Why the Rally in Mining Stocks Will Come to an End

Description

The recent rally in commodities has been a boon for miners such as **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK), **First Quantum Minerals Limited** (TSX:FM), and **HudBay Minerals Inc.** (TSX:HBM)(NYSE:HBM); all are experiencing surges in their share prices. This has led to speculation among some analysts that the long-awaited commodities rally has arrived, which will catapult the share price of beaten-down miners ever higher.

However, there are signs that the recovery in base metals and other commodities may be short-lived.

Now what?

There are growing signs that China's economy may be in for hard landing, and this certainly doesn't bode well for commodities prices.

You see, China is the world's single largest consumer of metals; it accounts for over 50% of base metals demand. Not only are there signs that demand for metals such as steel, copper, zinc, and nickel will decline, but China's metals inventories are growing.

It was only a week ago that copper inventories grew by 11% and, despite output from China's steel mills, falling steel inventories continue to grow. This is also applying pressure to nickel and coking coal as the demand for both steel and stainless steel falls.

In fact, much of the recent surge in prices for copper, nickel, and zinc can be attributed to recent stimulus measures being announced by Beijing, rather than any concrete increase in demand or decline in global supplies. This means that the recent rebound in mining stocks will be short-lived, and it is difficult to see miners such as Teck, First Quantum, or HudBay rallying higher; all three have made massive gains of 76%, 92% and 95%, respectively, over the last month.

Teck generates almost a third of its revenue from steel-making coal, and with declining demand for steel and growing production from Australia, its price remains under considerable pressure.

Teck is also weighed down by the poor outlook for crude; it holds a 20% stake in the Fort Hills oil sands project, which requires West Texas Intermediate be US$80 or more per barrel in order to break even. This is more than double the current price and, with Teck on the hook for a further investment of $1.2 billion in the project, it increasingly appears to have been a poor investment.

Teck, First Quantum, and HudBay will also feel the impact of rising copper inventories and declining demand in coming months. Copper is responsible for generating 29%, 76% and 84% of their revenues, respectively.

Nonetheless, the recent spike in precious metals prices has been a boon for First Quantum and HudBay as both generate between 8% and 13% from precious metals. There are signs, however, that the recent rally in gold lacks legs. A survey of analysts found that gold was expected to fall during 2016 to an average price of US$1,103 per ounce, almost 13% lower than its current price.

So what?

With the uncertainty surrounding the outlook for China and the impact that a hard landing will have on commodity prices, it is difficult to see any further upside for commodities miners. This means that investors would do better to look elsewhere for solid long-term gains.

CATEGORY

1. Investing
2. Metals and Mining Stocks

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. NYSE:HBM (Hudbay Minerals Inc.)
2. NYSE:TECK (Teck Resources Limited)
3. TSX:FM (First Quantum Minerals Ltd.)
4. TSX:HBM (Hudbay Minerals Inc.)
5. TSX:TECK.B (Teck Resources Limited)

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Date
2025/09/11
Date Created
2016/03/09
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