problems. At its worst, mining is described as the most environmentally destructive activity that we undertake. And despite the efforts of the industry to raise the bar, it is often still seen as only as good as its latest failure.

Globalised social media has created a platform for millions to express their opinions on the industry's performance. The impact of high-profile incidents such as tailings dam failures and cyanide contamination receives understandably high levels of public attention. It also has a negative effect on companies trying to operate in a responsible way.

This only increases the importance of adopting responsible practices in the area of environmental and social performance, and being seen to do so. That includes operators looking at how they can become more responsive to meeting the needs of local people and the wider community – especially where there are strong ties and expectations of jobs, services and infrastructure.

The Roşia Montană project in rural northwest Romania makes an interesting case in point. In 1997, Roşia Montană Gold Corp (RMGC) started exploration at the historic gold and silver mines located in a remote commune of 16 villages occupied by 4,000 people.

State-owned operations closed down in 2006, creating widespread unemployment in an area heavily reliant on mining and related industries. Seven years on, and following 16 years of work on the site, RMGC is still waiting for environmental permits from the Romanian government to start mining.

During this time, an NGO, Aburnus Maior, has led a long 'Save Roşia Montană' campaign. It and other protest groups recall the (unconnected) major cyanide spill from the tailings dam at Baia Mare in Romania in 2000. This led to the release of cyanide-tainted water into the River Lupes and out into the Tisza and Danube, killing hundreds of tonnes of fish.

Campaigners argue that large numbers in the Roşia Montană community are against the reopening of the mine, partly because of claims that many have been forced out of their homes and properties.

Yet my own independent study of Roşia Montană stakeholder views in 2010 as a

Photo: Nikolay Yushnikov

Although Lake Balkhash in Kazakhstan is the second largest lake in Central Asia, there are concerns over the lake's shallowing due to desertification and industrial activity