Gold Stocks: What to Expect in the New Year

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After three years of pain, can gold stocks break their losing streak and see a gain in 2014?

History says chances are good.

The most recent string of losses in the gold mining industry has been brutal, causing many investors to give up on the sector and sell their holdings. Since the beginning of 2011, the NYSE Arca Gold Miners, the FTSE Gold Mines, and the Philadelphia Gold & Silver Indices all declined more than 60 percent.

But ditching this sector may not be the best action to take this year because miners are approaching the historical limits of multi-year declines.

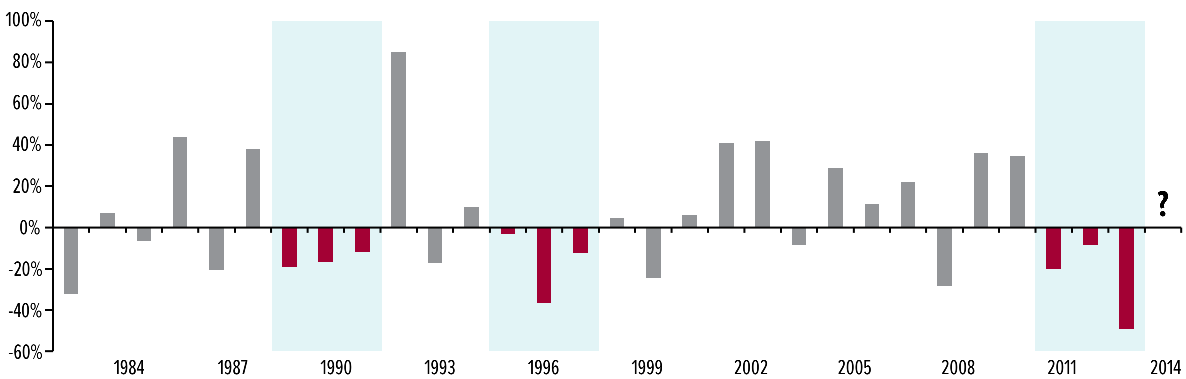
Take a look at the Philadelphia Gold & Silver Index (XAU) during prior periods of stress. While gold stocks have a history of higher volatility compared to the overall U.S. market, consecutive periods of declines are rare. In 30 years, the XAU never had a losing streak of more than three years.

In fact, there were only two previous times in these three decades in which the XAU saw a trio of losses.

One was back in the early 1990s, when the index fell 19.09 percent, 16.75 percent and 11.75 percent in 1990, 1991 and 1992, respectively.

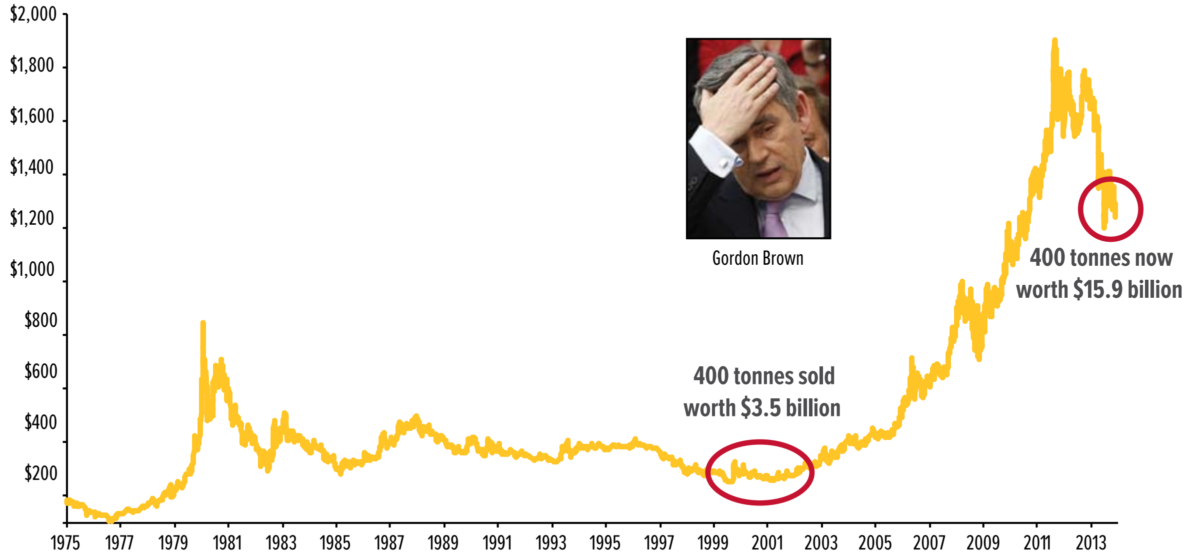
What's striking about this period is the incredible rebound that followed. The XAU rallied 85 percent in 1993. U.S. Global Investors' Gold and Precious Metals Fund (USERX) climbed even more, increasing a whopping 124 percent in 1993. **See recent performance of USERX.**

In 30 Years, the XAU Never Experienced a Losing Streak of More Than 3 Years
Philadelphia Gold & Silver Index Annual Returns



Source: Bloomberg, U.S. Global Investors

Gordon Brown vs. Gold
Spot Gold Price



Source: Bloomberg, U.S. Global Investors

Could we see a repeat performance?

Perhaps. A key is watching government policies, as they can be a precursor to change.

Let's take a look at the other period of weakness. This three-year loss occurred in the late '90s, with a muted rebound in 1999. However, at that time, the Bank of England (BOE) was auctioning off a significant amount of its gold reserves when bullion prices were at their lowest in 20 years. From 1999 to 2002, the central bank in England sold off 400 tonnes at a value of about $3.5 billion.

If the BOE had held onto this gold, it'd be worth nearly $15.9 billion today.

Following the period when the BOE sold its gold, the XAU rebounded. While the index gained only about 6 percent in 2001, gold stocks rose 41 percent in 2002 and about 42 percent in 2003.

During this period, gold and gold stocks were again influenced by a change in government policy. In this case, the liberalization of gold purchases was occurring in China, which was positive for gold.

So what about 2014?

What catalysts could turn gold stocks around and end the losing streak? Investors have multiple possible events to choose from that could cause gold and gold companies to rally. In a recent Mineweb article, **Lawrie Williams listed several:**

- **Gold ETF sales have slowed. See our chart** that shows how gold ETF redemptions ceased to be the main driver of falling prices.
- **The COMEX warehouse is "running out of available physical gold,"** which is causing more traders to demand delivery of additional gold, says Lawrie.
- **China may continue to build its gold reserves.** Lawrie speculates that China could have its first gold conference backed by "a slew of government organisations."
- **India could ease its gold import restrictions.** Last week in the **Investor Alert**, we highlighted the commerce ministry's request to ease restrictions, which would relieve jewelers hurt by import curbs.
- **Unrest in the Middle East likely could persist.**
- **There may be a "major hiccup" in U.S. growth.** Read U.S. Global's **special report**, which takes a closer look at how to evaluate unemployment and inflation numbers.
- **Newly mined gold supply may be underwhelming.**

Lawrie mentions a few downsides as well, which would result in an unprecedented fourth year of declines for gold stocks. For example, as the Federal Reserve cuts back on bond purchases, it could come "without adverse general stock market reaction." In addition, there may continue to be improvements in the unemployment situation in the U.S. and Europe.

Ralph Aldis, portfolio manager of U.S. Global's **gold funds**, the Gold and Precious Metals Fund (USERX) and the World Precious Minerals Fund (UNWPX), believes the best time to buy gold is when the market hates it. He recently talked with *The Gold Report* about gold, junior explorers and what investors should expect in the new year. When asked his thoughts about gold's direction in 2014, Ralph remarked:

> ***"I think pessimism has reached a maximum, particularly in the gold space. Historically, when pessimistic consensus is this strong and gold stocks are hated this much, these are turning points.***
>
> ***"The opportunity is here; don't get discouraged."***

Read the interview here.

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The NYSE Arca Gold Miners Index is a modified market capitalization weighted index comprised of publicly traded companies involved primarily in the mining for gold and silver. The index benchmark value was 500.0 at the close of trading on December 20, 2002. The FTSE Gold Mines Index Series encompasses all gold mining companies that have a sustainable and attributable gold production of at least 300,000 ounces a year, and that derive 75% or more of their revenue from mined gold. The Philadelphia Stock Exchange Gold and Silver Index (XAU) is a capitalization-weighted index that includes the leading companies involved in the mining of gold and silver. 14-004