Why 1 of the World’s Greatest Billionaire Investors Thinks You Should Buy Gold

Description

When it comes to investing, only one thing matters: long-term, verified performance. This is why when billionaire investors like Warren Buffett, for example, speak, it often pays to listen. Recently, one of the greatest investing minds of this generation laid out a case for why increasing allocation to gold is a wise idea, and investors with no exposure at all to gold would be wise to listen.

That investor is Stan Druckenmiller, who founded Duquesne Capital Management in 1981. Between 1986 and 2010 (when he closed the fund), Druckenmiller had historic annualized returns of 30% and did not have a single down year despite multiple bear markets. Today, he manages his own money, and recent disclosures indicate that as of December 31, 2015, 30% of his assets were invested in the **SPDR Gold Trust ETF** (NYSE:GLD)

Why Druckenmiller is buying gold

Druckenmiller recently laid out the case for why he thinks gold is a good investment. His thesis on gold is based on a bearish outlook for U.S. stocks and a view of gold being a currency as well as an excellent store of value in a world where increasing parts of the globe are experimenting with negative interest rates, which gives gold a positive carry relative to other safe-haven assets.

Druckenmiller’s bearish view on stocks stems from looking back at 1981 when he started his firm. In 1981 risk-free rates on five-year treasuries were 15%, companies were investing capital wisely (due to the high risk-free rates), stocks were priced at seven times earnings, U.S. credit market debt was only 165% of GDP (compared to around 360% now), and central banks had plenty of ammo in terms of cutting rates to stimulate growth.

Druckenmiller stated that if the U.S. borrowed more from their future than at any point and markets value the future, then stocks should be trading at a discount, not a premium, to historic valuations.

Druckenmiller is also concerned that the accumulated debt has been used unproductively, leading to a peak in profitability. He cites the fact that operating cash flow, which peaked five years ago (along with net debt), has been declining year over year, despite net debt continuing to rise at an incredible pace. Historically, these two things peak and bottom together, and the current five-year divergence is unprecedented in financial history.

If debt has been used unproductively, what has it been used on? According to Druckenmiller, it has been used predominantly for financial engineering. In the 1990s debt was predominantly used for productive capital expenditures and to fund the construction of the Internet; relatively little was used for share buybacks and acquisitions.

In 2015 $2 trillion was spent on buybacks and M&A compared to $1.8 trillion for R&D and capital expenditures. Since 2012 M&A and buybacks grew by $750 million compared to only $250 million for R&D and capital expenditures. With debt growing, profitability declining, and capital being used unproductively, Druckenmiller does not see value in equities.

Why gold is a good idea

This leads to gold. Back in the 1981 when Druckenmiller started his firm, gold would have been the last asset one would've wanted to own given the excellent outlook and affordable valuations at the time. With the situation being reversed today, it makes sense that gold would be the asset to own, especially with negative real rates globally giving gold a positive carry, and a bearish outlook for stocks.

Barrick Gold Corp. (TSX:ABX)(NYSE:ABX) is an excellent way to gain exposure to gold. Barrick is currently the world's largest gold producer. Not only does Barrick offer strong leverage to gold prices, but it also pays a sustainable dividend and is expected to generate nearly $1 billion of free cash flow this year, which is it using to de-leverage.

CATEGORY

1. Investing
2. Metals and Mining Stocks

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2. NYSEMKT:GLD (SPDR Gold Trust)
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