



Will Commodities and Mining Stocks Bounce Back in 2016?

Description

It has been a tough year for mining stocks as the sharp collapse in commodities such as iron ore, coal, and base metals have taken a heavy toll. There are signs that 2016 will be just as tough or even worse for many commodity stocks, with a range of indicators highlighting that significantly weak commodity prices are here to stay.

Now what?

The key driver of weak commodity prices is a substantial decline in demand that can be attributed to a number of fundamental shifts in the global economy. Key among these is the rapidly cooling demand for commodities, particularly iron ore, coal, and base metals, from China as its economy slows and transitions from an export-oriented manufacturing economy to one that is more mature and focused on services.

China also has considerable stockpiles of raw materials including steel, which means that even if there is a marked uptick in demand, there will be considerable lag before it translates into higher prices as inventories will need to be exhausted first.

When this diminishing demand is considered in conjunction with a global commodity supply glut, which occurred because miners invested heavily to develop assets to boost output at the peak of the commodities boom, it is clear that any recovery is a long way off.

You only need to look at the world's largest mining company, Australia's **BHP Billiton Limited** ([NYSE:BHP](#)), which is determined to retain market share by boosting production in order to keep prices low for as long as possible and force non-profitable miners out of the market. BHP can manage this because of its exceptionally low cost base, its growing economies of scale, and its deep pockets.

As a result, it continues to boost the output of steel-making or coking coal through productivity improvements, which, when coupled with the close proximity of its operations to Asia, bodes poorly for Canadian coal miner **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK).

Teck is highly reliant on mining steel-making coal, which generates about a third of its revenue. While it

is a low-cost producer of coal, it is unable to access the same synergies that a global mining giant like BHP can. Its mining operations are also further away from key Asian markets, increasing transportation costs and making its coal less attractive than that mined in Australia.

The same phenomenon is being felt in base metals. Copper is trading at a six-year low and is at its lowest point in a decade. This is bad news for Teck because copper is responsible for a quarter of its revenue.

Weak copper and nickel prices are also having an impact on **First Quantum Minerals Ltd.** ([TSX:FM](#)), which earns the majority of its revenue from mining the two metals.

So what?

With China transitioning to a less commodity-intensive, service-based economy coupled with ongoing economic weakness across a number of emerging and developed markets, it is hard to see any major uptick in demand for commodities for some time.

When that is considered with a global supply glut for many commodities, it appears that weak commodity prices are now the new norm, meaning that miners such as Teck and First Quantum offer little to no upside for investors.

CATEGORY

1. Investing
2. Metals and Mining Stocks

TICKERS GLOBAL

1. NYSE:BHP (BHP Group)
2. NYSE:TECK (Teck Resources Limited)
3. TSX:FM (First Quantum Minerals Ltd.)
4. TSX:TECK.B (Teck Resources Limited)

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