Friday Favorites: Gold vs Goldminers

Our Commentary from last Tuesday, Gold Miners Enter The Bears Den, elicited a few questions from readers. The article highlighted that Gold Miners, at the time, were down 25% from recent highs, thus technically in a bear market. It then compared the technical situation to a similar setup in early 2023, as we elaborate on in this article.

One of our readers asked if we could provide a longer-term analysis of the relationship between gold and gold miner prices.

Gold Miners Are Not Gold

Gold mining stocks are not always a substitute for Gold. Gold miners can benefit from higher prices and often employ leverage to boost returns. However, gold miners are companies that have unique risks. Consider, for instance, that in times of inflation, gold prices may rise, but the expenses of mining gold rise commensurately, offsetting the higher price.

Here are a few factors for consideration:

Operational Risks: Mining companies face various operational challenges, including rising production costs, labor disputes, and mine-specific risks like accidents or equipment failures. Furthermore, many gold mines are located in countries that are not friendly to foreign interests, imposing various risks on their operations.

Financial Leverage: Many mining companies use debt to finance their operations. When gold prices fall, the burden of debt payments can become more pronounced, impacting the company?s financial health.

Hedging Practices: Some mining companies hedge by selling future gold production at fixed prices to manage price risk. While this strategy can provide stability, it can also limit upside gains when gold prices rise significantly.

Management Decisions: Poor management decisions, such as overexpansion or misallocation of capital, can hurt the company?s performance regardless of gold price movements.

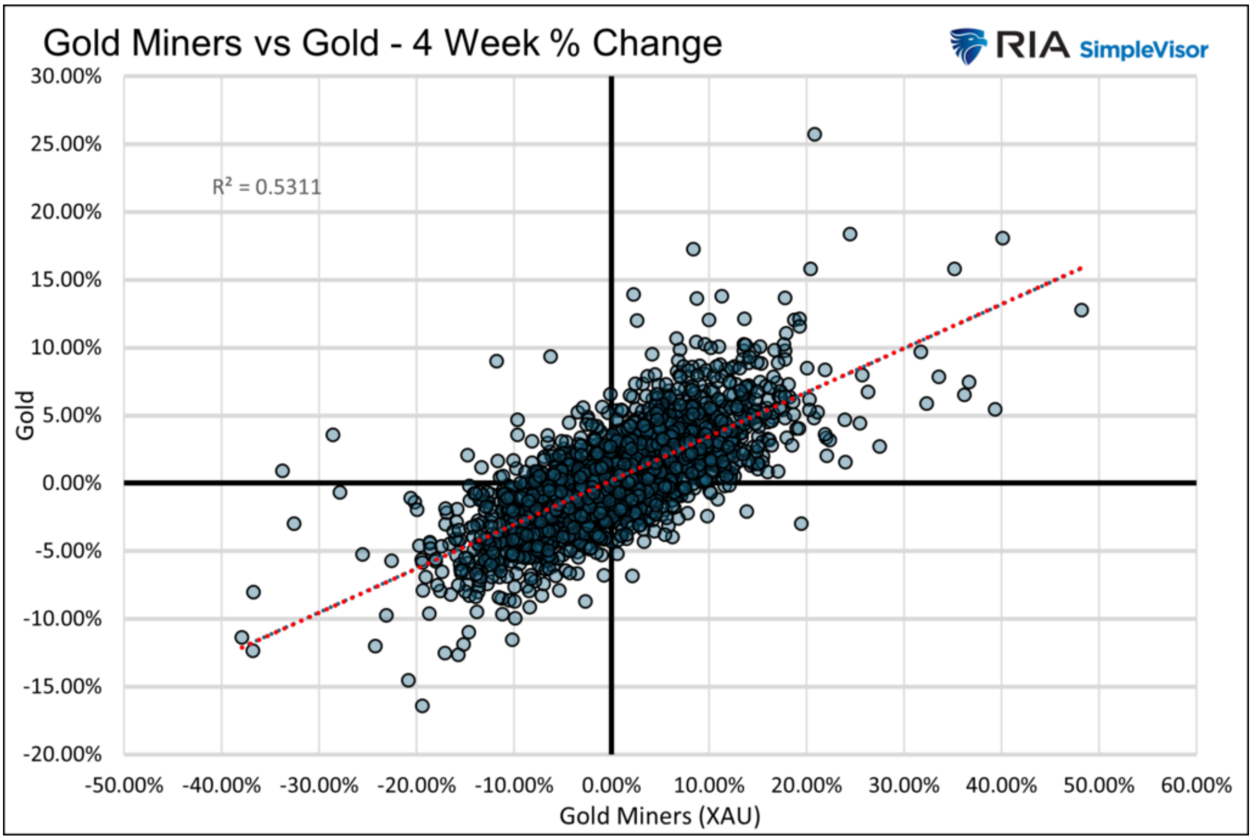
Investor Sentiment: The stock market?s perception of gold mining companies is influenced by global economic conditions, interest rates, and overall market sentiment, which do not always align perfectly with gold price movements.

Gold vs. Gold Miners ? Short Term

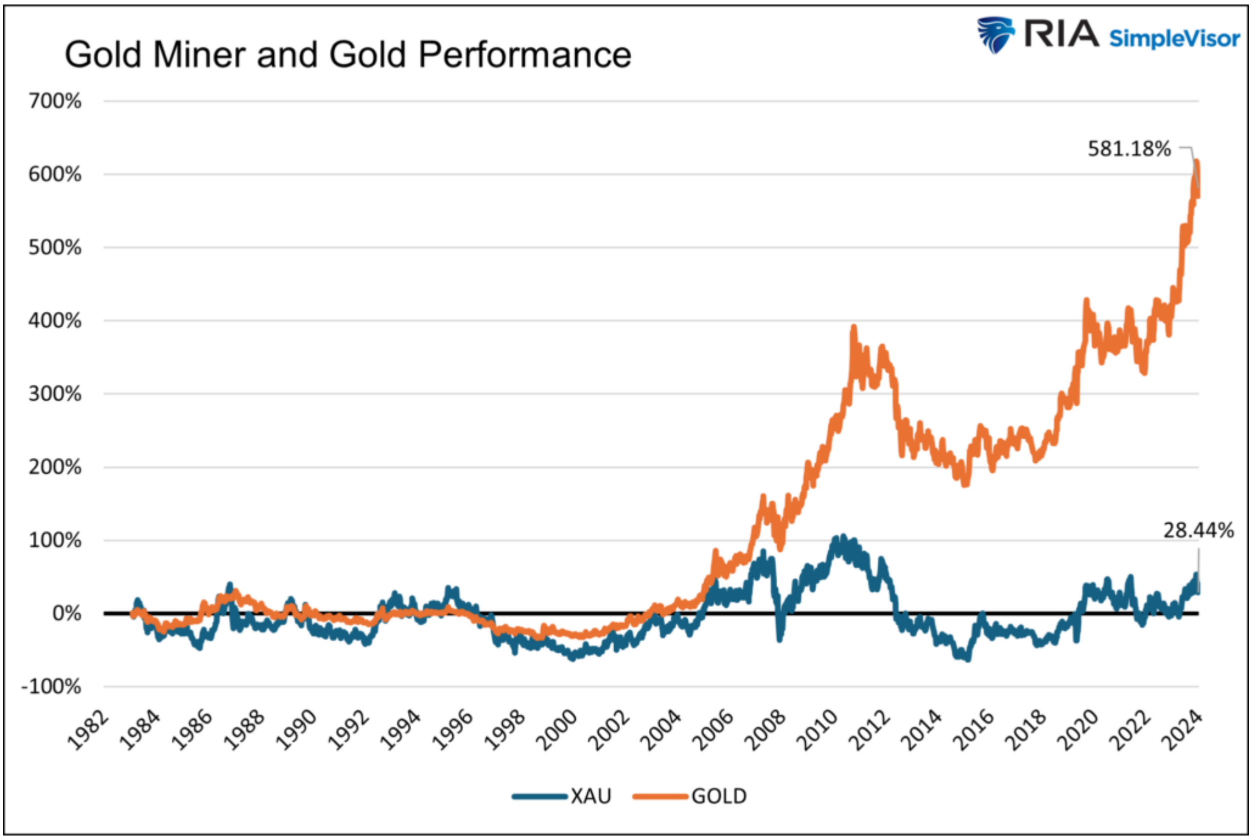
The graph below shows that gold miners have fallen appreciably over the last few weeks and are at MACD and RSI levels that are very oversold. Furthermore, miners (GDX) are resting on their 200-day moving average. Given how oversold they are and the critical support in the 200-day moving average, we suspect miners could experience a decent bounce from current levels. In 2023, a nice gain was earned on miners when similar technical levels were met. The gains were erased from the peak over the following year.

Gold Miners vs. Gold ? Long Term

The scatter plot below shows that the monthly change in Gold and Gold miners correlates well. The R-squared of .531 is statistically significant.



The following graph again shows that the correlation between the two is strong, but just because they tend to move in similar directions doesn?t mean that the longer-term performances of the two are similar. As shown, the price trends tend to mirror each other. However, Gold has been up 581% since 1982, while miners have been up a mere 28%.



Summary

If you like the fundamentals and technical situation of Gold, we suggest you stick with Gold. While the miners may benefit significantly from a continued rise in Gold, history is not on your side.

Disclosure

This report is not a recommendation to buy or sell the named securities. We intend to elicit ideas about stocks meeting specific criteria and investment themes. Please read our disclosures carefully and do your own research before investing.