Why the Recent Rally in Commodities Will Come to an End

Description

Despite the upbeat view of some analysts and industry insiders who have predicted a strong rebound in commodities over the course of 2016, the outlook remains gloomy. This is because industry fundamentals and recent economic data indicates that demand will remain soft and that sharply weak commodity prices are here for some time to come.

Now what?

Over the last two decades the primary driver of growing commodity prices was China's insatiable demand for raw materials as it rapidly modernized and developed. This triggered a massive construction boom as the promise of a better life and higher wages sparked one of the greatest waves of rural-to-urban migrations ever witnessed.

This industrialization and manufacturing activity pushed commodity prices (particularly for iron ore, metallurgical coal and base metals) ever higher. This in turn generated a frenzy of development among mining companies as they sought to cash in on the boom that some pundits claimed would never end.

However, the economic outlook for China is becoming increasingly gloomy as fears of a hard economic landing grow in intensity.

Even distinguished investor George Soros, who famously broke the Bank of England, believes that a hard landing in China is unavoidable.

Recent economic data confirms this.

China's construction industry is caught in an intractable slump, and manufacturing activity in January 2016 contracted for the sixth straight month to be at its lowest level in over a year. This means that there is declining demand for steel, copper, and zinc from two of the world's greatest consumers of those commodities. There are no signs of any rebound in activity in either of those sectors occurring any time soon.

You see, during the boom years, China massively overbuilt and this in conjunction with a sharp reduction in the rate of rural-to-urban migration means there is sufficient housing stock that could last for up to a decade.

Then it should be considered that China's manufacturing industry is export oriented, meaning that it is dependent on external demand for its finished products in order to drive activity. Much of this demand remains weak, and a number of major export markets such as the Eurozone, Canada and Latin America are experiencing their own economic headwinds.

Even recent news highlights the poor outlook for commodities.

Global mining heavyweight **BHP Billiton Ltd.** has ended its progressive dividend policy and slashed its dividend for the first time in 15 years because of the collapse in commodities.

Meanwhile, companies such as **Anglo American Plc.** and **Glencore Plc.** that have been bleeding copious amounts of red ink are hurriedly divesting themselves of poorly performing assets as they attempt to engineer a return to profitability.

So what?

This certainly isn't good news for a number of Canadian miners despite a weak loonie and significantly lower oil prices working in their favour.

These fundamentals indicate that there is little to any significant long-term upside for commodities and that the recent rally experienced by miners such as **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK) and **First Quantum Minerals Limited** (TSX:FM) will run out of steam.

As a result, there are investment opportunities outside of mining that offer investors far greater long-term upside.

CATEGORY

1. Investing
2. Metals and Mining Stocks

TICKERS GLOBAL

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

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Date
2025/07/03
Date Created
2016/02/23
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