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HD **Gold and Gold Stocks in 2014**

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- Gold price seen as stabilising - Physical demand not to be ignored - Rationalisation and consolidation amongst miners - Brokers discuss stock preferences

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The weakness experienced by the gold price in 2013 came to a head late in December when the US Federal Reserve finally announced it would begin to taper its QE program. While gold hit technical support at US$1180/oz on the news, support held. There followed a bit of "sell the rumour, buy the fact" as the gold price recovered somewhat before the weak US December jobs report prompted some renewed buying interest. As such gold today is sitting back around the 1250 mark.

There is not a great deal of agreement among gold analysts as to what happens next. Yesterday Macquarie lowered its average gold price forecast for 2014 by 6% to 1215. A year ago Macquarie set 1250 as its forecast long term floor price and still believes such a level is more realistic than the giddy heights of prices seen in 2010-12. Impacting 2014, aside from monetary considerations, are current restrictions placed on domestic gold purchases by the Indian government, the purpose of which are to protect the rupee. Macquarie believes these restrictions will ultimately be eased, but not until the June or September quarter.

RBC Capital Markets also believes Indian restrictions will be eased some time in 2014, and furthermore expects increasing global inflationary pressures to support gold in the second half. RBC has thus set an average 2014 price forecast of 1300.

China took over India last year as the world's largest consumer of gold. While the Indian restrictions were one driving factor, RBC notes the fundamental driver was the growth of Chinese bar and jewellery demand. To focus on investor sentiment towards gold vis a vis monetary considerations alone is to overlook a more secular and positive trend for the metal, suggests RBC -- that of the emergence of China as the largest consumer of the metal.

Investor sentiment was best illustrated in 2013 by the solid and persistent fall in gold exchange-traded fund (ETF) holdings. Net holdings fell to 56.6moz at the beginning of 2014 from 84.6moz at the beginning of 2013. RBC believes, nevertheless, that 2014 will see a bottoming out of ETF withdrawals to establish a more normalised post-QE level.

Combine easing ETF pressure and growing Asian physical demand and 2014 should be more supportive for gold prices, RBC argues. The biggest threat will become Asian currency weakness, driven by a rising US dollar and a repatriation of risk capital back to a recovering US investment market, which would undermine Asia's capacity to afford the gold it might otherwise wish to purchase. Here the Indian rupee is the greatest risk, given the Chinese renminbi is controlled on a managed exchange rate, although the Indonesian rupiah, Thai baht and Turkish lira are also currencies to watch, RBC suggests.

The other side of the equation for global gold producers is that of costs. If the gold price remains around current levels there will be flow-through downward pressure on gold input costs, RBC suggests, including energy and labour. Add in gold companies' own cost-cutting drives and producer margins should at least be able to stabilise in 2014.

UBS notes gold producers have responded to the depressed gold price environment by instituting firm-wide cost savings programs focused on efficiency and leaner operations. Australian producers have further benefited recently from stronger gold sales and a lower Aussie dollar. UBS expects this trend to continue in 2014, resulting in lower net cash costs for producers.

Not only was 2013 a significant net down-year for the gold price, it was a year of significant price volatility. The trend was down, but sharp daily and weekly moves in either direction were experienced as flighty traders responded to a constant flip-flopping of Fed policy assumptions. Goldman Sachs sees greater stability in global gold producer share prices in 2014 flowing from less volatility in the gold price and a more rationalised industry.

Lower gold price volatility will allow producers to reconfigure mine plans, maximise cash flows and reduce losses, Goldman suggests. The majority of producers are carrying low debt levels, and there will be no urgency to raise funds for capital expenditures. On the other hand, assuming no sharp rebound in gold prices, some miners will be forced to sell or write down assets that are no longer economic once they adjust year-end reserve valuations to lower gold prices. Put it all together and Goldman sees lower volatility not only in the gold price in 2014 but in the share prices of gold producers.

Year-end reserve valuations are a case in point. Gold producers revalue their reserves only once a year (the equivalent of a stocktake) and at that point mark to the market gold price. As most US companies report on a calendar year, that process is underway now within quarterly profit results. Given most Australian producers report on a June year-end, they have another six months before having to bow to the inevitable, Macquarie notes. That said, Beadell Resources ((BDR)), AlacerGold ((AQG)) and OceanaGold ((OGC)) report on a December year-end, while Newcrest Mining ((NCM)) chooses to revalue on a calendar year basis.

Australian producers are nevertheless in the process of reporting their December quarter production and sales numbers as we speak, and in many cases results have outperformed expectations. This has led to short-covering rallies for the likes of Newcrest and Perseus Mining ((PRU)) in particular and Macquarie believes the trend may continue through the reporting season on a combination of short squeezes and bargain hunting.

Another response among gold producers to 2013's sudden gold price tumble is that of corporate consolidation. Macquarie is interested to note Goldcorp's recent bid for Osisko Mining Corp's flagship mine in Canada is the first hostile bid we've seen in the sector since 2010. Once the hostile bidding merges we can expect a hurry-up to occur amongst gold companies keen for friendly M&A. Macquarie expects producers with debt problems and explorers with quality assets to be most sought after. The broker sees Beadell, Perseus, Gryphon Minerals ((GRY)) and Papillon Resources ((PIR)) as potential targets for the likes of Regis Resources ((RRL)), Oceana and Evolution Mining ((EVN)) as potential suitors.

In general, Macquarie is targeting those gold producers in 2014 with the best quality assets, coupled with experienced management teams and strong balance sheets. Cost containment, reserve downgrades, hedging, limited expansion and good judgement are the key themes the analysts are looking for.

On that basis, Macquarie prefers Beadell, OceanaGold, Northern Star Resources ((NST)) and Papillon in the sector.

Bell Potter suggests the fall in Australian gold stock prices in 2013 was overdone, with prices for junior goldminer stocks covered by the broker down between 31% and 79% compared to the 27% net gold price fall. Working backwards from share prices, Bell estimates the market is pricing spot gold at 1060, which is a good 10% lower than the broker's base case estimate and more a reflection of negative investor sentiment than future gold price expectations.

Bell Potter's top picks amongst junior producers covered are those with a relatively high probability of paying dividends in the near term. On that basis, the analysts' order of preference is Doray Minerals ((DRM)), Troy Resources ((TRY)) and Regis Resources. The other three stocks in the broker's coverage universe ? Kingrose Mining ((KRM)), Papillon and Phoenix Gold ((PXG)) are all dependent on project progress, the broker notes, including securing necessary funding and/or approvals.

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