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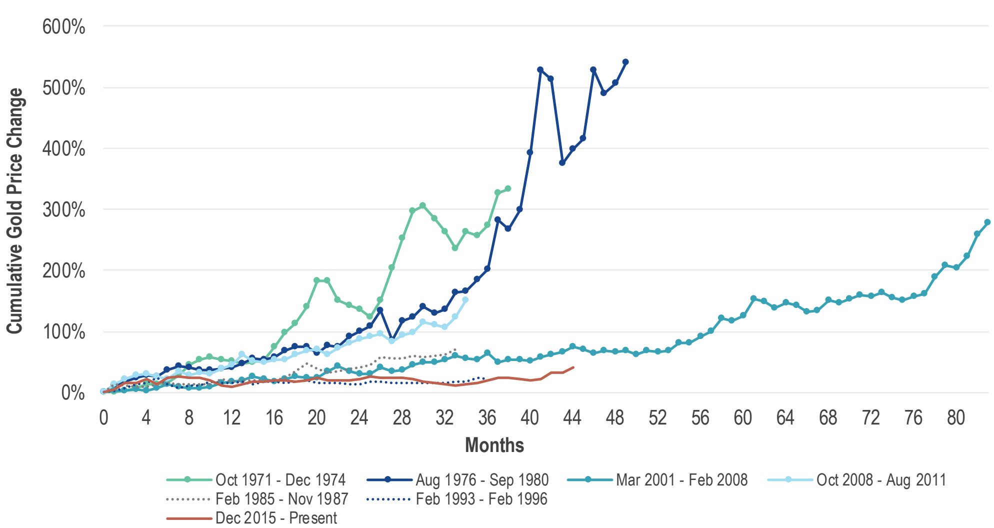
Gold Stocks vs. Bullion in a Gold Bull Market

By Joe Foster, Portfolio Manager/Strategist

Over the past few weeks, we have received questions about whether gold or gold stocks are the best way to access the current bull market so we thought it would be helpful to review how this bull market compares with those of the past.

Bull markets can be classified as either secular (long term) or cyclical (bull phases within an overall bear market). Before its $1,400 per ounce breakout in June, gold appeared to be tracking, on a technical basis, similar to its 36-month cyclical bull market from 1993 to 1996. However, its current $1,500 price level hints at a potentially longer, sustained rally—perhaps more similar to the secular gold bull market of 2001 to 2008.

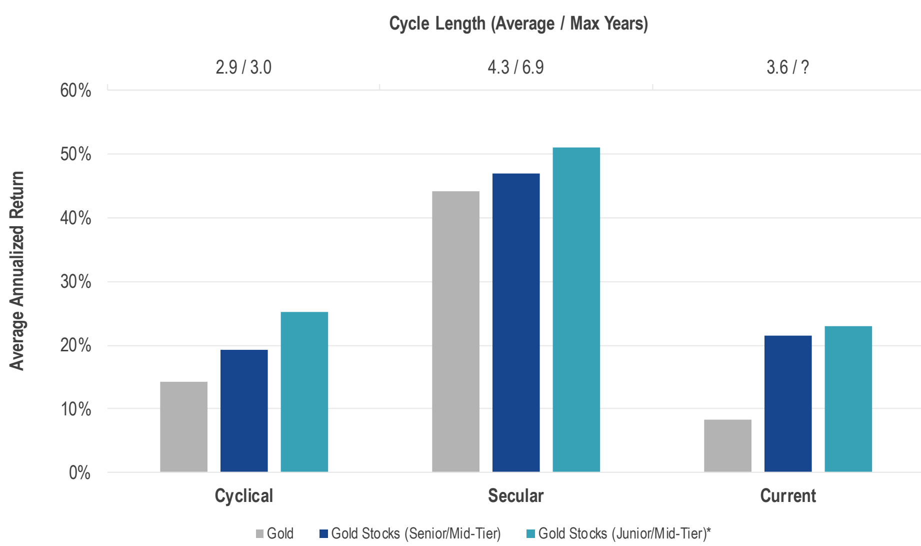
Historical Gold Bull Market Rallies Have Come in All Shapes and Sizes



Source: VanEck, Bloomberg. Data as of August 2019. "Gold" represented by Gold Spot ($/oz).
Past performance is not indicative of future results.

Gold stocks, on average, have historically outperformed gold during gold bull market cycles in the past—including through both cyclical and secular periods. This typically occurs because of their optionality to gold through earnings and resource leverage.

Gold Stocks Have Outperformed Gold in Past Bull Market Cycles[1]

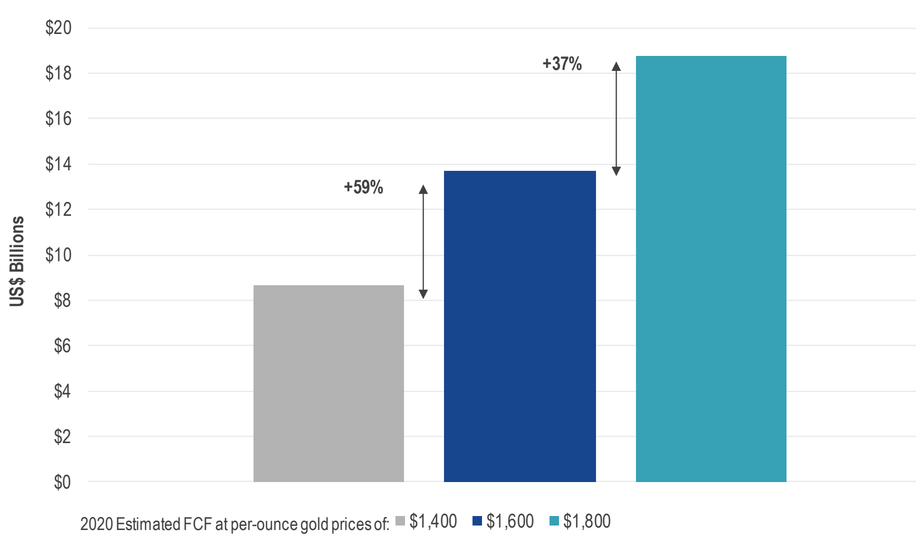


*Data first available beginning in February 1992.

Source: VanEck, Bloomberg, FactSet, Barron's. Data as of August 2019. Past performance is not indicative of future results.

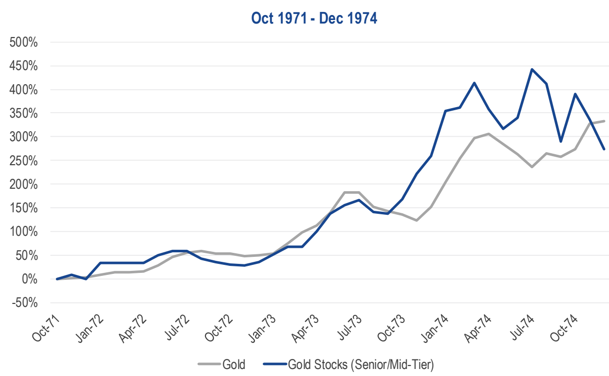
However, the greatest difference between the last bull market cycle (2008 to 2011) and the current cycle is the lengths to which these companies have gone to reduce costs and capital expenditures and to avoid mistakes of the past (such as "hedging" their production—i.e., buying futures contracts to ensure delivery of their gold at a fixed price at a later date in time—in a rising gold price environment). For senior or mid-tier miners, these efforts could translate to nearly 60% increases in free cash flow, on average, for a gold price move from $1,400 to $1,600. We believe that this makes a compelling case for gold stocks at the moment and, in particular, given their attractive valuation on both an absolute and relative basis.

Some Gold Senior and Mid-tier Miners Exhibit Favorable Leverage to Higher Gold Prices

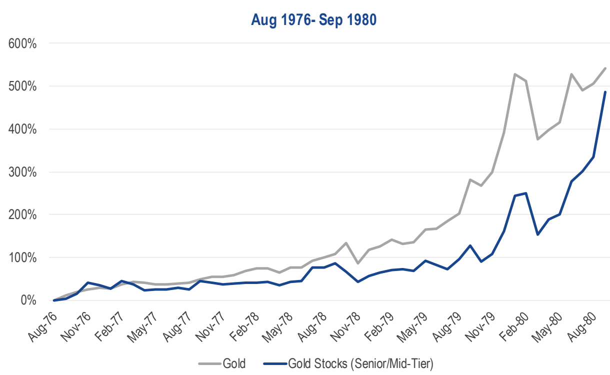


Source: VanEck, Bloomberg. Data as of August 2019. "Senior" miners defined by production levels of approximately 1.5-6.0 million ounces of gold per year ("Mid-Tier" approximately 0.3-1.5 million ounces per year).

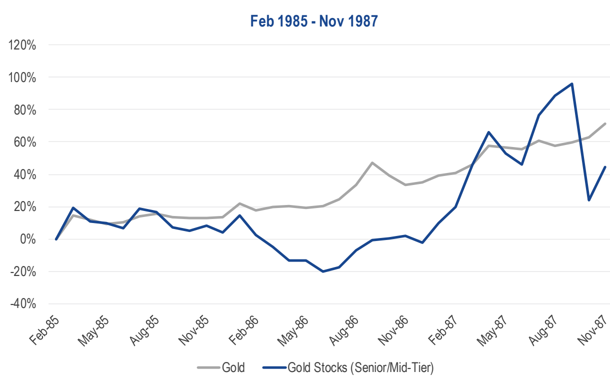
Appendix: Historical Gold Market Rallies Explained



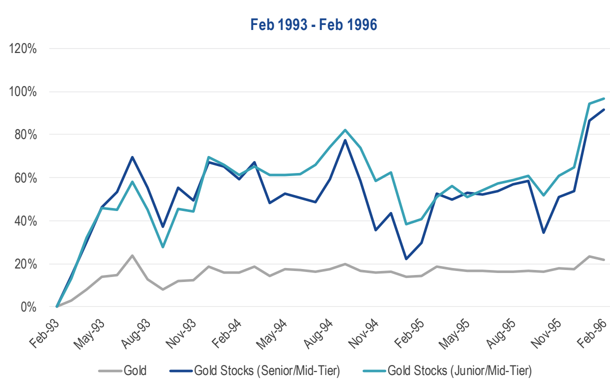
The 1970's secular gold bull market was predominately inflation-led. The U.S. Federal Reserve's (Fed's) loose monetary policies fostered inflation that they believed would encourage economic growth and gains in employment but, ultimately, just set the stage for rampant stagflation (slow growth, high unemployment and high inflation). (Note: first available date of Junior/Mid-Tier data is February 1992)



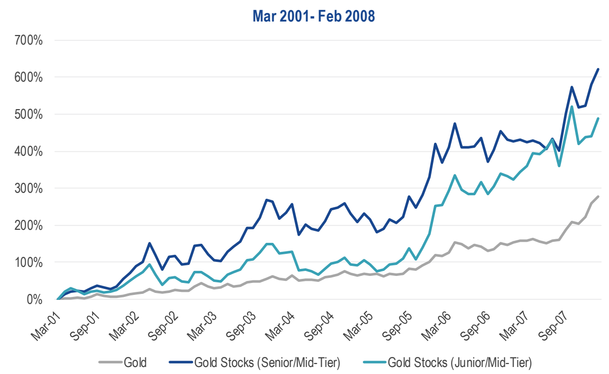
Following an 18-month hiatus in the gold bull market rally—when inflation retrenched and the U.S. dollar and markets rallied—inflation again trended higher and extended gold's gains into the early 1980's. Notably, the 1976 to 1980 bull market was among the few in which it was considerably better to own gold (vs. gold stocks) for a majority of the cycle.



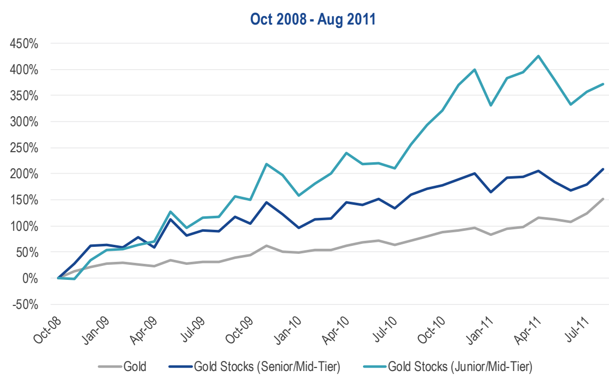
The short, cyclical gold bull market from 1985 to 1987 occurred in-line with excessive valuations in U.S. equity markets and looming signs of slowing economic growth. Gold stocks, despite benefiting from gold's two-year rally, were unable to avoid the eventual "Black Monday" sell-off that manifested itself in October 1987.



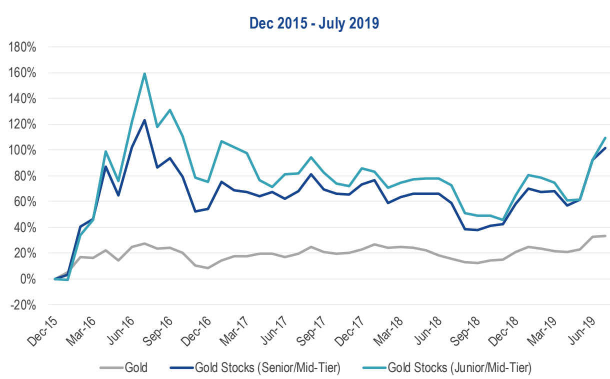
Gold experienced another cyclical breakout starting in 1993 when the U.S. Fed began to increase interest rates to slow an overheating U.S. economy. Unlike the majority of past rate hiking cycles (80% from 1950 to that point), the economy experienced a "soft landing"—ostensibly capping the rally. Gold stocks, on the other hand, continued their impressive move.



The 2000's secular gold bull market (including the period below) was fueled by a weak U.S. dollar. 2001 also marked the end of a long secular bear market for gold where negative sentiment towards miners reached extremes and companies were forced to operate "lean and mean" in order to maintain operating profitability.



In addition to a weaker U.S. dollar, fear of another potential market correction similar to that experienced in late 2008 pushed investors into gold and gold stocks as a safe haven investment. This period was one of the most dramatic periods of outperformance by junior and mid-tier miners.



Today's gold market is very similar to 2001 in many ways: gold is coming off one of its worst downturns in 2011 to 2015 (and three additional years of stagnant range-bound prices), sentiment towards miners has been near all-time lows, and companies are, once again, hyper-focused on lowering costs, strengthening balances sheets, and streamlining management.

Source: VanEck, Bloomberg. Data as of August 2019.

[1] "Cyclical" bull markets include: February 1985 to November 1987; and February 1993 to February 1996. "Secular" bull markets include: October 1971 to December 1974; August 1997 to September 1980; March 2001 to February 2008; and October 2008 to August 2011. "Current" bull market includes December 2015 through most-recent month-end (August 2019). "Gold" represented by Gold Spot ($/oz). "Gold Stocks (Senior/Mid-Tier)" represented by Barron's Gold Mining Index (BGMI) from October 1971 to inception date of the Philadelphia Gold and Silver Index (XAUTR) in January 1984 and XAU to the inception of the NYSE Arca Gold Miners Index (GDMNTR) in October 1993. "Gold Stocks (Junior/Mid-Tier)" represented by the world small-cap gold subgroup index of the Dow Jones Global Index (DJGI) from February 1992 to inception of the MVIS Global Junior Gold Mining Index (MVGDXJTR) in January 2004. "Senior" miners are defined by production levels of approximately 1.5-6.0 million ounces of gold per year ("Mid-Tier" miners approximately 0.3-1.5 million ounces per year; "Junior" miners approximately <0.3 million ounces per year). Indices are not securities in which an investment can be made. Index descriptions provided in disclosures below.

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