3 Reasons Why I Remain Bearish on Gold for the Remainder of 2016

Description

After rallying quite strongly in recent months, the threat of a U.S. rate hike has taken the lustre off gold; it has fallen by almost 7% from its one-year high of US$1,294.70 per ounce. While some analysts claim that gold is well positioned to move higher over the course of 2016, I don't believe that to be the case.

Nevertheless, for May it closed its first losing month for 2016, and there are a range of indicators that highlight that the yellow metal will remain under considerable pressure for some time yet and could move back to around US$1,100 per ounce.

Now what?

Firstly, a key driver of the price of gold is the value of the U.S. dollar, with which it is inversely correlated.

A strong U.S. dollar means that the price of gold will fall because it makes it more costly to purchase in other currencies. In recent weeks the U.S. dollar has appreciated in value, primarily because of the Fed tabling the prospect of another rate hike in coming months. This can be attributed to the ongoing solid performance of the U.S. economy with stronger jobs, housing, and consumption data pointing to better than expected growth.

Secondly, higher interest rates increase the opportunity costs of holding non-income-paying assets such as gold.

You see, gold doesn't generate any income, and its returns solely come from capital gains. This means that as interest rates go up, the opportunity cost of holding gold rises, and money market and debt securities that have their yields linked to interest rates become more attractive.

As a consequence, investors could seek to shift from gold to those income-paying investments that benefit from an interest rate hike, placing further pressure on the price of gold.

Finally, investors also need to remember that gold has no real utility, meaning that demand is predicated almost solely on its perceived place as a store of value and a defensive hedge against economic volatility and geopolitical instability.

There are signs that global economic volatility is falling with the majority of commodities, including crude, bottoming and fears of a hard landing in China diminishing.

Furthermore, there have been no real earth-shaking geopolitical crises, which–in conjunction with a more optimistic outlook for the global economy–removes any need for investors to seek out safe-haven assets.

For these reasons, it is difficult to see gold sustaining its recent rally, and with the exception of a calamitous geopolitical or economic event, all the indicators point to gold weakening further.

So what?

Gold is an unattractive investment at this time. And because gold miners are a leveraged play on gold, they are particularly unattractive investments. The leverage of gold miners to gold may be a plus when gold is rising, but it is negative when it is falling, because it means the miners will fall harder and faster in value than gold.

This becomes more apparent when looking at the miner with the highest leverage to gold: **IAMGOLD Corp.** (TSX:IMG)(NYSE:IAG). IAMGOLD experienced a spectacular rally when the price of gold spiked. It rose by 130% for the year-to-date, but the reverse will occur as gold falls. This high sensitivity to gold prices can be attributed to IAMGOLD's high cost structure; it reported all-in sustaining costs of US$1,084 per ounce for the first quarter 2016.

As a result, IAMGOLD is a particularly unattractive investment, and I believe that the industry as a whole holds little to no value for investors.

CATEGORY

1. Investing
2. Metals and Mining Stocks

TICKERS GLOBAL

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