Why Investors Should Avoid Gold and Gold-Mining Stocks

Description

In recent weeks gold has bounced back, rising by about 9% from its August 2015 low of under US$1,100 per ounce. With the Fed deciding to hold off on a rate rise and growing concerns over the outlook for the global economy, particularly over a slowing China, there is a renewed interest in gold and beaten-down gold miners.

A number of pundits claim that now is the time to invest in gold stocks, with industry heavyweight **Barrick Gold Corp.** (TSX:ABX)(NYSE:ABX) being particularly popular.

Despite these recent events, I believe investors should avoid gold and gold miners.

Now what?

Predicting the outlook for gold is akin to picking a winner at the track. There may be a number of indicators highlighting that now is a favourable time to place a bet, but it all really boils down to luck; no one can accurately predict where gold will head next.

Gold has no utility. Essentially, this means that it doesn't produce anything of tangible benefit, or provide a good or service that can be consumed. As a result, its value is imputed by investors, with many psychologically conditioned to believe that gold is the ultimate store of value.

However, this couldn't be further from the truth. Its performance over the last 50 years has been particularly volatile. Its average annual returns over that period have been extreme, ranging between a low of minus 49% in 1981 to a high of 55% in 1979.

You only have to look at it has performed since the end of the gold bull market that grew out of the global financial crisis. In 2011, gold hit an all-time high of US$1,921.50 per ounce, but since then it has tumbled 38% lower to now be trading around US$1,185 per ounce.

Then consider that over the last 50 years, gold's returns have been particularly lacklustre. For that period, it has only generated an annual average return of 5%, well below the performance of other assets over that period, including stocks.

Furthermore, the threat of a U.S. rate rise by the Fed hasn't receded; it has only been delayed.

Any rate rise will make gold an unattractive investment, because higher rates increase the opportunity cost associated with holding zero yield assets like gold, while stocks with high dividend yields become more popular. A rate hike also indicates that the U.S. economy is performing strongly. This means that the U.S. dollar will remain strong, applying pressure to gold because of its inverse correlation to the dollar.

Higher rates are also bad news for mining stocks because of the capital-intensive nature of the industry, with many carrying considerable amounts of debt. This means a rate rise will significantly increase their financing costs at a time when the gold price is close to the cost of production.

Barrick Gold Corp. (TSX:ABX)(NYSE:ABX), despite selling assets in order to reduce its debt, still has a heavily levered balance sheet with over US$12 billion of debt. It also reported a cost of production, or all-in costs, for the second quarter 2015 of US$1,021 per ounce.

So what?

It is difficult to see how gold or gold miners can be attractive investments, especially with a rate rise on the table and a general outlook that gold has further to fall. This makes the miners particularly unattractive investments as the gold price is now perilously close to the cost of production for many, including Barrick Gold.

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1. Investing
2. Metals and Mining Stocks

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1. Editor's Choice

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1. NYSE:B (Barrick Mining)
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