Is Now the Time to Back Up the Truck on Gold?

Description

Whenever there's turmoil in the market, investors have been known to turn to gold as a safe haven.

Market action over the last few days has been no exception. Gold surged from around US$1,260 per ounce shortly before the Brexit became official to more than US$1,325 in just a few short hours. The price has been choppy since then, but the yellow metal has maintained its gains.

US$1,325 per ounce is gold's highest level since August 2014.

It's just the latest piece of good news for the commodity. Gold was trading at just over US$1,050 per ounce back in January. This recent move has boosted gold's price to the point where gains so far in 2016 are approaching 30%. Gold's last 30% upwards move was back in 2011.

There are plenty of reasons for investors to believe this trend could continue. Many feel another 2008-type meltdown might be just around the corner. Others think the Brexit will cause ripples that will be felt around the world. And some people just think stocks are plain overvalued and are due for a correction on valuation concerns.

Pundits have long recommended investors keep a 5% allocation to gold as a form of insurance. In today's turbulent markets, it's easy to follow that advice.

The only question is, How should investors get their gold exposure? Here are a few ideas.

Physical gold

Many investors insist on actually taking delivery of their gold, choosing to keep it either at home or in their safety deposit box. That way, if things start to go really bad, it's easy to access.

Still, there are disadvantages to this. Even if someone takes steps to secure it, physical gold is still at risk of getting stolen. And renting a safety deposit box can get expensive if you have a lot of gold.

Central Fund of Canada Limited (TSX:CEF.A) is a nice compromise. The fund currently owns 1.672

million ounces of gold–worth approximately $2.85 billion–and 75.644 million ounces of silver, an investment worth some $1.77 billion. It also has approximately $60 million in cash on the balance sheet.

Central Fund currently trades at a discount of about 3% compared to the value of the precious metals on its balance sheet. During periods of great bullishness in gold, it has been known to trade at a premium to net asset value.

In short, Central Fund is a nice compromise for investors looking for physical gold or silver but who don't want to take delivery of the metals.

Gold ETFs

One reason why investors might like a gold miner over the physical metal is something called operating leverage.

It's a simple concept. Say at $1,200 per ounce, a gold company makes $200 per ounce in cash flow. At $1,325 per ounce, the same company would make $325 per ounce in cash flow. Profits are up more than 60% without having to do anything different.

The problem with picking individual gold companies is they sometimes do dumb things. Thus, the only real way to get access to this operating leverage without picking a gold miner is to invest in an ETF.

The biggest gold ETF in Canada is the **iShares S&P/TSX Global Gold Index ETF** (TSX:XGD). It has positions in 41 of Canada's largest gold producers with a management fee of just 0.55%. It's a nice choice for investors looking for exposure to the sector who are unsure of which gold miner to choose.

Individual companies

When looking at individual gold miners, I like to focus on a company's all-in sustaining costs. My theory is that a company that mines cheaply will have plenty of operating leverage.

New Gold Inc. (TSX:NGD)(NYSE:NGD) has some of the lowest costs in the business, coming in at US$758 per ounce mined in its latest quarter. It also has a big new development projected to start producing in mid-2017 to go along with its four main assets in Canada, the U.S., Australia, and Mexico.

Rainy River is a prize many investors are discounting. Management expects it to add some 75% to 2016's production when it finally comes online at costs lower than the company spends now. That new production plus gold's potential move even higher could be very good news for shareholders.

CATEGORY

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TICKERS GLOBAL

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