Is There Another Gold Rally on the Horizon?

Description

Gold has dropped sharply in recent weeks because of a stronger U.S. dollar and an ongoing global economic recovery, which has seen central banks move to normalize monetary policy and increase interest rates. While the economic outlook is positive, there are storm clouds gathering on the horizon. Trump's approach to trade, which has seen him place tariffs on a range of imports and threaten China, the world's second-largest economy, with up to US$500 billion in tariffs, poses a dire threat to global growth. There are also a variety of other economic and geopolitical threats that could derail growing global prosperity and even plunge the world economy into recession.

These events would give gold a decent nudge, because during times of crisis it is perceived to be a safe-haven investment. For this reason, gold's latest pullback, which sees it down by 6% since the start of the year, has created an opportunity for investors seeking to hedge against rising risk and growing uncertainty.

Now what?

Trump's protectionist approach to trade, according to some economists, could trigger a global recession. Even if that doesn't occur, a full-blown trade war would at the very least shave up to 1% off global gross domestic product. It would also cause China's already fragile economy to cool further at a critical time when Beijing's policies aimed at reining in excessive credit and eliminating uneconomic enterprises are already weighing on growth.

The impact won't be limited to China. There is the risk of global contagion because the East Asian nation is essentially the top trading nation for almost every other country on the planet. It is a particularly important export partner for resource dependent economies, such as Australia, and many developing nations, especially in Latin America.

If manufacturing activity in China takes a significant hit because of a trade war and reduced access to export markets, then consumption of commodities, notably metals and coal, will fall significantly. This is because — with the exception of crude — China is the largest consumer of commodities globally. That would cause the price of the majority of metals and coal to plunge to lows not seen since the end of the commodity slump in 2016. The impact this would have on already vulnerable emerging economies would be significant because of their economic dependence on extracting and exporting raw materials.

There is also the risk that higher oil could cause growth to slow while magnifying the headwinds created by a global trade war. Some economists and the International Energy Agency (IEA) have speculated that if crude trades at over US$80 per barrel for a sustained period, it would constrain economic growth and, combined with other factors, such as a trade war, could trigger the next recession.

So what?

If any of these events occurred, it would give gold a solid leg-up, which could push it through the US$1,300-per-ounce barrier. This would be a boon for precious metals miners and streamers. An attractive investment to hedge against this growing uncertainty and cash in on higher gold is **Wheaton Precious Metals Corp.** (TSX:WPM)(NYSE:WPM).

Because Wheaton is a precious metals streamer, it offers a less-risky means of gaining exposure to gold, because it doesn’t engage in mining activities. Instead, it provides financing to miners in return for buying a proportion of their precious metals production at a cost far lower than the market price.

Wheaton has a diversified portfolio of streaming agreements spanning 20 operational mines and nine development projects across three continents. These give it reserves of almost 12 million ounces of gold and 545 million of silver. Such significant diversification further minimizes risk, because, unlike a miner, it is not dependent on a small number of mines to generate earnings. Wheaton has been steadily growing production and expanding its exposure to gold, which is now responsible for almost half of its quarterly revenue.

Wheaton’s cost structure is significantly lower than precious metals miners, reporting a first-quarter average cash cost of US$4.49 per silver ounce and US$399 for each ounce of gold. That makes the streamer highly profitable in an environment where gold and silver are appreciating. Because of its regular and sustainable dividend yielding just over 1%, it is a far more appealing investment than gold or silver bullion, which do not produce income.

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