



Gold's Huge Pullback Creates an Excellent Buying Opportunity in These 2 Gold Miners

Description

On October 4, gold set an unfortunate milestone—in the course of just one day, it fell 3.3%, which marks the largest single-day decline in the metal since 2013. This caused gold to drop below the key US\$1,300 an ounce level (to about US\$1,270), which was an important level for investors.

Investors now have questions on their minds: Was gold's drop a normal pullback in an otherwise healthy bull market, or is the move the start of a new downtrend for gold? There is good reason to think this is a healthy pullback, and if this is true, then the correction is an opportunity to buy high-quality gold miners at a discount.

To understand why this is a correction, it's wise to look at why gold sold off. One reason was that the U.K. prime minister pursued an exit from the European Union by the end of March. This weakened the British pound and strengthened the U.S. dollar. Gold prices typically weaken when the U.S. dollar strengthens.

Another reason for the drop was that the president of the Richmond Federal Reserve, Jeffrey Lacker, said that the U.S. Federal Reserve should begin hiking interest rates, considering how close they are to their target of 2% inflation. The current federal funds rate is 0.25-0.5%, and Lacker thinks it should be 1.5% with the idea being the Fed should be raising rates even before it starts seeing inflation.

Higher interest rates (long-term rates in particular) are typically bad for gold since they encourage investors to purchase assets that have a yield. The problem with Lacker's statement is, not only is he not a voting member of the Fed's rate-setting committee, but he is notoriously in favour of rate hikes.

The U.S. Federal Reserve may indeed decide to hike rates in December, and this wouldn't change the outlook for gold. In fact, according to Adam Hamilton, in the last 11 Federal Reserve rate-hike cycles (since 1971), gold rallied during six out of 11 of these cycles. Gold performs well during gradual rate-hike cycles, and, given the slow economic growth that is currently being seen globally, the gold bull market isn't at risk.

With this in mind, here are two miners that are looking particularly attractive.

Barrick Gold Corp. ([TSX:ABX](#))(NYSE:ABX) is the world's largest gold producer, and shares fell about 11% on October 4 and are also down 30% from August highs after a massive run earlier in the year.

Despite this, Barrick is expected to earn US\$2.66 per share of cash flow in 2017 (assuming \$1,400 per ounce gold), which gives it a price-to-cash flow ratio of six. This is down from eight in mid-August, and at that point Barrick was still trading at a discount to its peer group average of 9.5.

Nothing has changed fundamentally for Barrick since August, and the company is making steady progress towards de-leveraging and has a clear plan to reduce its Q2 debt of \$9 billion down to \$5 billion in 2017 through a mix of asset sales, current cash, and free cash flow (which the company is growing).

Eldorado Gold Corp. ([TSX:ELD](#))(NYSE:EGO) shares were down by about 8% on October 4. Eldorado has traded well below its peer group average for some time when valuing its peers by price to net asset value.

Eldorado is currently trading at only 0.63 times the value of its assets minus its debt compared to its peer group of large-cap names that are trading at around 1.35 times their net asset value. Even if Eldorado trades at one times its net asset value, it would be worth \$7.29—a huge upside from current levels of \$4.64.

What's interesting is that the company clarified growth plans, which should see production double by 2020, at an Investor Day about a month ago. The company is proceeding with expansion of its crushing capacity at Kisladag, which, combined with its Greek operations, will support its production targets. Such strong growth is rare in gold companies today, and investors will catch on.

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1. Investing
2. Metals and Mining Stocks

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2. NYSE:EGO (Eldorado Gold Corporation)
3. TSX:ABX (Barrick Mining)
4. TSX:ELD (Eldorado Gold Corporation)

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Author

amancini

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