



## Why Gold Miners May Be 2017's Top-Performing Sector

### Description

In 2016 so far, investors who'd invested in a basket of gold miners would have seen high double-digit returns—the **VanEck Gold Miners ETF** (NYSE:GDX), which holds 53 gold names, is up about 70% for the year. In mid-August, however, GDX was up over 130%, and a return to mid-August levels would be a 35% return from current prices.

These returns stem from the fact that as of the end of September, gold was 2016's second top-performing commodity (next to oil) with returns greater than 20%. Going into 2017, a combination of bullish headwinds for gold, an attractive relative valuation, and improving fundamentals for gold miners should help the sector see a very strong 2017.

### The recent concerns over gold are unfounded—a good time to buy

Some of the best opportunities come during periods of negative sentiment. Bullish investors are a minority during these periods, and getting positioned in a sector with good fundamentals before other investors offers some of the best risk/reward trade-offs.

Earlier in the year, **National Bank** published a report that explained the movement of gold through four key factors—stock market volatility, 10-year real interest rates, the U.S. dollar, and inflation. Falling real interest rates (the 10-year bond yield minus inflation) benefit gold since they make the opportunity cost of holding gold less.

Much of the recent sell-off in gold has been attributed to fears of an upcoming federal reserve interest rate hike in December. This fear is greatly misplaced though; as gold analyst Adam Hamilton points out, during federal reserve short-term interest rate-hike cycles (defined as three or more consecutive increases), gold actually did extremely well.

Looking at the past 11 federal reserve rate-hike cycles, gold rallied on average 26.9%. Even more interesting is the fact that in the six of the 11 cycles where the price of gold improved, they improved by a huge 61%. During the five cycles where gold did poorly, it only lost 13.9%. This means there is much more to gain than to lose from federal reserve rate hikes.

What controls gold more is the longer-term 10-year real interest rate. The 10-year U.S. bond yield (before subtracting inflation) is extremely linked to GDP growth. With consensus expectations for GDP growth for the U.S. (and globally) being weak, it is unlikely long-term rates will rise significantly. In fact, the IMF just downgraded U.S. GDP growth expectations to only 1.6% in 2016. Lower long-term rates are a very healthy environment for gold.

### **Gold miners are trading at attractive valuations**

Ongoing low interest rates, low economic growth, and economic uncertainty are a good environment for gold prices, and gold miners are likely to benefit. According to **Bank of Nova Scotia**, gold mining stocks are currently pricing in long-term prices that are about 7-8% above the price of gold. Since 2013 this premium has ranged from -3% to 17%. From 2000 to 2007, however (before the gold miners' period of major capital issues and falling gold prices), the premium was between 40% and 240%.

In other words, gold mining stocks could be trading much higher than they are today and be within historical norms. Gold miners are doing well today—the industry is once again generating free cash flow, balance sheets are improving and many producers are meeting their debt targets, and businesses are once again focused on exploration and organic growth. Production costs also continue to fall.

Currently, the U.S. S&P 500 is trading in the 85th percentile of its historical valuation. The price-to-sales ratio for the S&P 500 is the highest it's ever been. With stocks trading near record-high valuations, there is plenty of room for investors to move into a sector like gold miners, which is traditionally seen as a safe-haven alternative to stocks that are reaching bubble proportions.

Investors looking for more specific exposure than a gold miner ETF should consider **Eldorado Gold Corp.** ([TSX:ELD](#))([NYSE:EGO](#)) and **Barrick Gold Corp.** ([TSX:ABX](#))(NYSE:ABX). Eldorado trades at a large discount to its peer group and is one of the few names with high production-growth prospects (110% from 2017 to 2020), and Barrick is the world's largest producer and a safe bet on rising prices.

### **CATEGORY**

1. Energy Stocks
2. Investing

### **TICKERS GLOBAL**

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

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