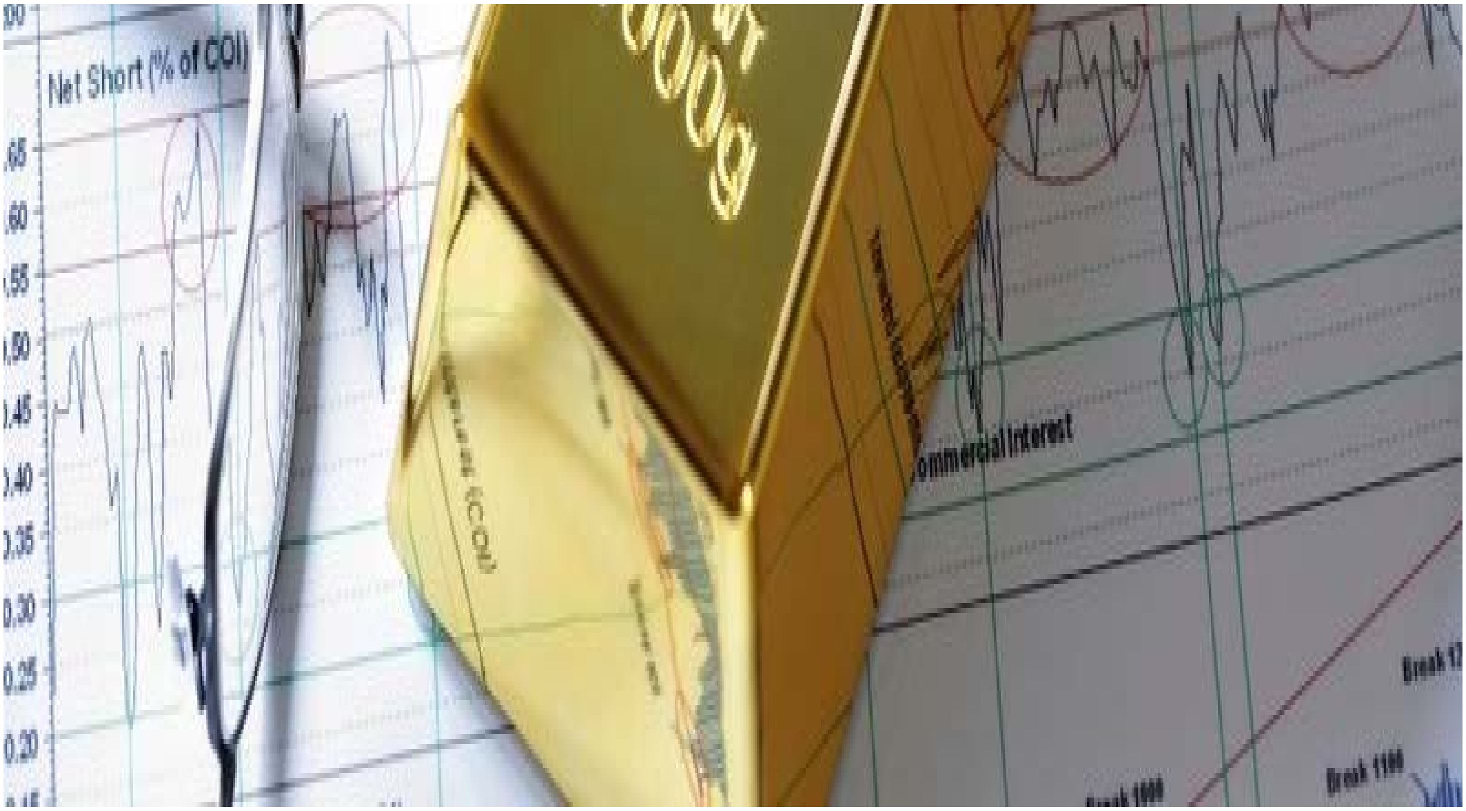
Precious metals funds ride gold trade to 120% rally

Gold mining stocks continue to leverage rising gold prices

Aug 5, 2016 @ 11:57 am

By **Jeff Benjamin**

3 Shares



If you have been a gold investor this year, you can be pleased with the 26% gain for the precious metal.

But if you had the foresight to leverage that gold play with an allocation to gold mining companies, you will be riding high on gains in the 120% range.

The question that has been asked at regular intervals over the past several months: How long can this rally last?

While the price of gold has been climbing against the backdrop of record-low global interest-rate policies and **macro-economic instability**, the gold miners have been doing a lot more than just coming along for the ride.

The equity precious metals mutual fund category, as tracked by Morningstar, **is up 118% from the start of the year,** and has a 12-month-trailing return of 120.5%.

With the worst-performer in the category, First Eagle Gold (FEGOX), up 88% this year, it would have been impossible to go wrong by just sitting in an equity precious metals fund.

The top performer in the category, by the way, is US Global Investors World Precious Mineral Fund (UNWIX), which is up 148.8%.

The rally makes perfect sense to Maxwell Gold, director of investment strategy at ETF Securities.

“The performance of the miners has been driven by margin expansion, which is the result of cost reductions, such as reducing debt levels and cutting capital expenditures,” he said. “It's been less about the top line and more about the bottom line.”

That kind of thing tends to happen when an industry goes through cycles of feast and famine, and the mining industry entered the year lean and hungry.

As a category, equity precious metals funds haven't finished with a positive year since the 41.6% gain in 2010, which was preceded by a 52.6% gain in 2009.

“These funds are, in theory diversified, because they hold individual stocks, but they are tied to the prospect of gold,” said Todd Rosenbluth, director of mutual fund and ETF research at S&P Global Market Intelligence.

In essence, the strategy is best if caught early, and can be risky to chase.

In late June, **when the category was already up 88%** on the year, Kashif Ahmed, president of American Private Wealth, stressed that he had no intention of chasing that kind of performance, and he's sticking with that philosophy.

“This most definitely is not the time to make an entry, especially for those folks that are long-term investors,” he said. “It's very likely I will continue to look like a fool into the foreseeable future. But history, and physics, tell us that what goes up, always eventually comes down.”

Mr. Ahmed said some of the credit for the rally in both gold and mining company stocks belongs to recent nods toward owning the metal by such **high-profile investors as**

DoubleLine's Jeffrey Gundlach and Janus' Bill Gross.

“The reason I have always remained skeptical of the gold trade is because it is hard to value something that produces no income, and has no cash flows,” Mr. Ahmed said. “Its price almost always reflects some sort of fear, and thus whatever a large number of people are willing to pay to hedge that fear.”

Whether or not Mr. Ahmed joins the mining company rally, he is right to keep the focus on the fluctuating price of gold.

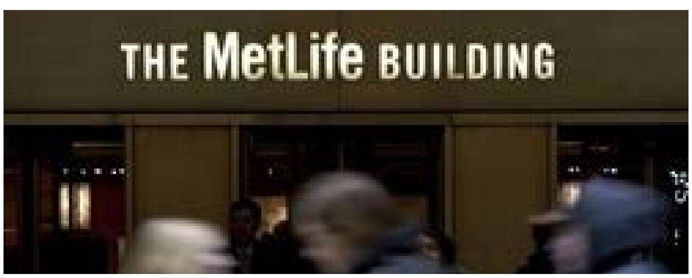
According to Mr. Gold of ETF Securities, certain valuations, including price-to-book, show some additional room for growth by mining company stocks. But to really continue gaining at the current clip, he said the price of gold would need to climb by another 12% to the $1,500-an-ounce range.

“The driving story for the mining companies is really the reduction in costs, but gold would have to get to $1,500 in order to maintain these levels of margin expansion,” he said. “There's a limit to the amount of operating costs you can reduce.”

0
COMMENTS

What do you think?

LATEST FROM INVESTMENTNEWS



MetLife to reduce costs 11%, cut jobs

Indexed annuity sales projected to plummet 30% because of DOL fiduciary rule