Global Conflict and a Weak U.S. Dollar Likely to Send Gold Higher

Description

Geopolitical risk

Last month, the U.S. bombing in Syria and the tension with North Korea led investors to think about a safe haven for their money. Now, tension with North Korea continues to escalate along with the U.S.'s potentially inappropriate relationship with Russia that's causing investors to think about a safe haven for their money.

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The point is that geopolitical risk is alive and well.

Weakening U.S. dollar

The U.S. dollar has been under pressure as geopolitical tensions remain and have been escalating. Further, the U.S. economy is reporting disappointing economic data, as consumer spending is coming in below expectations, as is inflation. Both indicate that the U.S. economy is not as strong as the market has been pricing in. Inflation came in at 1.9% in April and 2% in March, indicating that the U.S. Federal Reserve may reconsider its plan to raise interest rates, consequently sending the U.S. dollar lower.

All of these are positive for the price of gold for two main reasons. Firstly, as the U.S. dollar weakens, this means that gold and other commodities that are traded in U.S. dollars become less expensive for investors in other countries. Secondly, as the U.S. dollar loses its value, gold becomes a more attractive place for investors to store value.

This inverse relationship between the U.S. dollar and gold has held throughout history and was one of the major reasons for the most recent gold rally from 2000 to 2010. And when the U.S. dollar began to strengthen in 2011, gold began its descent from highs of over $1,800 per ounce.

Where does that leave us today?

In late 2011, gold prices peaked at close to $1,900 per ounce, then retreated steadily to levels of just over $1,000 per ounce at the end of 2015 and are currently in the $1,240 per ounce zone.

There are certainly many questions that remain with respect to where gold is going from here, but one thing is sure: the industry has suffered through a period of record production and declining demand. In response, companies in the industry have worked hard to reduce costs and improve balance sheets, and this leaves them well positioned to reap the rewards of rising gold prices.

Agnico-Eagle Mines Ltd. (TSX:AEM)(NYSE:AEM) stands to benefit greatly from the rise in gold prices and is the company that I feel has one of the best risk/reward propositions. The company is achieving a best-in-class operating structure with all-in sustaining costs of $741 per ounce. And based on how things have been going so far this year, it looks like management's all-in sustaining cost guidance of $850-900 per ounce will prove to be too conservative.

This compares to **Kinross Gold Corporation's** (TSX:K)(NYSE:KGC) all-in sustaining costs of over $1,000 per ounce and **Goldcorp Inc.'s** (TSX:G)(NYSE:GG) all-in sustaining costs of $800 per ounce.

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