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2 Reasons Gold Is Setting Up for a Historic Bull Market (and How to Profit)

Description

The price of gold has risen about 27% since the start of the year—recently closing at $1,318 per ounce—and while it has pulled back slightly, analysts at **Royal Bank** view any pullback as a buying opportunity. According to Royal Bank, gold has entered into a new bull market and predict gold will rise to $1,500 per tonne in 2017, 14% above current levels.

This is in line with the vast majority of gold analysts. Bank of America and Credit Suisse see gold at $1,500 in 2017, and firms like Natixis and UBS see gold rising to $1,400 per ounce by the end of this year. The bullish consensus on gold can be explained by a few key factors, and, combined, these factors will support the next run-up in gold prices.

Strong supply/demand fundamentals

While there has recently been news of prominent investors adding exposure to gold (George Soros and Stan Druckenmiller come to mind) there has been an even more significant buyer of gold over the past several years—central banks. Central banks are a key source of gold demand, and since 2010 the central bank portion of total gold demand has risen from under 2% to over 14% at the end of 2014.

Central banks typically hold gold as part of their foreign currency reserves due to its status as a safe-haven asset and store of value. In an uncertain economic environment with low interest rates, gold is seen not only as a protector against inflation and other economic risks, but as a means of diversifying away from U.S. dollar–denominated assets (the primary component of global central bank reserves).

According to a report by OMFIF, since 2008 there has been a significant shift in the buying behavior of central banks towards gold. For the past about 40 years, central banks have largely been divesting from gold after a 100-year period from 1870 to 1970 when annual gold purchases were the norm. The period since 2008 has returned to this century-long practice, and, according to the report, annual gold purchases of 350 tonnes per year are now in line with the average during the 100-year period between 1870 and 1970.

This would be the longest period of gold additions by central banks since after World War II, and total tonnes held by central banks (32,805) are at 1950 levels and not far off all-time highs of 38,350 set in

1965. This is a sign that gold is once again becoming a key component of central bank reserves, which provide a supportive backdrop for gold prices.

This source of demand will coincide with a diminishing supply outlook. Chuck Jeannes, **Goldcorp.'s** CEO, sees gold as hitting peak supply in the next year or two, which means that gold production will decline annually going forward. Goldcorp sees global mined production falling 13% by 2022. The demand for gold, however, is only set to strengthen.

Low interest rates make gold more attractive

As long as interest rates globally remain low, the opportunity cost of holding gold will shrink and demand for it will grow. Gold's main drawback as an investment is the fact it pays no yield, but when global bonds also pay no yield (or, in some cases, have a negative yield), it pays to hold gold. With Blackrock recently reporting that Canadian and U.S. equities are the most expensive in the world when compared to historical norms, equities are not attractive either.

With average global bonds having yields of only 0.67%, gold will only seem more attractive compared to bonds. For investors looking to play this increase in gold prices, **Barrick Gold Corp.** (TSX:ABX)(NYSE:ABX) is an excellent choice. It has a rapidly improving balance sheet (total debt of $15 billion in 2013, which will fall to $5 billion in 2017), growing free cash flow, and a strong project pipeline.

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Date
2025/08/03
Date Created
2016/09/22
Author
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