Storm Clouds Gather on the Horizon for Gold and Gold Miners

Description

Predicting the outlook for gold has become something akin to gazing into a crystal ball. There is growing uncertainty over what the future holds for the lustrous yellow metal.

One thing that is becoming increasingly clear is that as with other commodities, low gold prices are here to stay. This makes investing in gold and gold miners unattractive investments.

Now what?

Gold, like other commodities, is a hard asset that is tangible in nature. What sets it apart from them is that it behaves very differently because it possesses many of the characteristics of a monetary asset.

It is here that the confusion starts for investors, analysts, and economists alike.

You see, unlike other commodities, gold has little to no utility. This means that in contrast to silver, copper, zinc, or nickel, it has few productive uses, making it difficult to determine its fundamental value.

The majority of gold is used in the manufacture of jewellery or is directed to the investment market and central banks where it is a store of value and hedge against risk.

It is this distinct lack of utility that makes gold a particularly volatile asset. Data shows that it has been among the worst-performing assets over the last 40 years.

There are signs that this can only continue.

The Fed's rate hike in early December 2015 has increased the opportunity cost of holding zero-yield assets such as gold. This has triggered an outflow of capital to those investments that offer higher yields when interest rate rise.

Then you have to consider the growing strength of the U.S. dollar.

When the U.S. dollar rises the value of gold, just like other commodities, falls. With an increasingly robust U.S. economy, the dollar can only appreciate further in value, applying even more pressure to the price of gold.

As a result, gold could fall below US$1,000 an ounce in the coming months, which, for many gold miners, is below or close to their cost of production. This means many higher-cost producers such as **IAMGOLD Corp.** (TSX:IMG)(NYSE:IAG), which has all-in sustaining costs in excess of US$1,000 per ounce, will become unprofitable.

It will also force many gold miners to revise their gold reserves, their core asset, downwards. Gold reserves are calculated using a market price that determines whether or not they are economical to mine, and US$1,000 per ounce means that many reserves are uneconomical.

You can see this occurring with industry heavy weight **Goldcorp Inc.** (TSX:G)(NYSE:GG). It last calculated its reserves using US$1,300 per ounce, so a reduction to US$1,000 per ounce will force it to revise its reserves downwards and take a series of write downs on its mining assets. This will ultimately force its share price lower as its assets fall in value.

The rate hike will also impact miners such as **Barrick Gold Corp.** (TSX:ABX)(NYSE:ABX) that have highly levered balance sheets because the cost of servicing that debt has increased. Barrick, despite aggressively reducing its debt load through asset sales, still has over US$11 billion in debt, which cost it almost US$600 million to service for the first nine months of 2015.

So what?

The outlook for gold and gold miners remains significantly pessimistic at this time, and I expect it to remain so for at least the first half of 2016. This makes gold and gold mining stocks rather unappealing investments, which are likely to head lower as gold continues on its downward trajectory.

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2. Metals and Mining Stocks

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