

4 Stocks to Avoid If China's Growth Slows

Description

Over the past decade, a big reason for Canada's economic success has been growth in China. As the Chinese invested in modernizing their country, Canadian raw material producers reaped the benefit of higher prices and increased demand. And even after the Great Recession of 2008-09, the government created a huge stimulus program to ensure growth would continue, further helping out Canadian resource companies.

Lately though, growth numbers out of China have begun to slow. Recent GDP numbers show the country narrowly avoided a 14-year low in growth rates. Manufacturing growth rates have also slowed, which is significant for a country so dependent on making things. And these are the official government numbers, which many investors regard skeptically. They fear the real numbers are actually much worse.

Billionaire investor Prem Watsa expressed worry about China's sustainability in his last shareholder letter, pointing out that China has borrowed the equivalent of the entire United States' banking system in the past five years. That much borrowing will catch up to any economy, even one as strong as China's.

With those points in mind, it's easy to see why investors should be cautious investing in any Canadian companies that are levered to Chinese economic growth. Here are four I'd avoid.

1. Teck Resources

Shares in **Teck Resources** (TSX: TCK.B)(NYSE: TCK) were strongly rumored to be close to bankruptcy during the Great Recession, but have bounced back nicely since. The company has done all the right things in turning the ship, including paying off debt, cutting costs, and buying back stock.

Teck is a big player in the coal business, as almost 50% of the company's revenue comes from mining coal. The company estimated that it exported more than 27 million tons of coal to Asia last year, most of which went to China. Coal is needed to produce steel, which is then used in the construction that's fueling Chinese growth. With no obvious customer to replace China, shareholders in Teck better hope for the country's growth to continue.

2. Labrador Iron Ore

The other main ingredient in making steel is iron ore, a commodity **Labrador Iron Ore** ([TSX: LIF](#)) sends to China in large amounts. While China is the world's largest iron ore producer, its domestic ore is low in iron, causing the country to seek outside sources of ore. It does so in a huge way, buying up an estimated 60% of worldwide production.

Labrador Iron Ore is having problems of its own, warning investors that operations may shut down if additional funding isn't secured. As the company's shovels dug further underground, the quality of ore

mined from the James Bay facility declined, leading to a loss in the third quarter last year.

If ore prices continue to stay weak and China's imports also decline, look for the market to turn pessimistic on shares of Labrador quickly.

3. Lumber Producers

The other product that's heading from Canada to China in a big way is lumber. Shares in **Canfor** ([TSX: CFP](#)) and **West Fraser Timber** (TSX: WFT) have been beneficiaries, shrugging off the struggles experienced when U.S. housing starts collapsed.

Softwood lumber exports to China broke 2011 records last year, as B.C. ports moved more than \$1.1 billion worth of trees to China. While this still pales compared to exports to the U.S. — which totaled more than \$2 billion in 2013 — it's still a significant percentage of revenue for B.C. lumber producers. China is also the market growing the most, as shipments to the U.S. and Japan were largely flat.

Foolish bottom line

If growth out of China slows in a significant way, every natural resource company will feel the hit. Prices of raw materials will fall, and companies will close unproductive mines. Chinese growth is the main thing holding up commodity prices.

Companies that export mainly to China will feel the pinch twice, as prices decline and their biggest buyer puts on the brakes. Investors in resource companies should be cautious going forward.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:TECK (Teck Resources Limited)
2. TSX:CFP (Canfor Corporation)
3. TSX:LIF (Labrador Iron Ore Royalty Corporation)
4. TSX:TECK.B (Teck Resources Limited)
5. TSX:WFG (West Fraser Timber Co. Ltd.)

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