What Is the Best Way for Investors to Cash In on the Impending Gold Rally?

Description

Despite global markets continuing to hit new heights, I remain bullish on gold as more investors move some portion of their portfolios into safe-haven investments as a hedge against global issues that are fueling uncertainty and market volatility.

Many of these events include the collapse of economic growth in the eurozone coupled with growing fears of deflation, which would undermine hard asset values and negatively impact stocks. The slowing of the world's second-largest economy China remains a key issue. In August, industrial activity continued to pull back, and there are growing fears that China's property bubble will burst, taking the country's $15 trillion shadow banking system to the brink. If the latter does collapse, there would be a significant negative impact globally. Then there are the escalating geopolitical crises in Libya, Iraq, Syria, and the Ukraine, which have the potential to create further political and economic uncertainty worldwide.

While I certainly don't advocate dumping your entire portfolio into gold, it does warrant a closer look as a means of hedging against this growing fear and uncertainty.

How to invest in gold

Investors have a vast array of options for investing in gold, all of which have their own advantages and disadvantages. Firstly, there is buying the physical metal, and while I don't subscribe to this being a practical investment, I always feel a sense of guilty pleasure every time I touch a gold coin or ingot. The key problem with physical gold is its illiquidity, which creates significant buy-sell spreads for retail investors, making it virtually impossible to make a profitable trade unless there is a significant appreciation in its value.

A more practical option is a gold exchange-traded fund, which virtually mirrors the gold price, with the largest being the **SPDR Gold Trust ETF** (NYSE: GLD). Year to date, it has gained 2% and its biggest single investor is famed hedge fund manager John Paulson, who has bet big on a rally in gold, investing $1.2 billion, holding 2.3% of the total shares outstanding.

But gold ETFs come with one distinct disadvantage, they charge investors a fee for the benefit of gaining that all important liquidity and while for the SPDR Gold Trust it is a mere 0.40% it does add up over time, eroding investor returns.

I believe the best bet is to invest directly into gold miners which gives investors leveraged exposure to the price of gold enhancing the bang for their back, but this does come with significantly more risk than either physical gold or an ETF.

Among gold miners my favorite plays are **Yamana Gold Inc.** (TSX: YRI)(NYSE: AUY), **Agnico Eagle Mines Ltd.** (TSX: AEM)(NYSE: AEM), and **Goldcorp Inc.** (TSX: G)(NYSE: GG). All three are low-cost operators and have worked hard to bring down operating costs to maintain profitability in an operating environment dominated by softer precious metal prices. For the second quarter 2014 Yamana reported all-in sustaining costs of $844 per ounce, whereas Agnico's were $990 and Goldcorp's $852 per ounce, meaning even the smallest bump in the gold price will significantly boost revenues, cash flows, and ultimately their bottom line.

They also continue to focus on boosting gold production, allowing them to take full advantage of any gold rally as well as maintaining a portfolio of projects under development to boost reserves.

While I believe these are the best picks among the miners, there is a final option for risk-averse investors: precious metals streamer **Franco-Nevada Corp.** (TSX: FNV)(NYSE: FNV). The company appears expensive with an enterprise value of 21 times EBITDA compared to Yamana's 14 times, Agnico's 11 times, and Goldcorp's 16 times, but it comes with a distinct advantage over gold miners.

As a precious metals streamer, it doesn't operate mines but instead loans money to miners in exchange for the rights to buy gold and other precious metals at a set price, which is typically well below the spot price. This allows it to avoid making the same intensive capital expenditures or operating costs of the miners in order to sustain production, meaning it is able to generate a significantly higher margin while creating greater returns even for a small rise in the gold price.

Another advantage is that it holds a diversified portfolio of streaming assets covering all the major precious metals and crude. For the second quarter, 61% of total revenue was derived from gold, 13% from platinum group metals including palladium, and 22% from oil and natural gas — thereby giving investors access to a relatively low-risk portfolio of globally diversified commodities assets, mitigating many of the risks associated with investing in gold miners.

CATEGORY

1. Investing
2. Metals and Mining Stocks

TICKERS GLOBAL

1. NYSE:AEM (Agnico Eagle Mines Limited)
2. NYSE:AUY (Yamana Gold)
3. NYSE:FNV (Franco-Nevada)
4. NYSEMKT:GLD (SPDR Gold Trust)
5. TSX:AEM (Agnico Eagle Mines Limited)
6. TSX:FNV (Franco-Nevada)
7. TSX:YRI (Yamana Gold)

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