



Recession Risk: Should You Sell Your Resource Stocks?

Description

Commodity companies now trade at valuations that are extremely attractive, often at very low price-to-earnings (P/E) ratios or below book value. The investing world is littered with the corpses of commodity investors. Therefore, investors either need to be willing to hold these stocks for the long term or get out while the getting is good.

A global recession could decimate commodity stocks

During a recession or a period of economic unrest, many commodity stocks can come under pressure. In large part, this is due to the fact that economic production slows down. If the recession is global, the effect could be even more pronounced. If the recession includes a recession in China, there could be a lot of pain in the commodity sector.

The only exception to the rule could potentially be gold companies. If there is political unrest or a destabilization of the monetary system resulting from excessive debt, gold could potentially increase in price, helping any precious metal-related companies.

Not a lot of money has been made holding commodity stocks for the long term

Look at a chart of basically any commodity company over a long-term period, say, 10-30 years. Chances are that any investor over that period either would have lost money or not made any money over that time frame. [Commodity companies](#) like **Teck Resources** ([TSX:TECK.B](#))([NYSE:TECK](#)) and **Hudbay Minerals** ([TSX:HBM](#))([NYSE:HBM](#)) have not had any meaningful returns over long periods of time. Buy-and-hold strategies are basically useless.

The problem for value investors is that these stocks tend to look cheap at the height of their cycles. The reason is relatively simple. When times are good, these stocks tend to trade at low P/E ratios. For Teck, this is certainly the case, trading at a ridiculously low [current P/E](#) of 5.57. Hudbay is less obvious, with a P/E of 21.68. On a price-to-book basis, both appear cheap with Teck trading at 0.7 times book and Hudbay at 0.8.

This is a direct result of increased commodity prices, making earnings and book values high when times are good. But the time to buy these stocks is when times are bad, when P/E ratios are high or non-existent, and when everyone is chucking the stock out of portfolios.

Dividends have been rather unstable

Both Teck and Hudbay have cut their dividends significantly over the past several years. Long-term investors would have been extremely disappointed by the cuts but should not be surprised. Similar to Canadian households, commodity companies have a tendency to take on debt and spend during good times and cut costs (which includes dividends) and sell assets during bad times.

At the time of this writing, Teck sports a dividend yield of only 0.67% and Hudbay has one of 0.21%. If good times continue, it is possible that these dividends could increase once again. But never forget, for most commodity stocks, dividends are not secure and are only good while they last.

There is only one time to buy commodity stocks for a trade

Commodity stocks are extremely difficult investments that have not made good long-term holds for the most part. There is only one time you should buy commodity stocks: after a major crash in the commodity space. In the years following 2016, many stocks, Teck and Hudbay included, have come roaring back. If you had the stomach to buy them when they were on the verge of going broke, and if you'd managed to hold on for a couple of years, you would have come away with some spectacular returns.

In reality, commodity stocks are best left to the experts. The markets are volatile, the businesses are complicated, and the results are unpredictable. If a recession is on its way, that alone might be enough to hit these stocks hard. Use your money and invest in stable businesses instead of unpredictable commodity companies.

CATEGORY

1. Dividend Stocks
2. Investing
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1. Editor's Choice

TICKERS GLOBAL

1. NYSE:HBM (Hudbay Minerals Inc.)
2. NYSE:TECK (Teck Resources Limited)
3. TSX:HBM (Hudbay Minerals Inc.)
4. TSX:TECK.B (Teck Resources Limited)

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