Gold’s Recent Rally: A Puzzling Phenomenon

Description

Gold continues to maintain its lustre, despite equities relentlessly climbing ever higher in recent weeks. This is certainly a disturbing occurrence. Gold commonly is negatively correlated to stocks, meaning they usually move in opposite directions. Even more startling is that gold surged after the Fed hiked interest rates, ending last week at just over 3% higher. This is particularly bizarre because higher interest rates are usually bad for gold because it is a non-yielding asset.

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You see, as rates rise, the opportunity cost of holding gold increases, meaning that investors will sell gold and buy assets that have higher yields because of higher rates.

Now what?

These strange occurrences can be attributed to a confluence of events.

On the one hand, there is the irrational exuberance surrounding stocks since Trump’s ascension to the White House and his promises to boost economic growth through wide-ranging fiscal stimulus.

Then on the other, there are growing fears that not all is well with the global economy. There are a wide range of economic and political fissures threatening to trigger another financial crisis. Among these are the potential emergence of another European banking crisis, the fallout from the Brexit, growing political tensions with Russia, and widening threats to the integrity of the European Union.

There are fears that Trump’s proposed policies will either fail or be incompletely implemented, meaning that the anticipated level of economic growth now priced into equities won’t materialize.

These factors are generating considerable uncertainty, fueling a stampede to safety as investors seek to crisis-proof their portfolios by increasing their exposure to gold**,** which is considered the ultimate safe-haven asset.

In such an odd environment, where there is a growing disconnect of the traditional linkages between asset classes, investors need to position themselves appropriately.

So what?

One of the best ways to take advantage of higher gold prices is by investing in a precious metals streamer. They offer the same leveraged exposure to precious metals like the miners but with a far lower degree of risk. This is because they don't engage in the business of mining, which is a hazardous activity.

Instead, they essentially provide financing to miners in exchange for the right to a royalty or to buy the precious metals produced at a price that is far lower than the market price. For this reason, they carry far less downside risk than miners while still letting investors enjoy the same outsized returns that higher precious metals price generate.

Furthermore, unlike bullion or an exchange-traded fund, streamers **Silver Wheaton Corp.** (TSX:SLW)(NYSE:SLW) and **Franco Nevada Corp.** (TSX:FNV)(NYSE:FNV) pay investors income in the form of regular dividends. Of the two, Silver Wheaton is my preferred choice, despite the ongoing tax investigation being pursued by the Canada Revenue Agency.

Because of its oil and gas streams, Silver Wheaton gives investors 100% precious metals exposure with revenue almost evenly split between gold and silver. The company also took advantage of the prolonged slump in precious metals to boost its exposure to gold by acquiring the Constancia and Salobo gold streams at what now appear to be deeply discounted prices.

Silver Wheaton is far more attractively priced than Franco Nevada because its stock price is roughly 18 times operating cash flow and 1.5 times net asset value compared to Franco Nevada's 31 times and 1.8 times, respectively.

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2017/03/21
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