

News

THE CASE FOR GLOBAL RESOURCES INVESTMENT

By John Robinson on 19 May 2011 0 comments

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Strong growth fundamentals that favour commodity price growth point to solid investor returns from global resources. John Robinson explains why global resources exposure remains compelling.

Investors considering their exposure to the resources industry should take note – strong global demand for resources will continue for some time.

The urbanisation of China and the associated need in that country for infrastructure development are powerful stimuli for resources demand – a process that will extend over decades.

There will inevitably be pauses and short-term interruptions along the way as inflationary pressures are managed, but the long-term trend will continue to support resources demand growth.

But it isn't just China's economic development that is driving global resources sector growth. There is development across a spread of emerging economies, many in the Asian region. India is moving along a growth path, similar in many respects to China's but with characteristics unique to India's political and economic structure.

In the developed world post-GFC, resources demand from the US and Europe is slowly picking up and their contribution to demand growth is expected to be gradual but increasingly positive.

Set against strong growth in demand, the supply response has been muted, with a range of factors constraining development of new major projects.

Slow recovery in the global financial sector has had an impact on new project funding and a repricing of risk has added to these constraints.

A lag in major infrastructure development in transport and ports has also been a drag, particularly in the bulk commodity sector where demand growth has been strongest. The lead time to bring on new production has been limited by shortages in skilled labour and construction inputs and a more aggressive approach to economic nationalism and fiscal settings has raised the development risk profile, both in Third World countries and those in the developed world.

Not surprisingly, with continuing strong demand growth and a muted supply response, commodity prices have trended strongly upward, with a relatively brief, though marked interruption during the GFC.

The daily movement in metal prices can be volatile and at times relatively sharp with corresponding daily adjustment in the share prices of resource companies.

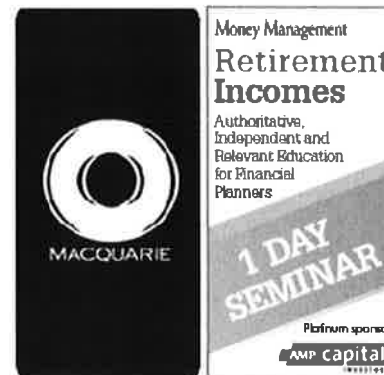
Investors with a medium to long-term horizon need to differentiate between daily movements that reflect speculative trading in metal derivatives and the increasing influence of commodity-based exchange-traded funds (ETFs), as well as the more fundamental supply/ demand relationship that governs longer-term price trends.

For many Australian investors, direct access to the global resources sector is limited to those companies with an ASX listing. Most seek this exposure through BHP and Rio Tinto, with perhaps only peripheral

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awareness of other major global miners active in Australia, but not locally listed.

Xstrata, for example, is a major globally diversified mining company and the world's largest thermal coal exporter. It has a high profile in Australia, but being based in Switzerland and with a London stock exchange listing it is not readily accessible to local investors.

Other major global resource companies active in Australia include:

- Anglo American: one of the world's largest mining companies and the second-largest exporter of Australian coking coal. It has its primary listing in London;
- Brazil's Vale: a major global diversified miner. It is the world's largest iron ore exporter with coal operations in Australia's Bowen Basin and Hunter Valley; and
- Canadian company Teck: the world's second-largest coking coal exporter and third-largest zinc producer, an active explorer in Australia.

For local investors looking to gain exposure to these major global players, as part of a diversified resource sector portfolio, there are two primary options:

Open-ended Managed Funds with specialised products in global resources. The Colonial First State Global Resources Fund is the largest in terms of funds under management, but others in this category include the Pengana and Perpetual Global Resources Funds. All have a unit trust structure and operate in the same manner as the broader Managed Fund sector.

The second option is to invest through an ASX Listed Investment Company, or LIC, that specialises in global resources.

There are 47 LICs in the ASX Composite Index but only three specialise in the global resources sector: the Global Resources Masters Fund (GRF), the LinQ Resources Fund (LRF) and Global Mining Investments (GMI), the largest of the three.

ETFs can also provide investors with resource sector exposure, but there are no locally listed products that offer a global resource perspective. There are ETFs that replicate the local ASX 200 Resources Index and there are a number of locally listed commodities-backed ETFs in the precious metals sector.

In developing an investment strategy to provide exposure to the global resources sector the argument for diversity across commodities, geography, markets and companies presents a prudent starting point. An investment in BHP and/or Rio certainly provides some of this diversity but there are many other substantial and globally diversified miners that can be added to the investment mix to generate a broader spread. This is best achieved by selecting from LICs and/or Managed Funds specialising in the global resources sector.

Some investors will prefer the LIC option with real time buy/sell pricing, a feature of all ASX listed stocks and the simple and transparent tax treatment of dividend income. Attaching franking credits can also add to the appeal of LICs, particularly for SMSFs with their internal income tax levels at either 0 per cent or 15 per cent. The closed structure of LICs can also

be advantageous, with buy/sell investment decisions made at a time and level to suit the investment management strategy, rather than being dictated by inflow or outflow of funds that result from an open-ended Managed Fund structure.

Some investors will be more familiar and comfortable with Managed Funds and their unit trust structure. Both investment options have similar fee structures with individual variations according to funds under management and performance drivers.

The role of selected ETFs is narrower but can provide an added element to portfolio construction, particularly where a specific commodity exposure is sought. ETFs typically have lower fees and are generally designed to replicate either the ASX 200 Resources Index or the particular commodity market price movement. But they are not designed to outperform the market.

Whatever the investment avenue, the reason to invest is compelling.

The global resources sector is underpinned by strong growth fundamentals and a supply/demand balance that favours commodity price growth, particularly in the bulk commodities sector of iron ore and coal (thermal and coking). The major global resources companies are well placed to provide investors with good returns, given their strong profits and operating cashflows. Continuing mergers and acquisitions in the global resources sector will provide additional benefits for those investors with broad exposure to the global mining sector.

John Robinson is chairman of Global Mining Investments.

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