My personal perspective on 10 years of the mining boom

By **Ashley Owen** on October 24, 2013 0

This year marks the 10-year anniversary and the conclusion of my big plunge into mining stocks. Starting in September 2003, I bought into about a dozen mostly speculative mining and mining-related stocks, to add to my existing BHP holding.

Great speculative mining booms occur about once every 30 years or so in Australia. Before the 2000s boom, the last big one was in the late 1960s. I will probably be old or long gone before the next big speculative mining boom comes along, and so it was good to experience one first hand.

Buying into hope and hype

Following China's entry into the World Trade Organisation in 2001, it took me two years to bring myself to buy mining stocks because of my fundamental dislike of their business model. Digging up rocks and loading them onto the nearest ship while other people in other countries use their brains to turn our rocks into useful things, then buying those useful things back at a thousandfold mark-up with money borrowed from foreigners, seems to me like a dumb idea. That's Australia's main export business model. Add to that the potentially enormous costs of remediating the giant holes in the ground and the environmental issues that are left behind.

So it took me two years to bring myself to buy rock diggers and, worse still, speculative explorers that hadn't even found rocks to dig up yet. I also bought several mining services companies with the idea that they would benefit from a possible mining boom even if the mining companies themselves didn't make money, as almost all miners don't.

Let's be clear. It was not investing, it was speculating, as most of the companies I bought had little or no revenues. Some had little more than hope and hype. It was a gamble that China would hold together politically after the 1989 Tiananmen Square crisis and not go down one of many disastrous paths it had taken before – like the 'Great Leap Forward' in the late 1950s or the 'Cultural Revolution' in the late 1960s to mid-1970s. It was a gamble that the handover of power from Jiang Zemin and Zhu Rongi to the new team of Hu Jintao and Wen Jiabao would be smooth and untroubled.

It was a gamble that the Chinese economy and social fabric would survive the massive banking insolvencies after the bad debt binges in the 1990s. It was a gamble that mining commodities prices would somehow arise from their slumber after going nowhere during the 1980s and 1990s (and indeed falling in real terms over the past century). It was a gamble that China could successfully undertake what would turn out to be the biggest construction boom in the entire history of human existence.

It was also a gamble because I knew the history of mining booms and busts in Australia and I knew of the extraordinarily high failure rate of Australian mining stocks.

Miners and explorers – the great Aussie gamble

Australians love a gamble and one of their favourite ways to have a punt has been on mining stocks. From the early days of the first stock exchanges in the Australian colonies right up to the present day, the majority of stocks listed on Australian stock exchanges have always been mining stocks (or explorers actually). The vast majority of them have never produced a cent in profits nor paid a cent in dividends.

Australians have always been happy to punt on the stock they discover for 1 or 2 cents per share, hoping it will shoot up to $100. There are very few ways in which an ordinary worker can hope to turn a small bet into a fortune – the lotteries, the pokies, the races, and mining stocks. Dot com stocks had their day in the sun in the late 1990s, but the prospect of making a fortune with mining stocks has been around for nearly 200 years since the first copper mine boom in Kapunda and Burra in South Australia, well before the gold rush in Victoria.

In every mining boom, hundreds of new companies are hastily thrown together to harvest money from the pockets of 'investors' (ie punters) caught up in the mining fever. Unfortunately most of the money raised in every mining boom has been lost – either pocketed by promoters, siphoned off by brokers, or simply wasted looking for minerals that are either never found or are found in too low grade to mine profitably.

In every boom the vast majority of mining companies run out of money and collapse, leaving only a small number that survive and sometimes prosper.

Western Mining

One very rare example of success (but only for those investors who got the timing right though the various phases of its life) was Western Mining. It was one of the hundreds of new gold stocks floated in the 1930s gold boom, and one of the few to survive more than a few years.

Western Mining was funded by a group of London investors in 1933 to explore for gold in WA in the gold price boom triggered by the Sterling and US dollar devaluations against gold in the depression. It found commercial grades of gold in Kalgoorlie and then moved progressively into other minerals, including bauxite in the 1950s, nickel in the 1960s, uranium, oil & gas, phosphates, copper, and finally back to gold.

Western Mining was rare in that it managed to make enough money out of several of these booms, and the management then had the unusual foresight and courage to recognise when each boom was over and then to move on in search of the next one. It was a hot gold stock in the 1930s gold boom, a hot bauxite stock in the late 1950s, it was the original hot nickel stock in the late 1960s nickel boom even before Poseidon. Western Mining's discovery of nickel at Lake Lefroy near Kalgoorlie in 1966 kicked off a wild nickel boom. Then it reverted to being a hot gold stock (or rather lukewarm by that time) in the late 1970s gold boom.

Western Mining's share price hit a peak of $19 per share in 1969. The late 1960s nickel boom collapsed in the early 1970s, the late 1970s gold boom collapsed in the early 1980s, and the prices of all commodities including gold, oil and industrial metals fell heavily in the 1990s. Even at the top of the gold bubble in early 1980, WMC only reached $3.50 per share. It reached a peak of $12 at the top of the 1987 stock market boom, but it then collapsed by 84% to just $1.92 in the October 1987 crash.

In 2002 the company was split into WMC Resources, which was taken over by BHP Billiton for $7.85 in cash – a loss of more than 50% for those who bought in the late 1968s boom, and that's before inflation. The remainder was renamed Alumina, which is still listed today and worth around $1 per share. Those investors who bought Western Mining shares its heyday in the late 1960s mining frenzy are still waiting to get their money back after 45 years! It had a great run, and fortunes were made in each of the booms, but the trick is to get out when prices are high and not hang on in the forlorn hope that 'this time it's different'.

Western Mining was very rare in that it survived as long as it did. BHP is another example but it diversified into several other industries beyond mining for much of its life, which included manufacturing behind high protective barriers until they were dismantled in the 1980s and 1990.

BHP shares peaked at £413 in February 1888 at the top of the late 1880s/early 1890s silver and lead mining boom. That's $34.70 in today's dollars in real terms after CPI inflation and after accounting for all of the spits and changes in capital structure over the years. People who bought BHP shares at the top of the 1888 mining boom had to wait 75 years for the share price to recover in real terms after inflation. BHP is still only $36 today as I write this in October 2013, some 125 years later!

These then are the reasons why it took me two years to finally bring myself to buy mining stocks in 2003, when you almost couldn't give away mining stocks, they were so unpopular.

Selling decisions

Making buy decisions is hard enough, but I find what and when to sell even harder. Fortunately several of the stocks I bought were taken over in the 2007-08 mining boom and so those decisions were made for me. Others I sold in the boom because of the crazy prices offered, and I finally sold the remainder this year (although I retain BHP and Rio Tinto shares).

Ten years was a great run and the gamble paid off. There was a lot of luck involved. Most stocks went through the roof, but that's what happens in a speculative bubble. You use the money you can afford to lose. My best stock was Fortescue Metals (FMG), which was little more than hope and hype when I bought in September 2003 for 27 cents per share (or 2.7 cents adjusted for the 10:1 split in December 2007). I had seen Fortescue founder Andrew Forrest take shareholders for a wild ride in Anaconda Nickel in the 1990s (from a safe distance, not as a shareholder) so I knew it was going to be a rollercoaster ride in Fortescue. The difference was that prospects for iron ore in the 2000s looked a whole lot brighter than nickel did in the 1990s (nickel prices halved in the 1990s), so I bought some shares. I sold most of the shares in 2007-08 and the rest recently.

My returns from several of the companies could have been significantly higher had it not been for some selling errors. I sold some too early and others too late, although it helps that they were bought in the early stages of the boom.

Speculating versus investing

There is still money to be made in mining stocks, but it is generally not at the speculative end of the market. Mining booms generally occur in three stages. First there is a commodity price surge when speculative explorers tend to do best – but only if they find something, or at least report that they find something. This was in 2003-2007. This first phase is usually triggered by a rise in demand (this time China) and also by the fact that mining investment had been virtually non-existent during the previous couple of decades since the last boom during which the low commodities prices from the last glut of production made exploration and development uneconomic.

The second stage is a construction boom, when engineering and mining services companies tend to do well. This was during 2006 to around 2010-11.

Finally, there is a production boom and the companies that prosper are the lowest cost producers, usually large scale and diversified. Commodity prices fall as supply increases when new mines start producing, costs rise, the higher cost producers get squeezed but the lowest cost miners prosper. Most of the holes in the ground end up being abandoned, boarded up or flooded with water.

I still hold shares in BHP and Rio Tinto, which are low cost, high volume producers that are likely to survive even if commodity prices fall, as they are likely to do as new supply comes on stream in the coming years. They are held as parts of well-diversified, long term, multi-asset class portfolios.

It is one thing to reminisce about speculative booms but they are few and far between, and the trick is to get in early when they are deeply unpopular. Never buy into the hype at the top of the boom – that is when you should be thinking about selling, not buying.

In the meantime investors need to be very careful with their long term wealth and this requires investing prudently, not gambling or speculating. Speculating is fine if done with money you can afford to lose, and kept well away from long term portfolios. Speculating is for buying beach houses, boats and Bentleys. If it doesn't work out it doesn't matter. On the other hand, long term portfolios are what investors and their families are going to have to rely on for the rest of their lives, and that calls for 'investing', which means sensible diversification and disciplined risk management.

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