



Is the Party Over for Australia's Mining Plays?

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This week, Australia's central bank Governor Glenn Stevens dismissed concerns that China's economy was heading for a hard landing; saying that millions of new Chinese consumers will continue to drive demand for Australia's commodities.

Australia exports billions of dollars worth of iron ore and coal to support China's massive steel industry. In 2009-2010 Australia exported \$52.3 billion worth of goods to China, out of which iron ore accounted for \$25 billion.

But how much longer will Australia's China sponsored resources boom last?

Some analysts have already turned negative on Australia's mining stocks. "The slowdown in China will affect the appetite for commodities, and that will hurt Australian miners," says Chris Stott, portfolio manager at Wilson Asset Management. He's been bearish on the sector since the beginning of the year, actively avoiding both big and small cap plays.

Australian blue chip resource plays **BHP Billiton**, **Rio Tinto** and **Fortescue Metals** have all lagged the broader **S&P/ASX 200 index** this year. Based on Thursday's close the S&P/ASX 200 was down 5.6 percent, while Rio was down 8.3 percent, BHP 7.2 percent and Fortescue 8 percent since the start of the year.

The S&P/ASX Small Resources Index, which tracks the performance of 68 small and mid-cap mining firms, has had a steeper fall, dropping about 20 percent from the peak in January.

With a forward price to earnings ratio of about 8 to 12 times these blue chip resources stocks look reasonably priced right now. But Stott expects earnings downgrades from these blue chip companies as demand slows, and says resources stocks will continue to underperform in the next 6 months.

John Corr, managing director and founder of Fortitude Capital, says he's most worried about high beta plays - the junior miners that are still in the exploration phase and yet to make a profit. He said that companies were projecting earnings, based on current high commodity prices, which they may not be able to deliver.

"People are pricing in too much optimism. There's a lot of hype and promises, not all will be delivered. (Stock) prices, in some instances, are approaching bubble territory, and investors should be careful especially with China's slowing growth looming," he says.

Is the Pessimism Overdone?

But James Dakin, First Vice President, Wealth Management at Morgan Stanley Smith Barney thinks the pessimism is a tad overdone.

"I don't think China's economy is in for a hard landing. If that were true, commodity prices would be much lower, Australian stocks would be much lower. I don't think the markets are reflecting that yet."

He believes that the recent pullback in resource plays actually gives investors a good window of opportunity to pick up quality stocks, which offer long-term value.

George Boubouras, Head of Investment Strategy & Consulting at UBS Wealth Management agrees. He says the broad-based selloff in commodities from early May is overdone as demand continues to outpace supply in certain areas.

"We're building portfolios for retirement. The Chinese economy is adjusting to a more durable growth cycle. Structurally, China is still a powerful economy that's going to consume more steel, more energy per capita. As such, when building portfolios, I'm going to need large miners like BHP, Rio and Vale in them."

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