



Can Teck Resources Ltd. Sustain its Monster Rally?

Description

Coal and base metals miner **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK) has experienced a tremendous rally. Its stock has rallied by a massive 290% since the start of 2016. There are signs, however, that the rally may be overdone as Teck's share price has appreciated at a far faster pace than the underlying commodities it mines. This has led to considerable speculation that it is overvalued; it's become the most shorted Canadian stock listed on the NYSE as investors bet that the rally is unsustainable.

Now what?

One of the biggest drivers of Teck's rally has been the overall increase in the value of commodities and the growing optimism surrounding mining stocks. By the end of 2015 the market was pricing many miners for bankruptcy because the world was caught in the midst of the biggest commodities slump since the global financial crisis.

Nonetheless, while the outlook for metals and steel-making coal has improved in recent months, it certainly doesn't support Teck's considerable rally. Over the last seven months the price of steel-making coal, which generates roughly 40% of Teck's revenue, has remained flat. Similarly, copper, which is responsible for 30% of its revenue, has only gained 6% and is trading close to its lowest point since the global financial crisis.

This is having a considerable impact on Teck's financial performance. Revenue from steel-making coal in the second quarter fell by 11% year over year and copper fell by a massive 27%.

There are signs that this won't change any time soon.

You see, the main driver of commodity prices is demand from the world's single largest consumer: China. And with China's economic growth slowing to its lowest level in over two decades, that demand is not as strong as it once was. Also consider that the two main consumers of steel and copper in China, the construction and manufacturing sectors, remain mired in long-term slumps that are causing the demand for basic materials to fall.

Many investors don't realize that the deleterious impact the decline in demand is having on metals prices is being exacerbated by China's growing metals inventories. Stockpiles of copper have been estimated by some analysts to now be at their highest level since 2004, while steel stockpiles continue to grow because of a surge in domestic production.

There shouldn't be any expectation of demand for metals and their prices to pick up anytime soon.

Not only is economic growth expected to slow further, but Beijing is determined to transition from a capital-intensive, export-focused economy to one where domestic consumption is the primary driver of growth. This will cause economic growth to slow to more sustainable levels.

Then there is the global oversupply of commodities created by the massive investment in mining assets at the height of the commodities boom, especially for coal, iron ore, copper, and nickel.

This supply glut can only continue to grow because the world's largest exporter of steel-making coal, **BHP Billiton Ltd.**, is determined to grow its coal output while cutting costs through the implementation of a range of efficiencies.

A similar phenomenon is occurring with copper. Despite the global supply glut and sharply weaker prices, a number of miners, including **Southern Copper Corp.**, are focused on boosting output. In fact, the International Copper Study Group expects global production to grow at an average rate of 4% annually, thereby placing further pressure on prices.

So what?

It is becoming increasingly clear that Teck has rallied too fast with the underlying fundamentals of copper and steel-making coal indicating that weak commodity prices are here to stay, which justifies the tremendous short interest in the miner.

CATEGORY

1. Investing
2. Metals and Mining Stocks

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1. Editor's Choice

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Date

2025/10/01

Date Created

2016/08/03

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