Are Gold Stocks a Buy After the Recent Pullback?

Description

Gold stocks outpaced the broader market rally off the March lows.

A pullback in the past two weeks, however, has investors who missed the surge wondering if this might be a good time to add gold exposure to their portfolios.

Let's take a look at the current situation to see if gold stocks deserve to be on your buy list today.

Pandemic response

Governments around the world slashed interest rates and unleashed unprecedented monetary stimulus measures in recent months to stave off a global depression.

This should be positive for gold over the medium term.

Gold tends to benefit when rates are low. The yellow metal doesn't provide any yield, so falling interest rates and lower bond yields reduce the opportunity cost of owning gold. Trillions of dollars of government debt already traded at negative rates before the crisis and more countries are joining the club.

Pundits speculate it is only a matter of time before U.S. bonds have negative yields. Japan, Germany, and, more recently, the U.K. are already in this situation. No-yield gold starts to look attractive when you have to pay the government to borrow your money.

Lockdowns due to the coronavirus pandemic have hammered the global economy, and countries around the world are printing money to get their economies back on track. The long-term impact of the moves could create a spiral of declining values in currencies and a potential surge in inflation.

Governments might be willing to let inflation run higher than normal before raising interest rates to cap the rise, as higher rates would put an economic recovery at risk and potentially push more businesses and highly leveraged consumers towards bankruptcy.

Gold is widely viewed as a good asset to hold if severe inflation arrives.

Geopolitical threats

Investors often turn to gold when geopolitical risk threatens to destabilize financial markets. The pandemic switched the focus of most governments to domestic concerns, but tensions between the United States and China, for example, are back in the news.

The U.S. blames China for not addressing the coronavirus outbreak early enough. In addition, China's recent move to implement a national security law for Hong Kong faces criticism from the U.S. government.

An escalation of tension between the two countries could put the global economic recovery at risk or at least delay its progress.

Gold outlook

Gold appears to have strong tailwinds. Pundits are calling for potential move to a new record above US$1,900 per ounce before the end of 2020. **Bank of America** rattled markets last month with a prediction of US$3,000 for gold over the next 18 months.

At the time of writing, gold trades at US$1,744. That's not far off the closing high near US$1,770 on April 14. The rally actually kicked into gear a year ago. At the end of May 2019, gold traded at US$1,300 and has been on a general upward trend for the past 12 months.

Should you buy gold stocks?

The **iSHARES SP TSX Global Gold Index ETF** rallied from $11.90 on March 13 to above $23 on May 15. Investors took profits in the past two weeks, as funds rotated back into other stocks on the hopes of a V-shaped economic recovery. At the time of writing, XGD trades near $20.50.

Gold miners still appear reasonably priced. They have the potential to generate significant profits and free cash flow at the current gold price and some are raising dividends. Any move higher in the gold market should send the stocks back to recent highs.

If you are underweight gold in your portfolio, this might be a good opportunity to increase your exposure.

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