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HD **Gold Stock Picks In A Low Price World**

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- Rising USD a headwind - Copper exposure provides offset - AUD gold supports local production

By Greg Peel

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Year to date the gold price is down around 6%, while ASX-listed gold stocks have suffered a collective fall of around 8%. The capital weighting of gold mining stocks in the ASX200 has fallen to a decade low 0.7%, notes Morgan Stanley, down from 3.8% in mid-2011.

Institutional investors can thus apply more discretion in their gold exposures, the broker suggests, given they aren't forced by cap-weighting to hold a particular stock or stocks. Absolute returns are possible but difficult to identify, with only four of 26 listed gold miners assessed by Morgan Stanley providing a positive return in the past six months.

The broker retains a subdued outlook on the US dollar gold price given a strengthening US dollar, rising US interest rates and a muted US inflation outlook, all of which act as headwinds. In 2014, geopolitical tensions and speculation over the timing of the Fed's first rate rise have added to volatility. Morgan Stanley thus warns equity selection is critical.

Per ounce total cash costs for the aforementioned 26 miners have increased around 6% in US dollar terms since the 2012 gold price peak, while production is up 9%, implying around a 16% rise in absolute operating costs, Morgan Stanley notes. The trend of "cost-outs" among miners has focused on reducing cash outflows through decreased new mine development and reduced exploration spend.

Morgan Stanley's analysts cover seven of those 26 stocks. Of the seven, only Alacer Gold ((AQG)) attracts an Overweight rating. On Equal-weight are Regis Resources ((RRL)), Medusa Mining ((MML)) and Evolution Mining ((EVN)), while Newcrest Mining ((NCM)), Perseus Mining ((PRU)) and Resolute Mining ((RSG)) all attract Underweight.

The analysts at Morgans disagree with Morgan Stanley on Newcrest and Perseus. They have run a sensitivity study to assess the impact on goldminers under coverage were the gold price to fall to US$1000/oz. Such a price would result in significant reductions in valuation, and certain assets would cease production or development. But if cost savings of 10% can be found, Morgans finds "it's not necessarily the end of the world".

There are two elements which separate those gold stocks Morgans likes in the space at present and those it doesn't. They are judicious price hedges in place, and copper exposure.

Perseus comes up trumps on the first factor, boasting a hedge book which provides a buffer to cost savings achievement as well as being debt free. Yet were the gold price to linger too long around US$1000/oz, Perseus would be forced to review production at Edikan and put the Sissingue development on hold, Morgans suggests.

Newcrest is a winner on the second factor given the copper exposure offered by the company's long-life (30 years), low-cost Cadia Valley operation. Copper revenues provide Newcrest with the opportunity to continue servicing debt were the gold price to fall, albeit the rest of Newcrest's portfolio would struggle, with Lihir particularly exposed.

OceanaGold ((OGC)) ticks both boxes, boasting both a low-cost, copper-exposed flagship operation at Didipio and hedges in place over much of the remaining mine life of its New Zealand operations. Oceana is also lightly geared and thus in a position to potentially exploit opportunities in a low gold price environment.

Morgans maintains Add ratings on all of Oceana, Newcrest and Perseus.

Macquarie's preference is for Australian-domiciled gold production. Gold in Australian dollar terms suffered its first meaningful decline in some time in October, falling $100 to a low in early November of $1130/oz, but it has since recovered back to $1385, putting it back in its $1350-1450 trading range, the broker notes.

Macquarie's commodity team retains a longer term positive outlook for gold, notwithstanding the potential for price volatility in the nearer term. Last Friday's easing actions from the central banks of China (rate cut) and the eurozone (asset purchases) provided a boost for the gold price given implications for renminbi and euro devaluation, however the coincident stronger US dollar acted as a counterweight in US dollar price terms. China's appetite for gold is nonetheless robust, with recent trade data suggesting exports to China and Hong Kong have been the strongest in months, Macquarie notes.

The broker is forecasting a long term gold price (2019+) of US$1500/oz, with incremental appreciation to US$1331/oz in 2015 and US$1390/oz in 2016.

The recovering Aussie dollar gold price nevertheless drives Macquarie's local gold stock preferences, in particular those stocks offering strong operational exposure to assets with a predominantly Aussie dollar cost base which are generating strong cash flow at current prices. Falling into this category are Regis Resources, Northern Star Resources ((NST)), Saracen Mineral Holdings ((SAR)) and Evolution Mining.

Macquarie also anticipates more M&A activity in the gold space before the year is out.

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