

Market views



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When I was 16 years old my first Economics teacher, Roy Leinster, told me that the price of any good or service is determined by the interaction of demand and supply. I've never forgotten that, though there are times when I wonder if the stock market has.

I'm a long term bull of the mining sector, mainly because of that little gem of economic theory that I learnt nearly 30 years ago. But it does feel a lonely place at the moment – miners have been battered by the Greek debt crisis, signs of 'tightening' by the Chinese authorities and finally by a worse than expected change in the Australian tax regime.

Yes, Southern European economies do face huge structural problems, but their contribution to global metals demand is minimal compared to the US economy, which is set for a robust recovery during 2010 – a point underlined by recent ISM manufacturing data. At the same time, I actually draw comfort from China's policy tightening as it highlights the underlying strength of their economy to drive metals demand going forward. And finally, while the new Australian mining tax is an unwelcome development, it doesn't come into force until 2012 and a lot can happen (including a general election) between now and then.

As of today the miners are rated as the deepest of deep cyclicals. The market clearly remains sceptical about the structural changes brought about both by the inadequate supply side response to the higher metals prices, as well as the structural shift in demand from China. The sector remains the hedge funds' short of choice when any form of risk aversion raises its head.

But at current valuations the mining sector looks good value. I can pick up Rio Tinto for just 5x current year's earnings. On that valuation and with these long term fundamentals, I'm happy to remain overweight the sector.

Bull points

Long term fundamentals remain supportive
Buying opportunities on investor weakness

Bear points

Uncertainty over UK election fallout
Hedge fund shorting creating volatility

Source: rlam as at 5th May 2010 unless otherwise stated.

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