Palladium Prices Soar, Impacts Auto Stocks

Description

The price of palladium is surging to a new historical record high. It hit over $1,800 on Monday, surpassing its prior record in the early 2000s of just over $1,000.

Stricter automotive emissions regulations in Europe and Asia have increased demand for the palladium metal among automotive manufacturers. The auto industry uses palladium in the catalytic converters of gasoline-powered vehicles to comply with air quality requirements.

Dividend stock **North American Palladium** (TSX:PDL) climbed to $19.65 on the news. When palladium prices last peaked in 2001, the price on the stock made an unbelievable move up to over $6,500 per share. Before the boom, shares of North American Palladium had been trading at around $480.

Canadian investors may want to keep an eye on this stock to see if it makes similar price moves this time around. The increase in palladium prices means higher margins, assuming production costs hold steady.

Higher rates mean growing profits and growing dividends in an already generous Canadian export industry. Likewise, automotive stocks will see rising production costs on gas-powered vehicles, making them less competitive than electric cars.

Low P/E ratio with predictable price movements

It may not hurt to pick up a small position in North American Palladium in the hopes that the value will nicely appreciate over the next few years in response to the increased profit margins on palladium.

North American Palladium's price-to-earnings (P/E) ratio is only 9.67, meaning that that the stock's price is less than 10 times the company's per-share earnings. This is cheap compared to many other industries. Typically, a stock with a P/E ratio over 20 is considered expensive, although traders also look at industry averages.

There is a real risk that the stock price could fall to a low of under $5 per share as it did at the end of 2015. Nonetheless, because metals and mining stocks usually move in the same direction as the price of the resource, a decline in value is less likely (today, anyway).

At the end of 2015, the spot price on palladium hit bottom – and the price on the stock followed it perfectly. When the price began rebounding in early 2016, the stock price also started to rebound to its current price of just under $20 per share.

Decent dividend yield may not compensate for risk

The dividend on North American Palladium is 2% of its current share price at the time of writing. The stock pays out $0.10 per share every quarter.

It would be nice to say that the stock reliably issues this dividend, but the stock just began compensating shareholders with dividend payments in February 2019. The company has brought up its earnings-per-share to $2.83 this year from -$9.39 per share in 2015.

Thus, if palladium's price sinks – the dividend will probably disappear.

Foolish takeaway

Metals and mining is a volatile industry – and may not be the best for your run-of-the-mill Tax-Free Savings Account (TFSA) or Registered Retirement Savings Plan (RRSP) investor. That doesn't mean you can't gain by watching the market moves in this industry.

Not only is it interesting to see how metal and mining stock prices move with the spot price of the metals, but other industries are also heavily influenced by these resources. In the case of palladium, 80% of palladium sold goes into the automotive industry. Jewelry and electronics use the remaining 20% as inputs.

Every aspiring Canadian retiree should understand how commodities prices affect their investment portfolios.

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