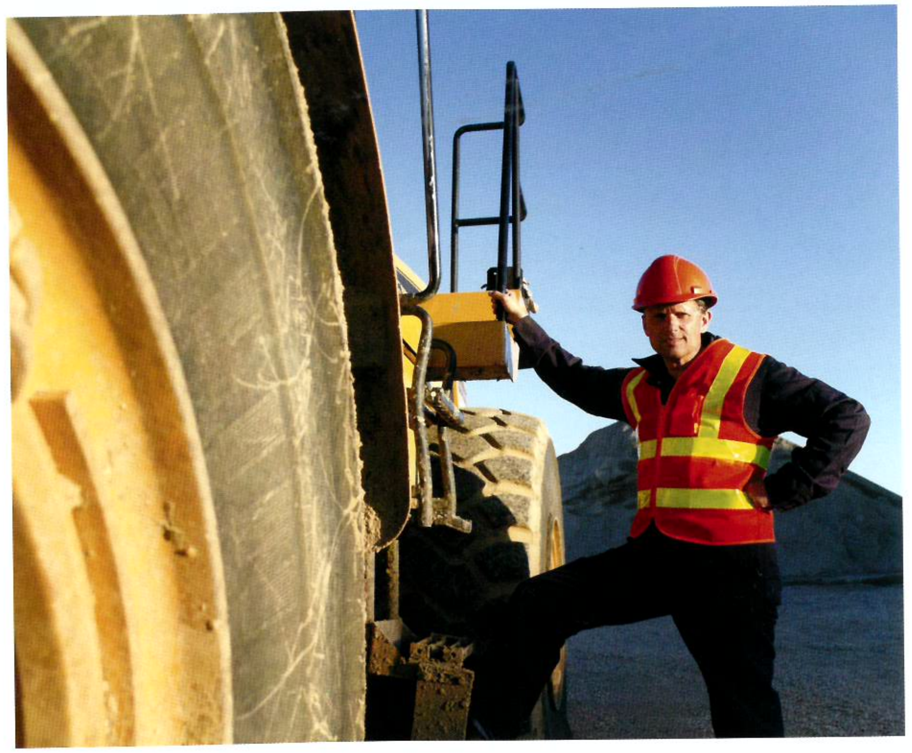
How miners can play it safe in the markets

The cyclical nature of mining makes it hard for industry workers to plan ahead and save for the bad times, as well as prepare for retirement.



With stockmarkets remaining volatile, interest rates falling to low or negative levels around the world, property markets appearing overheated and the mining sector riding out another downturn, how can miners play it safe when it comes to investing their hard-earned cash?

Boom to bust

Falling commodity prices, worries over China, geopolitical tensions and concerns over the global economic growth resulted in the worst start to a trading year on record.

For the mining sector, capital expenditure has been slashed, maintenance projects put on hold, and operational roles reduced to the bare minimum across Australia's $121-billion mining industry, threatening the retirement incomes of the industry's 187,000 workers and 600,000 people in support industries.

The job insecurity faced by those working in the mining sector amplifies the need for security in their investment and superannuation portfolios, but at the same time requires higher returns to adequately support them should unemployment or early retirement strike.

An investment strategy that combines high returns with moderate risk, however, has long been considered an oxymoron in the financial industry.

Finding a moderate risk investment given the current condition of the share market is considered challenging enough in itself. Further, while investors may have turned to property investment in the past to insulate themselves from market risk, skyrocketing property values have prompted London-based financial research firm Variant Perception to claim that Australia is in the biggest housing bubble of all time. Cash and bonds are also of little comfort, with yields currently at historic lows.

The current economic climate of low growth, low inflation, low earnings and low interest rates increases market volatility, and decreases the likelihood of double-digit returns on investment.

University know-how

What miners, or anyone with considerable capital or a self-managed super fund, need to consider is how to build the most efficient investment portfolio possible. An efficient portfolio is one that achieves the maximum expected return for an acceptable level of risk, or one that achieves the minimum level of risk while yielding the expected returns.

Creating an efficient portfolio that yields double-digit returns at reduced risk even in times of economic volatility and market downturn requires an alternative approach to the traditional portfolio of cash, shares and bonds.

Yale University's endowment fund, worth in excess of US$23 billion, produced a return of 13.9 per cent per annum between 1994 and 2014, when an investment in global shares over that same period only yielded 7.59 per cent per annum.

Yale's strategy was to invest 80 per cent of its endowment fund in alternative assets, including market-neutral funds and foreign equities. It was an approach that far outperformed the global share market over the 20-year period, and did so with less risk, which has caught the attention of the world's largest investors.

Yale's chief investment officer, David Swensen, hails the market-neutral strategy (also known as absolute return) for its proven efficacy.

'Well-managed absolute return portfolios provide a high-return, low-risk source of diversification,' Swensen says.

'Absolute return investing appeals to investors who believe that providing funds to superior managers operating with few constraints will lead to impressive investment results, regardless of the upswings and downswings of traditional marketable securities.'

A market-neutral approach intends to minimise share market risk by constructing two sub-portfolios: one that is long and one that is short, each holding approximately equal dollar amounts.

In this context, a long position involves buying a stock, currency or other assets, with the expectation that it will increase in value. In contrast, a short position involves borrowing stocks, currency or other assets from a broker, and selling them with the expectation that it will decrease in value, and can later be bought back at a lower price and returned to the borrower for profit.

A market-neutral strategy enables the portfolio to make money whether the share market moves up or down, and helps to insulate the portfolio from a crash such as the global financial crisis, while still yielding desirable returns.

Protecting investments

Glenn Rushton, executive director of Rushton Financial Services, and the investment manager for the Rushton Global Market Neutral Fund, says market-neutral portfolios are an excellent method of insulating an investment from market conditions.

'Since the global financial crisis, we've seen a heightened level of risk-aversion, with some commentators suggesting we shouldn't even think of double-digit returns anymore. This is quite concerning, particularly for those miners and other investors in retirement or nearing retirement,' says Rushton.

'This is where strategies such as market [neutrality] can add tremendous value to an investment portfolio, as they can perform equally well in rising and falling markets, are lowly correlated to the returns from shares, and can actually benefit from increased volatility.'

Rushton, who is also a former elite martial arts athlete, and the boxing coach of Australian Olympian Jeff Horn and Commonwealth Games silver medallist Joe Goodall, also says market neutrality is just one feature of the investment strategy investors need to be looking for.

Glenn Rushton (left) and Joe Goodall

'A market-neutral portfolio is just one way to manage risk. It is equally important that any portfolio is well diversified, and that means diversification both at the strategy level – implementing numerous strategies that yield profits at different times and in different market conditions – and spreading that investment across numerous markets,' he says.

Like boxing, Rushton says investors should not enter the ring without assessing all the risks and minimising the potential for a knockout blow.

For miners suddenly getting reacquainted with the boom-bust cycle, making gains from investments without compromising on risk could help in successfully riding out the downturn until the good times ultimately return – and ensuring there is no major hit to their finances.