

Can Market Volatility Push Gold Miners Higher?

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As geopolitics rattles markets, has gold regained its haven status? Gold miners, well known as a leveraged play on gold, have benefited after a lackluster performance last year. The [WisdomTree Efficient Gold Plus Gold Miners Strategy Fund \(GDMN\)](#) has gained almost 10% year-to-date on a NAV basis (through February 23)¹ as broader equity markets tumble—and we think conditions are prime for more gains ahead.

The three key factors that may drive gold miners' performance in 2022 are (1) leverage to the price of gold, (2) rising dividend yields and (3) attractive valuations within equity markets.

Gold Miners' Performance Fails to Catch Up with Rising Profitability

The golden era from 2001 to 2011 rewarded gold miners for aggressive growth over cash flow generation, eroding their value over the long run as they were funded by record amounts of debt.

Since the peak attained in the middle of 2012, the gold mining industry conducted a big cost-cutting exercise by slashing capital expenditure ("capex"), selling off non-core assets to raise US\$33 billion and shedding nearly 200,000 jobs to boost productivity growth.²

This trend began to reverse in 2018 as exploration activity rose, thereby supporting margins and providing gold miners with some flexibility to further increase exploration spending.

Yet the higher profitability witnessed among gold miners failed to lend a tailwind to gold miners' performance. We believe this can be partly explained by the upward cost pressures faced by the industry, which contributed to negative price sentiment.

Figure 1: Higher Capex Moves in Lockstep with Profit Margins



Sources: Bloomberg, WisdomTree, as of 1/31/22. Please note that Capital Expenditure and Profit Margins are represented by the market cap-weighted basket of the constituents of the NYSE ARCA Gold Miners Index. You cannot invest directly in an index. YoY=year over year.

Upward Costs Pressure Pales against Higher Gold Prices

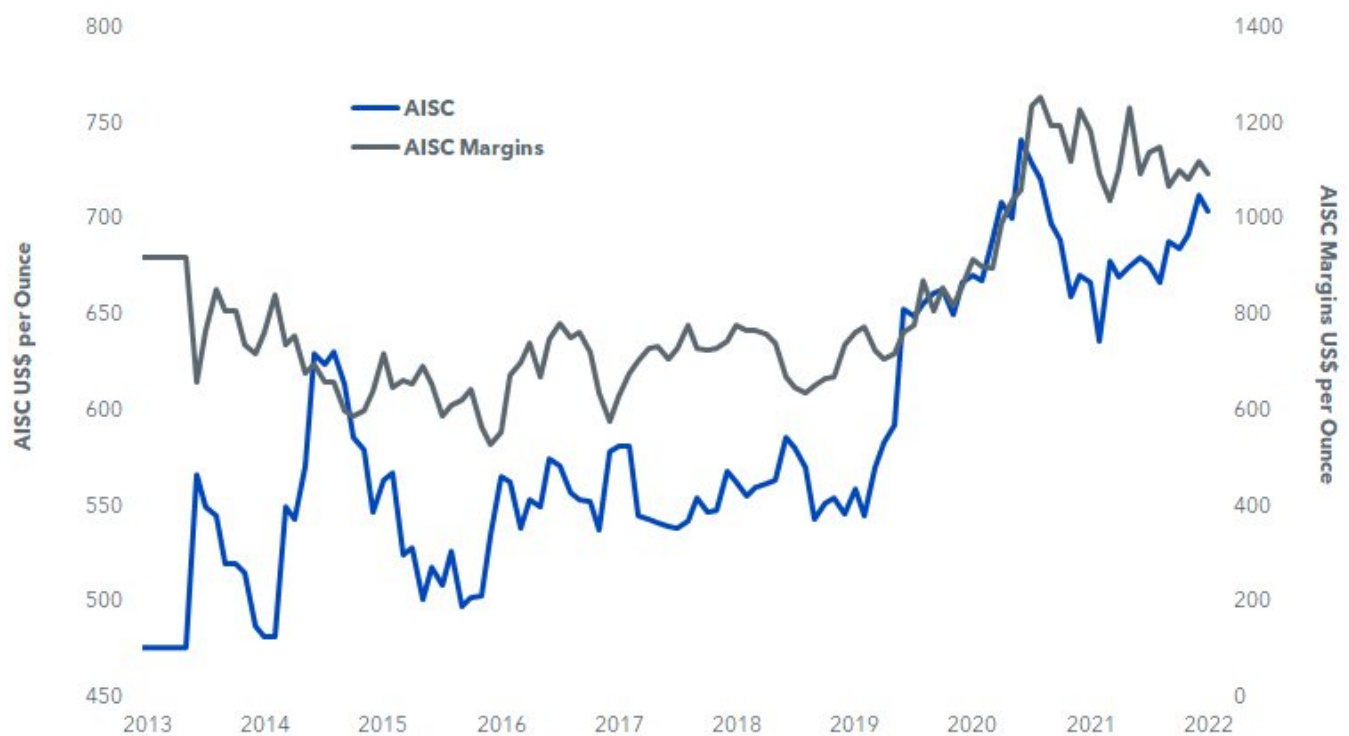
Over the course of 2021, total cash costs were impacted by rising inflation across several inputs. Labor shortages, turnover and changing shift patterns due to COVID-19 restrictions and infections led to rising wages for workers.

The World Gold Council (WGC) established a new cost disclosure framework in 2013 by introducing “all-in sustaining cost” (AISC) as an extension to cash costs. AISC focuses on all costs incurred in sustaining production for the complete mining lifecycle, from exploration to closure.

In 2020, gold miners’ AISC rose to its highest level since 2013. Pandemic disruptions put upward pressure on unit costs, mainly during the ramp-down and ramp-up phases around the closure periods when mines were unable to operate at full capacity.

As AISC rose at a faster pace than gold prices in 2021, gold miners’ price performance was negatively impacted. Gold miners’ performance does not appear to reflect just how strong AISC margins are currently.

Figure 2: All-in Sustaining Cost (AISC) Rose to Its Highest Level since 2013



Sources: Bloomberg, WisdomTree, as of 1/31/22. Please note that the chart represents a market cap-weighted basket of the constituents of the NYSE ARCA Gold Miners Index. You cannot invest directly in an index.

Attractive Valuations Favor Gold Miners

Key valuation metrics such as price-to-book (P/B) at 1.23 for gold miners reveal they are trading at a 21% discount to the long-term average.

Gold miners' profit margins remain healthy, and companies are generating significant free cash flow. The current free cash flow yield on the NYSE ARCA Gold Miners Index is 4.3%. In the current rising rate environment, dividend yields for gold miners have risen to 2.17% in January 2022 from 0.96% during the pandemic in 2020.

Evidently, despite rising costs, miners' profit margins have expanded, thereby increasing cash flow. Mining companies are clearly using the recent strength in earnings growth to compensate investors in a higher inflationary environment.

Figure 3: Gold Miners Offer an Attractive Dividend Yield amid a Rising Rate Environment



Sources: Bloomberg, WisdomTree, as of 1/31/22. Past performance is not indicative of future results. You cannot invest directly in an index. S&P 500 Index: Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor's Index Committee designed to represent the performance of the leading industries in the United States economy.

Conclusion

The market has been too fixated on rising costs for the gold mining sector, causing it to ignore the more important attributes such as higher capex expenditure, stable profitability, rising free cash flows and attractive dividends.

As markets are caught in the crosshairs of rising geopolitical tensions, gold's haven status is likely to be reignited, which could benefit gold miners.

1 Actual YTD NAV Return = 9.63% (as of 2/23)

2 Source: Metals Focus

Important Risks Related to this Article

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