3 Reasons Why Gold Is Headed Even Lower

Description

It hasn't been a good few years for gold bugs.

After the price of the yellow metal peaked at more than US$1,900 per ounce back in late 2011, it's been on a steady downward march since. Recently, gold made headlines for dipping below the level it at traded five years ago. That's not good news for gold bulls.

Even though the price of the commodity is down some 50% from its peak, there's still potential pain ahead. Here are three reasons why the price of gold could head even lower in the next few months.

Inflation? What inflation?

In 2010-11, many investors were convinced that gold was the place to be as central banks around the world printed money and used it to buy government debt. It seems kind of silly now, but many smart investors were concerned that all the quantitative easing happening at the time would lead to massive inflation as the money supply expanded.

That hasn't happened. In fact, the opposite is beginning to happen. The new liquidity in the market did temporarily boost inflation rates, but lately the Consumer Price Index has been dropping like a rock as the decreasing price of oil, natural gas, and other commodities has helped keep prices down. Right now, short-term inflation is barely positive.

In this type of environment, nobody sees any use for a commodity that's traditionally been used as a hedge on inflation. Hardly anybody sees excess inflation being a problem anytime soon.

Gold has even lost its traditional place as a safe haven. When markets fell in the past, investors would flock to gold, content in riding out the pain in the yellow metal. These days, U.S. Treasuries are the go-to asset class for folks who are nervous about the market. At least Treasuries pay interest, even if it is a pretty anemic yield.

It still has no utility

The very existence of gold as the world's reserve currency is still puzzling. Instead of governments hoarding gold, it makes far more sense to accumulate assets that actually produce income and could pay dividends.

Investors are starting to realize this. There are other assets that provide the same type of inflation protection that gold does, while spinning off cash flow for their owners. Real estate is one; even if you believe Canada's real estate bubble is poised to pop, you can still buy one of the better REITs and collect a dividend of 5-6%, while knowing the underlying assets will likely do at least as well as inflation over the long term.

Strength of the U.S. dollar

At least some of the decline in gold has been caused by the strength in the U.S. dollar. As the dollar strengthened, the price declined. But when you look at the price of the metal in Canadian dollars or euros, the latest decline is much less pronounced.

With the U.S. Federal Reserve poised to raise interest rates sometime before the end of 2015, it's easy to see a scenario where the U.S. dollar strengthens even more, which wouldn't be good news for gold.

Avoid the sector, particularly this company

Needless to say, I'm not bullish on gold right now. If there's one gold miner I'd avoid, it would be **Barrick Gold Corp.** (TSX:ABX)(NYSE:ABX).

My big issue with the company is the debt. Thanks to years of buying assets during inopportune times, the company's debt load has ballooned to a massive US$12.9 billion. That compares to a market cap of just $11.6 billion. It's obvious the debt has the potential to bankrupt the company if the price of gold continues to fall.

The company wrote off nearly US$3.7 billion in assets at the end of 2014, and more write offs are coming this year. It has US$4.4 billion worth of goodwill on the balance sheet that is all but worthless now. So, even though Barrick trades at just a little more than book value, it's hardly cheap if the assets aren't worth the value on the balance sheet.

Investors looking for inflation protection should forget about Barrick and the whole gold sector. It's that simple.

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