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Investors won't be able to ignore gold miners in 2021 - Sprott's John Hathaway

Kitco News has launched its 2021 Outlook, which offers the most comprehensive coverage of precious metals markets in the new year. Trillions of dollars were pumped into financial markets in 2020 and that won't come without consequences. Economists expect that investors will be Bracing For Inflation in 2021.

(Kitco News) - Gold is starting the new year on a strong note, with further political turmoil in the U.S. pushing prices well above $1,900 an ounce.

Not only is the gold market shining bright in the new year, with growing expectations that it is only a matter of time before prices push past their all-time highs above $2,000 an ounce, but one fund manager says that he expects mining equities to attract a lot of new investor interest.

In a recent interview with Kitco News, John Hathaway, senior portfolio manager of the Sprott Gold Equity Fund, said that with significantly improved margins, rising gold prices, and healthy production, investors can't ignore the value currently being generated in the mining sector for much longer.

"I have been doing this for more than 20 years, and I have never seen mining stocks as cheap as they are," he said.

Quoting research from Sprott, Hathaway noted that gold is significantly undervalued compared to the S&P 500. Analysts at the investment firm pointed out that The S&P 500 Index trades at 16.3x EV/EBITDA while gold miners trade at 7.6x EV/EBITDA, representing a 50% discount.

"Just looking objectively at equity markets, there is a huge tilt in favor for mining stocks from a value perspective, and I think that is going to attract a lot of attention," he said.

While the mining sector could be on the cusp of a new leg in its long-term bull rally, Hathaway said that the industry still needs to address the genuine issues that kept capital away for so many years.

Hathaway explained that many investors are waiting to see if mining companies have learned their lessons from the last bull market. Although gold prices rallied to record highs in 2011, mining companies reported terrible margins as they overleveraged their balance sheets.

However, he added that it appears that companies have learned their lessons as they increase their dividends and give back money to shareholders.

Hathaway also said that some investors are worried that gold prices could be nearing a top around $2,000 an ounce. However, he said that he thinks this is only the start of a larger bull market in the precious metal.

"Looking at the macro picture, gold looks well supported as interest rates can't go higher," he said. "If interest rates go higher, that would cripple stock valuations. I just can't see how interest rates can go higher without wreaking havoc on the global economy."

Another factor that is holding the mining sector back is its size compared to the overall market. Many analysts have noted that the entire market cap of the mining sector is less than the market cap of Apple.

"I think for most people, the mining sector is just a sideshow," he said. "Investors aren't interested in mining because they are very comfortable with their existing kind of mainstream strategies."

However, Hathaway said that as general equities push further and further into bubble territory, investors will be forced to look for value in other sectors. He added that gold equities will look attractive when mainstream strategies start to fall apart.

One trend Hathaway said that he would be watching in 2021 is the need for the mining sector to generate liquidity to attract bigger investors. He noted that the raw commodity is attracting a lot of capital right now because it is so liquid.

To generate more liquidity, mining companies have to grow, which means more mergers and acquisitions. In this environment, Hathaway said that he sees more potential in the smaller to mid-tier producers.

"If Barrick Gold were to buy a company, it probably wouldn't have much impact on its production guidance," he said, so for smaller companies, it is much easier to move the needle and generate value with M&A."

Ultimately, it's the price of gold that will eventually bring investors to the mining sector, Hathaway said, reiterating his stance that gold is in a new long-term bull market. He said that the next phase of the bull market would come from more significant institutional funds, sovereign wealth funds, and pension funds. He pointed out that this market is valued at $100 trillion globally.

"If just 1% of that capital flows into gold, you are looking at value representing five-year of current mine production," he said. "Forget about, COVID, forget about inflation. Just assume that you would need to get to $2,500 to $5,000 an ounce just to clear the market in a normal environment. I believe that that's the world we're in and it's very, very favorable for gold. And if it's favorable for gold, it's good for the mining stocks."

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Definitions: The S&P 500 Index is an index of stocks issued by the 500 largest U.S. companies. You cannot invest directly in an index. The EV/EBITDA ratio is a popular metric used as a valuation tool to compare the value of a company, debt included, to the company's cash earnings less non-cash expenses.

Important Disclosure

John Hathaway is Senior Portfolio Manager of Sprott Gold Equity Fund (SGDLX). In this article, he mentions gold mining company Barrick Gold. As of 12/31/2020, Barrick Gold represented 2.64% of the total net assets of Sprott Gold Equity Fund (SGDLX). Portfolio holdings are subject to change and should not be considered a recommendation to buy or sell individual securities.

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