After stock sell-off, what lies ahead for battered mining sector?

An across-the-board sell-off in mining stocks is picking up speed, leading to new questions about what lies ahead for the battered sector.

On Monday, the metals and mining group in the S&P/TSX composite index plunged 6.5 per cent, a remarkable fall for an industry that has already seen its share values devastated by falling commodity prices.

The losses hit both gold miners and base metal producers and far outpaced the rest of the market, which slid less than a percentage point. The damage to miners also exceeded the declines in metals prices themselves.

Observers said the sell-off may have been related to growing fears around the U.S. Federal Reserve's likely move to raise interest rates on Wednesday, as well as the desire of shareholders to sell stakes and reap tax losses before the end of the year.

Ultimately, though, the widespread selling is evidence of investors' revulsion for a sector that has struggled with falling prices for four years and has demonstrated no clear schedule for a recovery.

"The whole commodity sector is done," said Barry Schwartz, chief investment officer at Baskin Wealth Management in Toronto. "It's over, put a fork in it. It's going to take years for many of these companies to recover."

Many mining companies, in Canada and elsewhere, prospered by catering to China’s insatiable appetite for raw materials, but as the Asian country’s expansion has slowed, demand for commodities has sputtered as well.

Without an obvious replacement for Chinese consumption, many miners find themselves facing glutted markets for their products, especially as new mines continue to come into production.

The Bloomberg World Mining Index, a measure of how mining stocks around the world are performing, is now at levels it first hit in 2003, just as the so-called commodity supercycle was beginning. The S&P/TSX composite metals and mining industry index has lost 28 per cent so far this year.

Among the hardest-hit Canadian-listed companies on Monday were base metal producers First Quantum Minerals Ltd. (down 11.5 per cent) and HudBay Minerals Inc. (off 11 per cent), as well as gold miners Centerra Gold Inc. (down 13.3 per cent) and B2Gold Corp. (off 10.3 per cent).

One factor hanging over the entire commodity sector is the strong likelihood that the Federal Reserve will choose to raise interest rates this week for the first time in nine years. That would likely attract more funds and drive the already strong greenback even higher.

Since prices for nearly all commodities are denominated in the U.S. currency, a stronger dollar would also have the effect of making raw materials more expensive to most buyers around the world. That would not be good for demand.

Gold may be particularly hard hit, since investors who buy it as an alternative to paper currencies are likely to find its appeal diminishes as the U.S. dollar begins to offer higher yields in real, or inflation-adjusted, terms. Gold, which pays no interest, generally loses its lustre as real interest rates on paper currencies increase.

“The only broad-based factor affecting commodity prices right now is the expectation of a Fed rate hike on Wednesday,” said Jessica Fung, a commodities analyst at BMO Nesbitt Burns.

To some degree, the sell-off on Monday may also reflect a delayed impact from Anglo American PLC's announcement last week that it plans to shrink by nearly two-thirds. Anglo, one of the giants of global mining, appears to expect a prolonged period of low commodity prices.

Trafigura, the big commodity trader, buttressed that viewpoint in its annual report, made public on Monday. "Markets, whether for oil or for metals and minerals, will be characterized by surplus supplies and relatively depressed prices for some time to come – in some markets, for another several years," said Jeremy Weir, Trafigura's chief executive officer.

For now, observers say investors should approach the sector with caution despite the apparent bargains on offer.

"I'm sure there are several of these companies trading below replacement value," said Mr. Schwartz of Baskin Wealth Management. "There could be bargains to be had. But by and large, I don't think there are a lot of people brave enough at this point to take advantage of them."

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