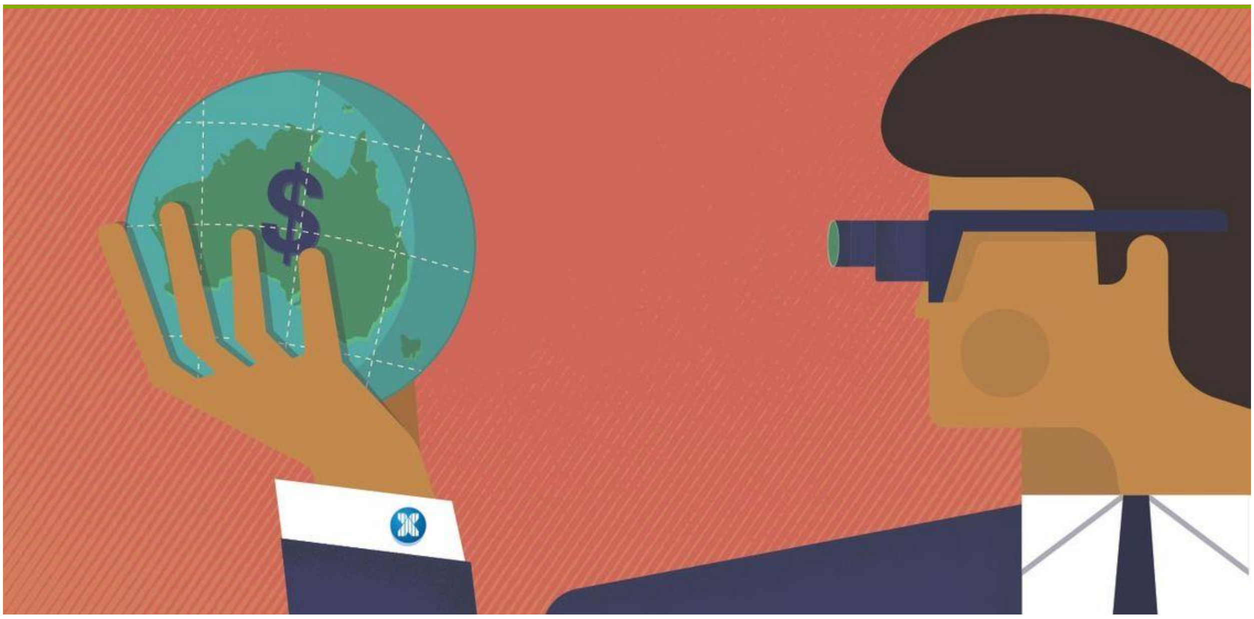
Mining Journal

Viewpoint > From-the-capital

Appealing narratives raise investment risk

Catchy narratives, having superseded return on capital as drivers of investment decisions, raise the risk profile of investment markets.

John Robertson*



30 October 2019

An increasingly striking feature of non-mining and mining investments alike is a focus on narrative at the expense of investment basics. Among more than 70 non-mining presentations I have attended in recent weeks and dozens of mining pitches, only one company has made any reference to a return on capital, the amount of capital employed in the business or what constitutes an acceptable or target return.

Many of the big information technology companies have set the standard. Amazon, Apple, Alphabet and Facebook, among others, have accumulated global recognition, great economic power and huge revenues. Sometimes mind bogglingly high valuations have implied indefinitely extraordinary growth. Profits have played second fiddle to extravagant visions of the future.

Promoters act as though repeated use of the word ‘disruptor' is sufficient to underpin value. Speculating about revenue or profit is discouraged by regulators but ‘addressable market' numbers sound so much more impressive, anyway. Some companies, like ride sharing pioneer Uber Technologies, have never offered a pathway to future profitability.

The easiest access to capital in history, underpinning an abundance of negatively yielding securities, has also negated the need to worry about the cost of capital.

Vast numbers of smaller businesses are seeking to emulate the big tech model even as signs of stress to their facade of success emerge.

Judgements of big vision founders have been increasingly called into question. Travis Kalanick, founder of Uber, was dumped as chief executive. Mark Zuckerberg and Elon

Musk have been placed on tighter leashes. Zuckerberg's push for a privatised global currency is proving one step beyond regulatory tolerance.

Investors, who had readily embraced disruption, are pulling back their support. Uber's market value is now more than US$20 billion below its last private funding round before going public. More spectacularly, office space supplier WeWork had to cut its capital raising valuation from the $47 billion used in January 2019 to $10 billion before jettisoning its floundering September IPO, forcing the company's principal funder to wrest control from the visionary founder.

> **Persuading other investors to join the throng is a prerequisite for success in the world of imagined futures**

WeWork proved little more than a leveraged real estate company masquerading as a technology innovator led by a lifestyle coach with scant regard for conventional governance practices. Under his spell, supposedly serious private equity investors and pension funds appeared blissfully unconcerned about any traditional measures of economic value.

Styles change. In 1991, G Bennett Stewart published "The Quest for Value", extolling the virtues of economic value added (EVA) as "the bedrock upon which a new and completely integrated financial management system can be constructed".

Over nearly 800 pages, Stewart outlined his view that markets move because value changes, no matter how much commentary and noise may be focussed elsewhere. And, there was only one legitimate way to create value, in Stewart's mind: only invest when the cash flow return on capital exceeds the funding cost.

The Stewart investment paradigm showed how sustainable business decisions should be made. Jens Beckert, director at the Max Planck Institute for the Study of Societies in Cologne has more recently coined the term 'Imagined Futures' for how companies behave in practice and, as a consequence, why modern capitalism is subject to repeated cycles of growth and crises.

Beckert's book ("Imagined Futures: fictional expectations and capitalist dynamics", Harvard University Press, 2016) and related papers do not explicitly cite the mining industry but his descriptions of decision making bear an uncanny resemblance to how miners behave.

Beckert argues that even the intentionally rational decisions of individuals are anchored in fictions or "images of some future state of the world or course of events which are cognitively accessible in the present through mental representation". Fictions are needed because the wide range of potential economic, social and political influences dictating future outcomes make it impossible to predict what is going to happen from what we know presently.

Despite the unknowability of the future, company managers frame expectations about the future. Like literary fiction, these views are not based on any observable truth but on the imaginings of an author. Without such imaginings, analytical paralysis would ensue. Only by acting as if fictional depictions of the future were true representations of what will occur, can a decision be taken.

In this model of decision making, the fictional depiction of the future can become a self-fulfilling prophecy if sufficient numbers believe the narrative. If disappointment ensues, the narrative can be adjusted and a new fiction crafted with a wider appeal. But resort to a new fiction can prove costly, as the 2008-2009 financial crisis showed.

Beckert observes that fictionality is proudly displayed in the literary world but that the authors of non-literary fiction do their best to hide it because "only if [fictions] are perceived as factual anticipations of future states will economic actors base their choices on them". Quantification is one strategy to shore up a fiction. Calculations in situations characterised by fundamental uncertainty do not allow us to anticipate the future, according to Beckert, but are merely tranquilisers against the effects of having to cope with unpredictable environments.

Miners may spend millions of dollars on feasibility studies to legitimise their future actions. Beckert would regard such appearances of rationality as smokescreens to hide the incalculability of outcomes.

Imaginings about the future are often contested. This is especially the case in financial markets where the strategic spread of fictional expectations is commonplace. Investments based on the BRIC economy phenomenon, the commodity super cycle, the 1990s dot-com revolution or a perpetual rise in real estate prices were all sources of profit opportunities before they were not.

Persuading other investors to join the throng is a prerequisite for success in the world of imagined futures. A sustainable business of the Stewart variety is ideal but not necessary for financial gain.

Assembling a sufficiently large number of individuals supporting the same fictional account of the future through a compelling enough narrative is the priority and a potentially swifter route to personal wealth.

**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*