# Why I Remain Pessimistic About Investing in Gold Miners

## Description

Gold has surged strongly in recent months; it is up by 18% for the year-to-date, giving a much-needed reprieve to beaten-down gold miners.



In fact, the sharp rise in the price of gold has sparked a renewed interest in gold mining stocks. Many investors, such as George Soros, believe they are set to benefit from an inevitable economic hard landing in China.

Soros invested US$264 million acquiring 19 million shares in **Barrick Gold Corp.** (TSX:ABX)(NYSE:ABX). While Barrick may be on the cusp of turning its operations around and emerging from a lengthy period of poor performance, I am yet to be convinced that gold miners are a worthwhile investment.

**Now what?**

A number of analysts are claiming that gold is on the cusp of a new bull market, and that growing uncertainty over the outlook for the global economy and fears of an economic slump in China will see it return as a key safe-haven asset.

In fact, analysts at **Morgan Stanley** believe that gold could rise as high as US$1,400 per ounce, or 12% above where it is trading now. This would be a boon for the gold miners, but I believe it is unlikely that gold will perform as strongly as is being predicted.

You see, the outlook for China is not as severe as some analyst would have us believe.

While slowing economic growth, an ongoing slump in the construction industry, and weaker than expected manufacturing activity doesn't bode well for commodities demand, it does not mean that China is facing economic collapse.

Then consider that the U.S. economy continues to perform well, which should help to prop up the value of the dollar and could push the Fed to hike interest rates. The U.S. dollar and gold share an inverse relationship, which means that as the dollar firms, the price of gold falls.

Furthermore, a rate hike increases the opportunity cost of holding non-income-producing assets, which means that investors will exit gold and move to investments that yield more because of higher interest rates.

A rate hike also increases the cost of financing debt, and with gold mining being a capital-intensive industry, gold miners typically have tremendous piles of debt.

These factors certainly don't bode well for the financial outlook of gold miners or their margins, which means their profitability will suffer, despite many like Barrick having made considerable efforts to cut debt and reduce costs.

It should also be considered that mining is a risky and costly business with large portions of the operations funded by debt. This means there is very little upside for miners even if the gold price remains around US$1,200 per ounce.

For the first quarter 2016, at an average gold price of US$1,183 per ounce, Barrick reported a net loss of US$83 million. Even industry heavyweight **Goldcorp Inc.** (TSX:G)(NYSE:GG), which has a relatively clean balance sheet and all-in sustaining costs of $836 per ounce for the same period, failed to generate any free cash flow.



**So what?**

The recent spike in gold appears unsustainable with signs that the lustrous yellow metal will weaken in coming months because of a stronger U.S. dollar and the possibility of a rate hike. When this is considered in conjunction with the significant risks and costs associated with mining as well as the inability of even a low-cost mining major such as Barrick to post a profit despite higher prices, it underscores how perilous investing in the industry can be.

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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)
2. TSX:ABX (Barrick Mining)

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