Alert: China Could Be on the Verge of a Financial Meltdown

Description

Dark clouds are looming over China's economy. The country's largest real estate developer Evergrande is on the verge of bankruptcy. For context, this is the largest property developer in a country where real estate accounts for 28% of the economy. Evergrande's bad debts are larger than Lehman Brothers at the height of 2008. This could be China's "Lehman moment."

An economic crisis in the world's second-largest economy could have ripple effects. Or the damage could be limited to China. It's too early to say. But if you're concerned, you may want to consider adding some exposure to gold stocks for protection. Here's what investors need to know.

What's happening in China?

Protests are rare in China, so the fact that a crowd has gathered to chant "Evergrande, return our money," at the company's headquarters is noteworthy. The company is unable to meet its debt obligations, which has left investors and property buyers holding the bag. The stock is down 90% from last year.

A default of this size is likely to spread. The Shanghai and Hang Seng indexes have been steadily dropping since mid-June. One Chinese billionaire lost US$27 billion (CA$34.30 billion) this year!

The fact that China's central bank or government hasn't stepped in yet to offer relief is concerning some investors. Debt crises in major economies could go global, as we say in the 2008 crisis. During that crisis, one asset class served as a safe haven: gold.

Gold stocks for safety

The price of gold is a buffer for economic pain. When stocks and real estate crash (as they did in early 2020) gold skyrockets (which it did in early 2020). Similarly, the price of gold nearly tripled from 2006 to 2011 during the Global Financial Crisis. That's why adding gold exchange-traded funds or gold miner stocks like **Barrick Gold** (TSX:ABX)(NYSE:GOLD) could be a good idea right now.

Barrick Gold stock is down by about 20% year to date. The selloff coincides with the decline in gold's market value over the same period. But the company has strong fundamentals, and the stock is undervalued, even if gold remains stable.

For the first six months of the year, Barrick Gold's net earnings have amounted to more than $1 billion. Additionally, the company's total revenues have totaled $5.85 billion, backed by a profit margin of about 17%.

With gold prices averaging between US$1,700 and US$1,900, Barrick gold remains well positioned to generate significant returns from its gold reserves. While the cost of production may increase, putting pressure on profits, those costs would likely be offset by rising gold prices.

Bottom line

China's economic struggles and the risk of global contagion make gold an attractive asset for investors looking to hedge their portfolios. Gold miners should certainly be on your radar right now.

At the moment, Barrick Gold looks undervalued, as the stock always moves more than the precious metal price. Additionally, the stock is cheap, as it is trading with a price-to-earnings multiple of 13. Therefore, the 20% pullback presents an opportunity to buy the stock at a discount.

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