It Was Bound To Come

written by Melissa (Mel) Sanderson | August 6, 2024

Economics is called the ‘dismal science’ for good reason. Its practitioners rarely seem to have good news to share. Yesterday was no different.

In the dark COVID days of 2020, when the entire world shut down and economies (as known and understood) ceased to function, governments stepped in to avert panic and support societies cast adrift. Then – and since – economists have said there is a piper to be paid for all the support that flowed as governments essentially printed money with no concern for future consequences. After all, perhaps there would be no future.

Macroeconomics 101. Printing money leads to inflation. Inflation eventually leads to contraction.

Paying companies to keep employees employed, without productivity and without profitability, distorts global economic activity producing inflation – and contraction.

Supply chain collapses fuel shortages and price hikes which… lead to inflation and contraction.

Housing subsidies, rent freezes, and prohibiting evictions lead to soaring housing costs, increased homelessness, and higher mortgage and insurance rates when controls are lifted which – yes, you got it, leads to inflation and eventually contraction.

In economic terms, what has happened in markets over the last couple of days is an eminently normal albeit dramatic market response to unnatural economic distortions enacted in 2020. Don’t forget that this isn’t the first sharp correction in tech stocks in particular, but other stocks also have been in various levels of correction for almost a year.

So, we’re paying the COVID piper – and the collective losses suffered to date still do not approach a leveling of the spending enacted by world governments, some of which (especially in the US) continued well into 2023 in an attempt to cushion the inevitable fall.

Although the short-term pain is undeniable, perhaps there is a longer-term upside possible if investors return to properly valuing economic fundamentals instead of the lure of flashy presentations and fast-talking pitch artists.

Take critical minerals stocks for instance. Over the course of the last two years, the market delivered soaring value on lithium stocks before a crushing decline which caused even large producers to reduce output, delay project growth and in some cases, put productive assets on care and maintenance. Ditto nickle. Ditto cobalt. In other words, battery minerals led a decline, pummeled by very real economic factors including decisions by major auto makers to cut EV production in the face of lagging demand and downward price pressure from market-dominant China. These stocks were responding to actual market factors.

Rare earths, however, are another story entirely. Investors barely, if at all, understand the variety of uses for rare earths. Most focus on their role in battery technology, especially for EVs, overlooking their use in a wider range of products from cell phones to wind towers to charging stations to nuclear power plants and defense and space applications. Of course, China’s market dominance again plays a role in depressing the value of the mostly junior-miners and exploration companies operating in this niche, and, at least in the US, lengthy permitting delays for new mines also discourage private investors.

However, the long-term demand curves for rare earths more closely resemble those for copper than any other extracted material, with demand far outstripping supply over the 5-25 year period. Investors with an eye on fundamentals and an understanding of the time horizons for new mines entering production should be putting their money into the sector (at least outside the US, where permitting regimes don’t impose the same penalties). But this hasn’t been the case.

So governments again have stepped in, providing unprecedented support to try and develop reliable supply chains and alternative technology options to combat China’s dominance and try to slow climate change by ‘greening’ economic activity. So far, investors haven’t followed governments but perhaps now, with markets adrift and nationalist sentiment (which would limit so-called resource sharing) on the rise, money will move toward the most fundamental of all industries – mining, without which we essentially would have no economies at all.