Gold Stocks: Look Out Below?

Description

Gold bugs are getting crushed, and investors are wondering if more pain is on the way.

Let's take a look at the current situation to see if the pullback is overdone or just getting started.

The 2016 rally

Gold staged an impressive rally in the first six months of this year, but it has been on a downward trend since the beginning of July and is now at its lowest level since the Brexit vote.

Most of the gains, and recent pain, can be attributed to the change in expectations for interest rate hikes in the United States.

The US. Federal Reserve entered 2016 with a plan to raise rates as much as 1% in four quarter-point increments. As the year began to unfold, weak economic data and uncertainty in global financial markets put the Fed on hold.

Higher rates tend to be negative for gold because they increase the opportunity cost of holding non-yielding bullion. Rising U.S. interest rates can also drive up demand for the greenback, raising its value against a basket of foreign currencies. This often puts pressure on gold, which is priced in American dollars.

Reduced expectations for rate hikes helped take some steam out of the dollar rally earlier this year, and that drove gold higher.

The surprise Brexit vote provided another boost to an already impressive rally, but that didn't last long, and gold has trended lower for most of the past three months.

Why has the rally stalled?

The Fed is still sitting on its hands, but comments from board members have been increasingly hawkish and better U.S. economic reports have the market preparing for a move by the end of the year.

As a result, investors who'd bought gold stocks in early 2016 are hitting the sell button to lock in their remaining profits.

Should you buy the dip?

The downward trend has picked up steam, and that could continue if the market starts to believe the Fed will get aggressive in 2017, but pundits have varying opinions as to what will actually happen next.

The gold bulls point to the global trend toward negative rates and believe the U.S. could be forced to follow suit if the economy slips into a recession in the next couple of years. If that scenario pans out, gold could move significantly higher.

However, if the U.S. economy starts to show more strength, the Fed will likely begin to raise rates, and that could extend the pullback in gold and push stock prices much lower.

As such, investors should be careful stepping into the market right now. Gold stocks are still sitting on some impressive gains with names such as **Barrick Gold Corp.** (TSX:ABX)(NYSE:ABX) and **Kinross Gold Corporation** (TSX:K)(NYSE:KGC) up an impressive 100% on the year, so there is strong downside risk in the near term.

As we all know, momentum can change on a dime. A surprise in the U.S. election or the collapse of a major European bank could quickly reverse the trend, but I would wait for confirmation that the pullback has run its course before putting new money into the sector.

CATEGORY

1. Investing
2. Metals and Mining Stocks

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1. Editor's Choice

TICKERS GLOBAL

1. NYSE:B (Barrick Mining)
2. NYSE:KGC (Kinross Gold Corporation)
3. TSX:ABX (Barrick Mining)
4. TSX:K (Kinross Gold Corporation)

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