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Gold miners miss the point

Gold miners need a more finely honed message if they are to become mainstream equity investments.

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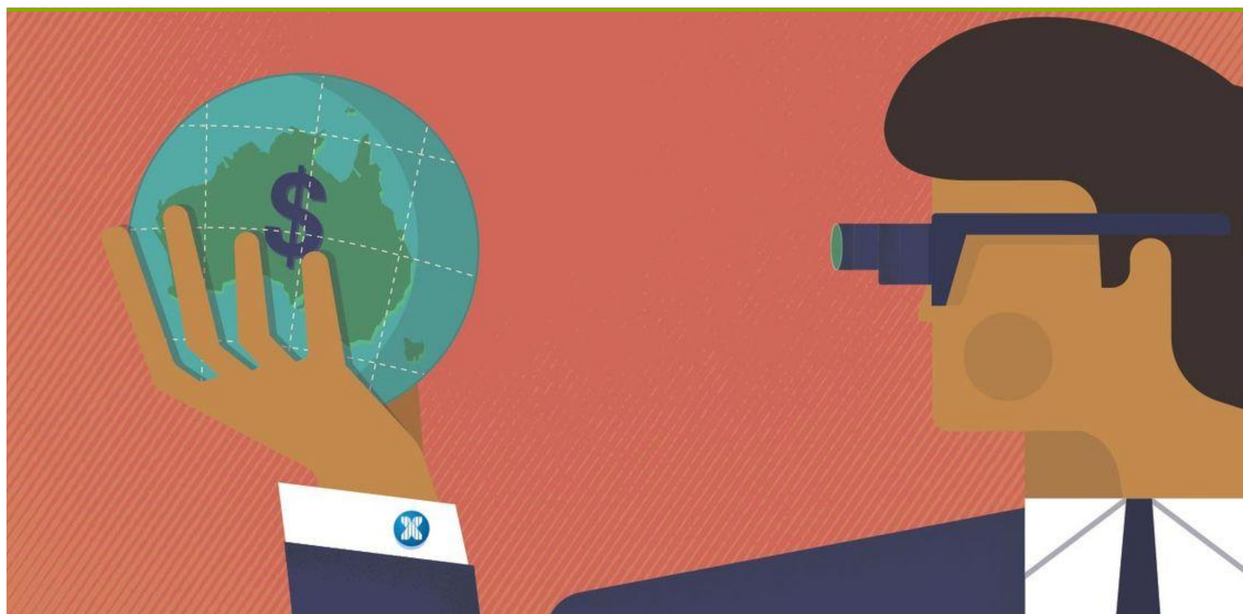

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Last week's 'From the Capital' column recounted efforts by Tom Palmer, the head of leading gold miner Newmont Corporation, to broaden the company's investment base. A critical element in Palmer's plan was the message that Newmont "has a steady production profile for decades to come".

Investors will refuse to capitalise near-term earnings in setting the price of Newmont, or any other company, if they are sceptical about the durability of financial outcomes.

Politicians, their advisers and marketers, more generally, always extol the virtues of a simple but meaningful message to lure and motivate followers. Boris Johnson proved the efficacy of the three-word slogan in winning the recent British elections with his 'Get Brexit Done' catchcry.

Similarly, the big moves in investment markets are often underpinned by catchphrases or slogans around which herds can congregate to create momentum.

Snowballing themes signify scope for sustained sectoral price moves. A steepening yield curve can underpin bank profitability. Rising long-term bond yields have been a simplified argument for buying US financial services stocks.

The ability of social media platforms to capture advertising is the theme driving decisions to buy stocks like Twitter, Facebook, Snap, Instagram and Pinterest. Cord cutting is the catchphrase for the willingness of consumers to support streaming services like Netflix and Disney+ in preference to traditional sources of movie and broadcast entertainment.

Transport electrification and autonomous driving are themes helping to capture investors for companies like Tesla, Uber and Alphabet.

The disruptive effects of Amazon and a plethora of more highly specialised digital sales portals is the theme behind many billions in market value and a valuation collapse for historically high-profile stocks in the retailing space.

> **Neither Palmer nor Bristow were able to replicate the abilities of Apple to increase iPhone sales**

Sector-wide share price moves typically require promotion of easy to communicate themes to build momentum, no matter how complex the underlying analysis. Nowhere is this more evident than in the biotechnology sphere where a cure for cancer is a compelling proposition.

In mining, the most obvious similar example has been the commodity super cycle but, at various times in the past few years, synchronised global growth, the reflation trade and, more narrowly, shortages of battery storage metals have been catalysts for fund shifts.

In Palmer's CNBC interview to which I referred in last week's column, the Newmont chief was asked about his outlook for the gold price to which his profitability is anchored. He deftly skirted a forecast by giving three reasons, in response, for why gold prices had risen in the last year or so.

Palmer first cited a slowing down in mine supply as underpinning higher gold prices. Then came growth in Chinese and Indian middle classes. The third reason Palmer gave was that gold-backed exchange-traded funds (ETFs) had started to grow. Together, Palmer said, these factors gave him confidence that "gold could stay at pretty healthy levels".

Palmer's remarks emphasised physical balances as a primary determinant of prices. Putting aside whether this is an analytically valid representation of price formation in the gold market, a generalist investor will find inconsistencies among those supposedly on the same side of the messaging. The World Gold Council itself said in the past week that "gold demand fell 1% in 2019 as a huge rise in investment flows into ETFs and similar products was matched by the price-driven slump in consumer demand".

In trying to duck a forthright view about the future direction of gold prices, some of what Palmer said was also analytically contentious.

Retail demand does not drive prices. High gold prices have usually deterred consumer demand. Higher demand has come when prices are low. Moreover, in a supply constrained industry, large increases in gold use by ETFs and central banks, often portrayed as indicators of gold market strength, must be countered by lowered holdings elsewhere.

Chinese and Indian nationals no doubt have a cultural connection with gold. But the development case for both countries relies on a recasting of cultural proclivities to raise living standards. The digitisation of interactions between its citizens and the Indian government, their widening access to banking and a rundown in Chinese savings driven by demographic shifts are powerful modifying factors.

The trajectory of the gold price since 1980, including the fall after 2011, coincides with trends in China's national savings. The question for Palmer is whether the number of people or the size of their savings pool is the more important price influencer. The two are now moving in opposite directions.

Palmer's adversary at Barrick Gold, Mark Bristow, has adopted a different tone in talking about the gold market. In a CNBC interview earlier in the year, Bristow's top-three reasons for a higher gold price were US politics, the unsustainable growth in the US economy and Europe, and Brexit.

Exactly how those three influences would work their way through the gold market was unclear from what he said. Bristow's appeal to fear contrasted with Palmer's more positive perspective.

Bristow's concluding thought that "gold is a measure of the complexities or normalities of the world" was hardly the compelling slogan the industry needs to sell itself to investors.

Neither Palmer nor Bristow were able to replicate the abilities of Apple to increase iPhone sales, Netflix to attract higher subscriber numbers or Tesla to ramp up production every year in the coming decade to validate sharply climbing market values.

Palmer's version of gold market fundamentals is wishy washy in comparison. Bristow's remarks about gold may have been barely comprehensible but he was clear that the two leaders in the industry are achieving poorer financial outcomes and producing less value for their shareholders than they could.

Given global platforms, two of the most prominent spokesmen for the industry have advanced half-a-dozen reasons for a higher gold price, none of which have sounded especially convincing or easily encapsulated into a market-moving slogan.

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