The Catalysts that Caused the Crashes

A Monday Morning Musing from Mickey the Mercenary Geologist

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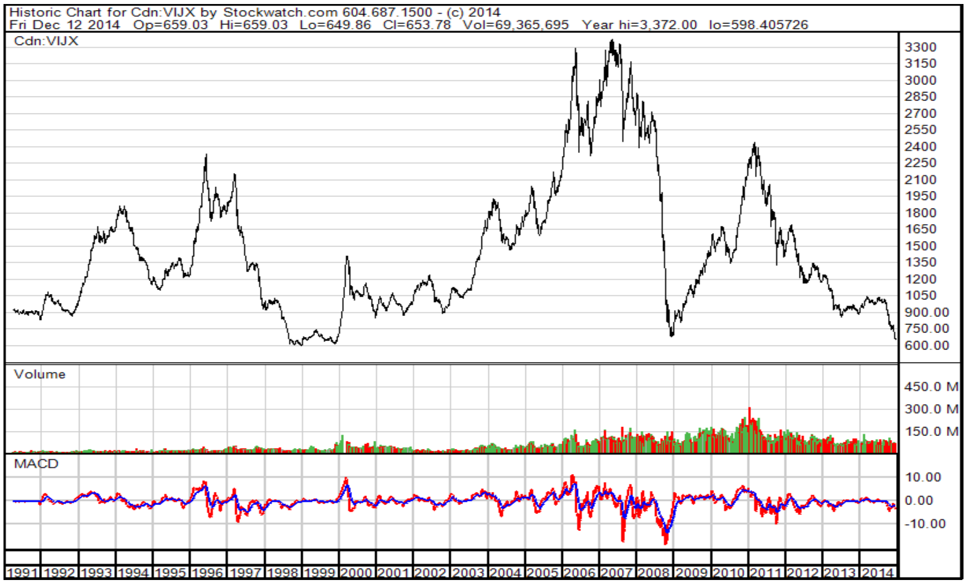
The Toronto Venture Exchange (TSXV) and its predecessor, the Vancouver Stock Exchange (VSE), have always been dominated by listings of micro-cap resource stocks. Most companies have focused on exploration and mining of precious and/or industrial metals, but a significant number have been involved in oil and gas exploration and production.

These companies, commonly known as “the juniors”, are a group of high risk-high reward speculations. Like all venture capital endeavors, they tend to trade in boom and bust market cycles. The stock market cycles have a general periodicity of 4-6 years, and they are usually correlated with the rise and fall of hard commodity prices.

Over the past 30 years, there have been four major bear markets in the junior resource equities sector. The busts occurred from late 1987 to early 1992, Q2 1997 to mid-2003, late 2007 to early 2009, and Q1 2011 to present and are illustrated by a proxy for the junior resource sector, the stock exchange index.

Here is a composite chart for the VSE Index commencing in March 1991 and its superseding market, the TSX Venture Index, from 2002 to the present. I have been unable to locate data before early 1991 and suspect there was no market index that tracked Canadian junior stocks prior to that time:



For each of the four periods, I will document a single event that occurred on a single day and triggered a bear market lasting from a little more than one to over six years.

- **Q4 1987- Q1 1992**: The world's major stock markets crashed on October 29, 1987, aka "Black Monday". It was the largest one-day percentage decline in the history of the Dow Jones Industrial Average at nearly 23%. Although the Dow actually showed a gain for the year, it took more than two years to finally regain its high prior to that day. This event caused junior stocks to go into immediate and drastic decline. The sole financing sources of the day, private placements led by a few select brokerage houses, dried up completely and it took over four years for the resource sector to recover.

  The junior markets emerged from the shadows in early 1992 upon discovery of diamonds in the previously unexplored remote barren lands of the far Northwest Territories of Canada. This diamond discovery initiated a claim staking rush the likes of which the mining world had never seen, led to discovery of a world-class nickel deposit in Labrador a couple of years later, and fueled a bull market for all metal commodities that lasted until the next fateful day in 1997.

- **Q2 1997- Q3 2003**: On May 4, 1997, the Busang project in Kalimantan, reportedly hosting the world's largest "gold deposit" at over 70 million ounces, was conclusively revealed to be a salting scam containing absolutely no gold. The junior company perpetrator, Bre-X Resources, fell from a high of $280 to a few pennies a share, wiping out $6 billion in market equity.

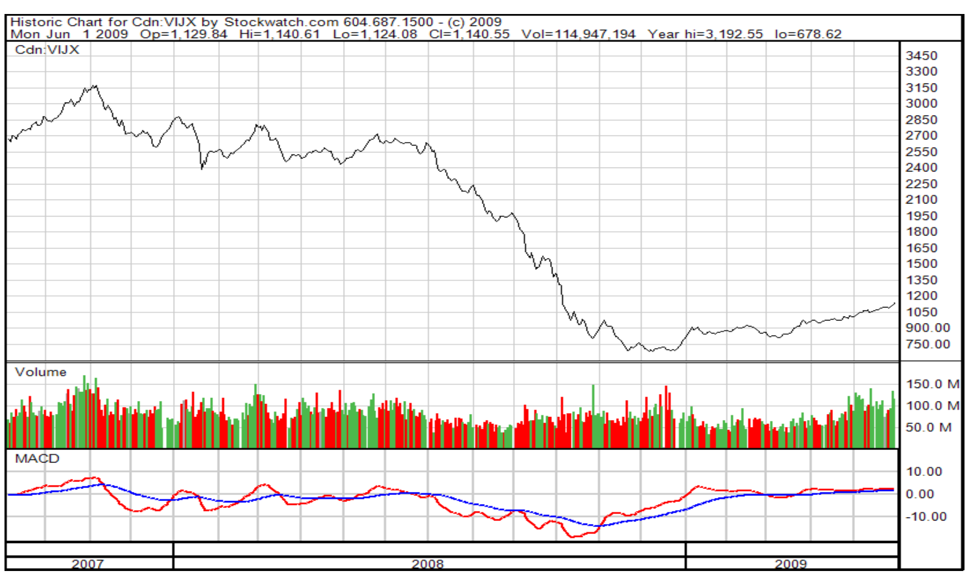
  From late March 1997 when red flags were first raised on the project to the end of 1998, the Vancouver Stock Exchange Index went from a high of over 2150 to what is still the market's all-time low of less than 600.

  Most other junior resource stocks failed and were delisted; by early 1999, the industry was moribund. The dregs from the USA's dot.com bubble led a brief respite on the VSE from late 1999 to early 2000 but that too crashed quickly:

In mid-2003, over six years post-Bre-X, a steadily rising gold price led to a resurgence of the junior explorers. The boisterous bull market for gold soon spread to other metal commodities and was driven by hard commodity demand from double-digit economic growth in China and other emerging market countries. This bull lasted until late 2007 when another single event triggered a junior bear market.

- **Late Q4 2007 - early Q1 2009**: On November 26, 2007, Teck Cominco Ltd and Nova Gold Resources announced shelving of development at their jointly-owned Galore Creek copper-gold project in northern British Colombia due to massive cost overruns and construction delays.

  The junior mining sector reacted immediately. The TSXV Index fell from its all-time high of 3171 in early November 2007 to below 2400 by mid-January 2008. It went sideways until June then capitulated. By December 2008, the Index was below 700, copper had fallen to $1.25 a pound, and oil briefly touched $30 a barrel:



In retrospect, speculative resource stocks were the proverbial "canary in the coal mine" in late 2007, foreshadowing what lay ahead for the world in the fall and winter of 2008-2009. Nine months after the Galore Creek debacle, a banking crisis struck full force worldwide with equity and commodity markets cratering concomitantly.

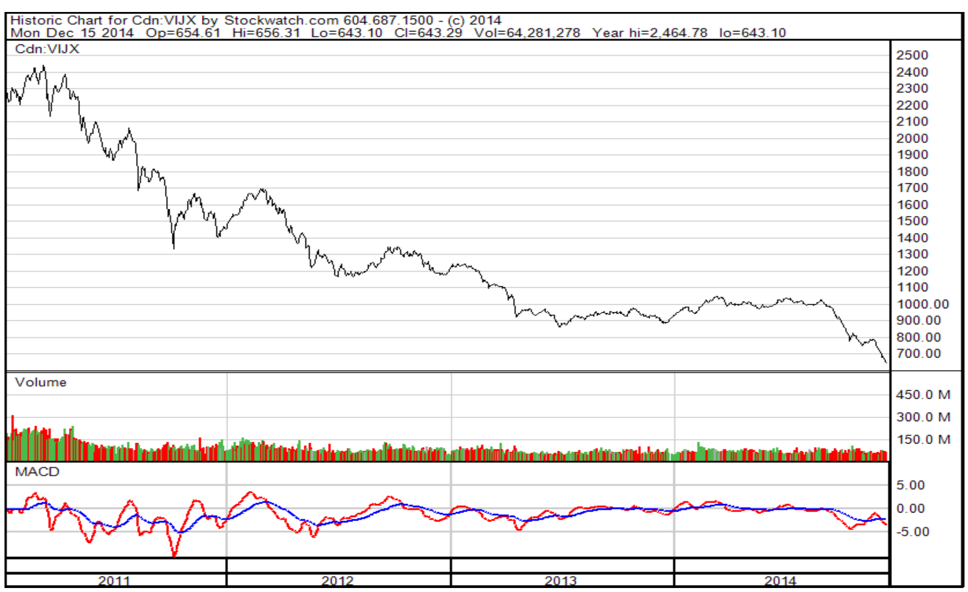
Though brutal, this bear market was brief. By January 2009, major and mid-tier gold mining companies led a resource revival driven first by demand for both physical and paper gold. Gold became the safe haven buy for millions of worried investors all over the world.

Trickle down to the juniors was almost immediate and this in turn generated the strongest bull market for the sector over the past 30 years. There was a two-year exponential rise in the Venture Exchange Index as metals prices again pushed record levels.

Once again, however, the runaway resource train was derailed by a single event; this time it was a catastrophic natural disaster.

- **Q1 2011 – present**: On March 11, 2011, the fourth largest earthquake ever recorded (magnitude 9.0) hit northeastern Japan and the 10 meter-high tsunami it generated killed an estimated 16,000 people. The tsunami also caused power outages that resulted in meltdown or irreparable damage to four of the six nuclear power plants at Fukushima.

  At the time, the Toronto Venture Index was four trading days removed from its post-global economic crisis high of 2465. The Fukushima incident first devastated uranium stocks. Then the stock bubbles that had been blown up since 2009 burst, including lithium, rare earth elements, Colombia, and the Yukon. Six weeks later, silver collapsed from a short-lived attempt to reach $50 an ounce. The damage soon filtered down to most other junior metals explorers and miners with the Index exhibiting a classic exponential fall to Q2 2013. It was range-bound until this past Labor Day when falling commodity prices and tax-loss selling have again taken their tolls:



> The current junior bear market is now three months shy of four years in duration. The TSXV Index continues to fall with historic lows being set over the seven of the past eight trading days. It closed another leg down today at 643. Will it reach the post Bre-X low of 598 before tax-loss selling is over?

Unlike other busts, commodity prices remained relatively high for most of the current downturn. Only during the past five months have the major world-traded hard commodities (precious metals, copper, and oil) broken below previous trading ranges. I have shown that these recent losses are directly and overwhelmingly attributable to the strength of the US dollar (**Mercenary Musings: November 14; November 24; December 1, 2014**).

However, world demand for "stuff" is dropping due to a slowdown in Chinese growth, a stagnant European economy, and the scuttling of "Abenomics" in Japan. Meanwhile, the United States remains saddled with a CEO harboring a socialistic agenda that is executed via an ever-growing, do-nothing government bureaucracy, burdensome regulatory policies, and staunch opposition to our country's much-needed infrastructure and natural resource developments.

As a result, oil is in oversupply worldwide with prices now in freefall below $60 a barrel; gold, silver, and platinum hit five-year lows in early and late November; and iron ore is off over 60% from its 2011 highs.

On the other hand, copper demand remains strong, holding its own in the high $2.90 per pound range. Its price decline basically equates to the rise in the DXY since July 11. Of the major industrial commodities, only uranium has gained since mid-summer, at +35%. That said, at $38 per pound on the spot and a $49 term price, the other yellow metal is still only half way back to prices that approach mine production costs worldwide.

We know it generally takes an uptick in commodities prices to bring end to a junior resource bear market. Low commodity prices will linger until the cure becomes low prices and historically, that does not happen in a short time frame.

Therefore, none of the above bode well for a quick turnaround in the junior resource sector.

However, bears beget bulls. As you know, I can always find a long position or trade for speculation. Now is when the contrarians among us find, found, and finance startup ventures. Our new companies may be public or private, but they all possess three key characteristics:

- Management is experienced and composed of successful geologists, engineers, and financiers with strong track records of success in the micro-cap resource business.

- Principals have the technical and financial wherewithal to evaluate good deposits and struggling mines then acquire them from distressed companies at sale prices.

- Financial resources are sufficient to hold dormant resources until market demand for stuff once again exceeds supply.

That said, I have no clue when this bear will finally go into hibernation; no one does.

Contrarianism requires patience folks; my advice is to act accordingly.

Ciao for now,

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Acknowledgment: Gwen Preston is the editor of **MercenaryGeologist.com**.

The **Mercenary Geologist Michael S. "Mickey" Fulp** is a Certified Professional Geologist with a B.Sc. Earth Sciences with honor from the University of Tulsa, and M.Sc. Geology from the University of New Mexico. Mickey has 35 years experience as an exploration geologist and analyst searching for economic deposits of base and precious metals, industrial minerals, uranium, coal, oil and gas, and water in North and South America, Europe, and Asia.

Mickey worked for junior explorers, major mining companies, private companies, and investors as a consulting economic geologist for over 20 years, specializing in geological mapping, property evaluation, and business development. In addition to Mickey's professional credentials and experience, he is high-altitude proficient, and is bilingual in English and Spanish. From 2003 to 2006, he made four outcrop ore discoveries in Peru, Nevada, Chile, and British Columbia.

Mickey is well-known and highly respected throughout the mining and exploration community due to his ongoing work as an analyst, writer, and speaker.

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