Warren Buffett: Hedging With Gold Right Now — Not a Bad Idea!

## Description

Warren Buffett's recent portfolio addition of **Barrick Gold** (TSX:ABX)(NYSE:GOLD) has taken the market by surprise. The idea that one of the greatest long-term investors of all time added a gold position raises the question: Is hedging one's portfolio right now a good idea?



Warren Buffett and his partner Charlie Munger have long talked about how valuations have gotten out of control. Indeed, this market is one which provides few value opportunities today. The levels of exuberance and greed right now are near all-time high levels. Accordingly, Buffett's mantra of "being fearful when others are greedy" seems to be taking hold.

Investing in gold in general and gold miners specifically are typically viewed as hedges. This is due primarily to the negative correlation gold tends to have with the U.S. dollar and economic growth. From time to time, gold takes off in a bull market, while equities lag.

Accordingly, I think investors need to consider Buffett's decision to add Barrick to his portfolio as one of two things:

# 1. Investors need to hedge right now

The number one goal of investing, according to many of the best investors of all time, including Warren Buffett, is capital preservation. It's not so much the growth aspect that one ought to seek. Rather, it's the reality that growth is required for one to keep up with inflationary forces that diminish the value of one's savings over time.

Preserving capital means not only obtaining inflation-beating growth each and every year. It means in down years, one doesn't lose as much as the market otherwise does. Portfolio hedging, particularly for those with substantial sums invested in the market, is a good way of having a capital preservation-first mindset.

Gold miners like Barrick provide returns that generally align with inflation over time. In a hyper-inflationary environment (what everyone is worried about as a result of the massive stimulus we've seen), these stocks do extremely well. In a market downturn, gold also tends to outperform. This sort of growth hedge is one that many long-only portfolios employ. This is because investors are still technically long equities, but can add more gold exposure depending on their bearishness level.

Warren Buffett did trim his stake in Barrick last quarter, so it may be that he has become less bearish overall. The fact remains that being hedged is not a bad idea if one is worried about valuations.

## 2. Gold miners are simply too cheap to ignore

The valuations of the broad index of gold miners are trading near its lowest levels in three decades. These companies are extremely cheap. Indeed, in a market that is super overvalued, finding these pockets of value can be enticing for value-oriented investors such as Buffett.

I think Barrick is one of those perpetually undervalued companies that may take a long time to be valued properly. That said, if one is holding this company as a long-term investment, patience can be your friend with this stock.

Right now, gold miners are priced as if the long-term average price of gold will be only around US$1,400 per ounce. If you're more bullish on the long-term trajectory of gold, buying companies like Barrick can provide nice long-term upside. This is, of course, in addition to the hedging value these investments have.



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**Date**
2025/08/15
**Date Created**
2021/01/29
**Author**
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