Why I'm Not Following in Soros's Footsteps by Buying Barrick Gold Corp.

Description

George Soros, renowned billionaire investor who once famously broke the Bank of England, has made a massive bet on gold, acquiring US$264 million of shares in miner **Barrick Gold Corp.** (TSX:ABX)(NYSE:ABX). This is after gold's recent rally; the metal shot up by 19% from its December 2015 lows, triggering increased interest in the lustrous yellow metal. Some analysts are predicting this is the start of a new bull market.

It is easy to see why Soros has chosen Barrick to play gold's rally. Barrick has the lowest all-in sustaining costs among the big gold miners and has significantly reduced its massive pile of debt by almost quarter over the last year.

Nonetheless, despite having such a prominent name, increasing his exposure to gold, and taking a position in what is arguably one of the better levered plays on gold, I won't be following in Soros's footsteps.

Let me explain.

Now what?

Soros is betting that China's economy is headed for a hard landing, and this coupled with increasing market volatility and global economic uncertainty will underpin a further rally in gold. A hard landing will also contribute to further global deflationary pressures, making gold the perfect safe-haven asset.

You see, the likelihood of a further massive rally in gold, especially with it having rallied quite strongly in recent weeks, is becoming extremely unlikely. This is because there are signs that the U.S. economy will strengthen over the course of 2016; **Goldman Sachs** chief economist Jan Hatzius is expecting the labour and housing markets to continue improving.

As a consequence, further interest rate increases are now back on the Fed's agenda, and bond markets are pricing in a rate hike for later this year.

A stronger U.S. economy and higher interest rates will cause the dollar to strengthen, placing further pressure on the price of gold. To put it simply, the dollar and gold share an inverse relationship; a higher U.S. dollar makes gold, which is priced in U.S. dollars, more expensive to purchase in other currencies.

A stronger U.S. economy also bodes well for the performance of growth-oriented investments such as stocks, making them more appealing than defensive investments such as gold.

Meanwhile, higher interest rates make zero-yield investments such as gold unattractive, placing further pressure on its price as investors move to assets that pay a higher yield.

These factors certainly don't bode well for the outlook of gold prices over the course of the year.

Furthermore, it should be noted that higher interest rates increase the costs of gold miners, particularly those like Barrick that have tremendous piles of debt. By the end of the first quarter 2016, Barrick had almost US$9 billion in debt and paid financing costs of US$211 million. Any rate hike would see its financing costs rise considerably.

So what?

Soros's expertise can't be denied, but it is difficult to fathom the basis of his investment in Barrick. Not only are there signs that gold's rally may be drawing to a close, but after crunching the numbers, I found that it has been one of the most volatile and poorest-performing asset classes over the last 40 years.

In fact, over that period, it underperformed the TSX Composite Index and was substantially more volatile. I don't expect these characteristics to change any time soon, making gold an unattractive long-term investment.

CATEGORY

1. Investing
2. Metals and Mining Stocks

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