



Has Warren Buffett Finally Changed His Stance on Gold Investing?

Description

News on Friday was that legendary investor Warren Buffett's **Berkshire Hathaway's** investment portfolio has, for the first time, opened a new position in a gold stock. The news has raised media speculation that the Oracle of Omaha might have changed his value investment philosophy. The man historically discouraged investing in the precious metal. Has Mr. Buffett changed his stance on gold investing?

What happened?

In Berkshire's latest 13F quarterly filing in the United States, the company's investment portfolio completely exited seven positions, including all airline stock holdings. The firm completely sold off its holdings in **Occidental Petroleum** and investment banking giant **Goldman Sachs Group**. It also exited **Restaurant Brands International** stock.

However, to the market's surprise, the investing guru's firm opened a new position in the world's second-largest bullion miner, **Barrick Gold** ([TSX:ABX](#))(NYSE:GOLD).

Why is Warren Buffett's Barrick Gold stock purchase significant?

The value investing legend is known to dislike investing in the yellow precious metal. The fact that the metal doesn't produce any cash flows made him see no value in it. Actually, he is quoted as saying bullion "...doesn't do anything but sit there and look at you."

Now that the legend's investment firm has dipped into the world's [second-largest producer](#) of the glittering yellow metal, the market has many questions. Could he have changed his position and philosophy on bullion?

Has he changed?

From my desk, it seems like the investing legend hasn't changed much. It's more so if we try to avoid mixing up two distinct investment strategies. Direct investments in physical gold bars (bullion) and investing in gold mining stocks are two different things altogether — even more so considering the nature and form of expected returns and cash flows.

No, there's no change in Berkshire's investment philosophy

If you invest in the physical metal, your return is a function of the market price movement. The price is mainly quoted as XAU/USD. You benefit if XAU continues to rise but gain nothing if market prices remain flat near your entry price. In the meantime, you won't harvest any cash flows on the position. Rather, you could incur storage costs and insurance charges. I contend these are the points the legendary investor was alluding to when he discouraged investing in the precious metal.

On the contrary, the math is completely different when buying a stake in a mining operation. Your business will gain from expanding profit margins and reap gigantic cash flows as bullion prices soar. If it manages to control operating costs, operating leverage and financial leverage (the use of debt in the capital structure) will augment the business's profits and cash flows.

Barrick is a good example of a miner with a proven history of containing mining operating costs. It generates positive returns by selling mining production, even during periods of weaker market prices for the metal. Higher market prices amplify earnings and cash flows, but they aren't everything. And the business pays a nice quarterly dividend. It recently increased the dividend, too. Berkshire Hathaway will be collecting dividend checks on its 21 million shares in Barrick soon. But direct investors in bullion won't be getting any dividends.

Further, even if XAU prices were to stagnate, the company will continue to sell new production at higher margins, banking higher cash flows every month. Unlike on a direct bullion investment, it's not required that XAU prices should keep rising for investors in Barrick to make good returns on investment after the recent surge in the precious metal's price. The company only needs to churn out new production at historical costs to reap good cash flows.

Foolish bottom line

As we can see, directly buying the metal and investing in the precious metal mining stocks aren't exactly the same thing. We can't, therefore, say that the Oracle of Omaha is now open to buying bullion. Not exactly. Until there's a comment from the man himself to the contrary, his old position against directly investing in the precious metal remains untainted.

One important fact remains, though: Warren Buffett bought a gold stock. That's bullish news to bullion investors, even though Barrick is also a significant copper mining company.

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