Is it time to invest in Gold, or maybe just in Gold Miners?

written by Dean Bristow | September 9, 2021

It seems like nowadays when we start a conversation about investing in gold one has to also include commentary on Bitcoin. There's no doubt some investment funds that traditionally found safe haven in gold have drifted over to the much more volatile domain of cryptocurrencies. That's just part of the evolution of the market and, as an investor, one has to adapt. Nevertheless, I will argue that whatever the reason you have for putting a portion of your portfolio into gold or cryptocurrency, you definitely need to have a strong stomach to manage the day-to-day gyrations in Bitcoin, Ethereum, for example, and the like. Not that gold doesn't have its moments, like the weekend of August 6th when it essentially plummeted 7% over the weekend, but that was relatively short lived. Arguably gold has traded in a range from $1,700 to $1,950 for the last year. Bitcoin on the other hand has a one year range of roughly $10,000 to $63,000. I dare say a bit of a difference.

Now before you start complaining and telling me to go get my walker, because I'm a dinosaur and haven't kept up with the times, I need to point out that this isn't an article about the merits of gold versus crypto. This is solely an article about exploring the potential of investing in gold currently and that's it. The commentary on crypto is simply to highlight that gold may not be the "go-to" alternative investment it once was. Perhaps Bitcoin et al are attracting some of the same investment dollars meaning that maybe gold doesn't have the same upside it could have had in a different time…or maybe it does, we'll have to wait and see how that plays out.

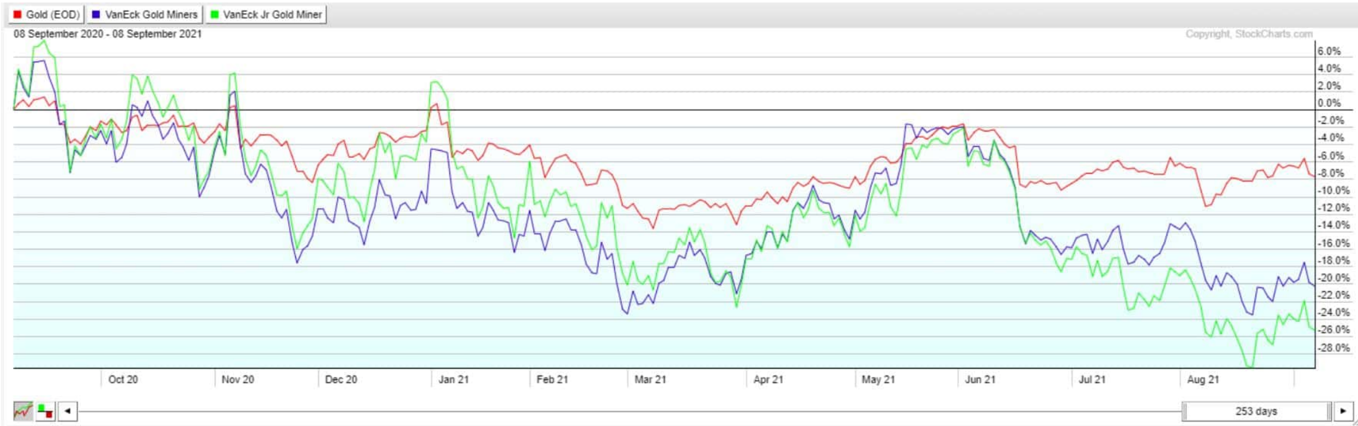
Another topic I’m not going to delve into is the merits of having gold in your portfolio as a safe haven investment or hedge against inflation or whatever. I’m not a gold bug. I’m just an investor. And as such it’s good to know things like: gold tends to have a negative correlation to the US Dollar; generally speaking, it usually doesn’t go down as much as equities in times of crisis or market meltdown (although that’s debatable in more recent times); and that as a finite resource it cannot be printed like a fiat currency. But ultimately, for something like gold, I’m simply looking at charts and momentum and the like because it’s tough to review the fundamentals of most of the above items that tend to affect the price of gold in order to come up with an investment thesis other than technical analysis. Gold miners on the other hand are a completely different story but we’ll get to that.

At present, I would suggest gold looks OK. Not outstanding, not screaming “buy me”, just OK. If we look at the 1-year chart below we see support levels at $1,770 and $1,675 with upside to potentially test $2,000. Depending on your risk tolerance you could buy it now, put in a stop loss around $1,750ish and have a decent risk-reward trade. On a bullish note, it recently broke above both the 50 day and the 200 day moving average, but is struggling to sustain those thresholds. So I’d give it another day or two to see how that plays out. If the price can rally back above $1,850 for a couple of days I would change my tune and say now we’re talking about something a lot better than just OK. In the meantime, it has piqued my interest as it appears to be a trade with more upside than downside.

Source: StockCharts.com

Having a strategy for the underlying commodity now allows us to look at the miners for additional opportunities. In my opinion, here is where things get interesting. The two charts below show the commodity price (red line) versus the gold miners (blue line) represented by the VanEck GDX ETF and the junior gold miners (green line) represented by the VanEck GDXJ ETF. Albeit, what the GDXJ ETF considers “junior” miners and what I consider junior miners may differ, you’ll still get the point.

The first chart is a one year comparison of the three in terms of relative performance, as in they all start at 0% return on day 1. The second chart shows what has happened since the start of June, when gold tested $1,900 but couldn’t decisively break above. As you can see both the miners and the junior miners have significantly underperformed the underlying price of gold over the last year, primarily in the last 3+ months.



Is this underperformance a result of the miners leading the gold price and should one anticipate gold to drop significantly? Or is it an opportunity to get long the miners right now because they have been unfairly punished relative to the price of gold?

What I do know is that almost all gold producers are making money hand over fist with gold over $1,750. One would think that as balance sheets get cleaned up with all that cash generation, as long as the sector as a whole doesn't revert back to old habits of overpaying for acquisitions when the coffers are full, we could start to see more share buybacks or dividends or a whole bunch of drilling to expand existing resources or define new ones. All of which should be quite bullish.

Ultimately an investor can play this however they like. I know I'm taking a lot closer look at the junior gold producers right now as I think there could be an opportunity there.