



Bullish on Gold? Then You Need to Own These 2 Stocks

Description

For the most part, the suggestions to most investors bullish on gold is to do either one of two things. An investor is typically told to either research and buy shares in a gold company, or buy gold bullion itself.

There's one big issue in buying physical gold, and that's the lack of cash flow. At least with many gold stocks, investors are being paid to wait for the price of the metal to recover. When investing in the metal directly, all investors can do is sit back and wait for the price to go up.

But while investing in a gold producer has the advantage of perhaps collecting a dividend, there are many downfalls to picking your favourite gold miner and buying its shares. Firstly, you're taking more commodity risk than if you were to buy physical gold because most producers benefit greatly when the price goes up. Fixed costs essentially stay the same, while the commodity fluctuates. That leads to either really good or really poor results.

Secondly, you're taking on operational risk. **Kinross Gold** is a great example of this point. A few years ago, investors loved this stock because of its low-cost Russian operations. A few years and a few international crises later, Russia isn't looking like such a great place to do business.

There are a couple of intriguing ways for investors to get exposure to the sector—investments that are more attractive than the traditional alternatives. Let's take a closer look.

Central Fund of Canada

Central Fund of Canada Limited (TSX:CEF.A)(NYSE:CEF) is a pretty simple investment, at least on the surface. It owns 1.7 million ounces of gold and 77 million ounces of silver, which are currently worth \$2.47 billion and \$1.51 billion, respectively. It also generates a small amount of income by selling a nominal amount of each per year.

Buying Central Fund has many advantages over buying physical gold and silver. It is able to buy assets at a much better price than the average investor, using its size to its advantage. It's also very liquid and there are no costs associated with owning it. They take care of everything, including the security of the precious metals.

The real kicker on this stock is the discount to net asset value. At the end of Monday's market action, Central Fund traded at a 7.5% discount to the value of the precious metals it holds, which is fairly typical—at least when gold isn't a hot sector. When precious metals are hot, so is the stock, which has traded at a 10-15% premium over net asset value. Essentially, investors can add another 20% to their returns over the whole business cycle by investing in this fund.

There's also a push from a couple of large investors for Central Fund to allow redemptions at net asset value, which would immediately push the price up to the net asset value. That's not terribly exciting on its own, but it's not a bad combination when you combine it with the other benefits.

Franco-Nevada

Think of **Franco-Nevada Corporation** ([TSX:FNV](#))([NYSE:FNV](#)) as a specialty bank for the precious metals sector.

Here's how it works: the company agrees to make a large, up-front investment in a mine in exchange for the right to buy a certain amount of the mine's production each year for a very low price, say US\$400 per ounce of gold. It then keeps the profit, which pays for itself in approximately 8-10 years, depending on the project. The next 8-12 years are gravy.

So, although Franco-Nevada is still affected by the price of gold, it's more insulated from price swings than the typical producer. After all, it buys production at such a low cost that it's impossible to not make money. And when gold goes up, 100% of that goes straight to the bottom line.

The company also boasts a debt-free balance sheet, nearly US\$600 million in cash, and pays investors a dividend of almost 2%. It also has all sorts of options on future exploration around the globe, meaning it still offers lots of upside if the sector gets hot again.

CATEGORY

1. Investing
2. Metals and Mining Stocks

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Author

nelsonpsmith

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