IMPERIUM CAPITAL

momentum

Weekly Digest

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As Good as Gold?

– *Stephen Nguyen, CFA*

The fourth quarter of 2018 proved a torrid time for global markets. Softening data and earnings guidance suggested a global slowdown. Combined with tightening global monetary conditions, US-China trade tensions and European political uncertainty, a backdrop emerged that weighed negatively on investor sentiment. As one would expect, this resulted in steep falls across most risk markets. Amongst the small subset of asset classes that performed well during this period was the traditional safe-haven: gold. A rally of 7.5% in this often-maligned commodity once again demonstrated its diversifying qualities which we believe justifies a holding in portfolios.

No lesser an investor than Warren Buffet often shares his dislike of the precious metal. The common argument is that gold is an 'unproductive' asset that is not useful for much, but the same can be said for cash, which, nevertheless still has a role within portfolios. The most valid challenge stems from the lack of income attached to an investment in gold which leads to considerable difficulty in estimating a fair valuation. Add on the impact of high storage costs and many argue gold does not deserve a place in portfolios. However, gold did not ascend to its rarefied status in the early days of freely convertible money for no reason. It is lustrous, and highly malleable, hence divisible. Critically it is also scarce.

Throughout history, when the powers that be have abused the printing press and debased paper money, gold has stepped in as the true store of value. Gold cannot be devalued by central banks. Globally we are in a period of dizzyingly high levels of debt, so having an alternative to fiat currencies would be prudent risk mitigation. Gold can be a good hedge against inflation and has been proven over time to preserve its purchasing power when compared with fiat money.

The typical design of most insurance policies is that a third party will pay out if a specified event occurs. In reality, you have no more than a pledge. In a truly adverse scenario, you must ask how prepared your counterparty is to live up to their liabilities. This is the fundamental risk in all insurance: namely that there is a scenario in which the private sector has, at least historically, been unable to cope, and the state sector has had to step in. Gold does not share this type of default or counterparty risk and unlike cash or short-term equivalents it cannot be destroyed by bankruptcies.

Until recently we have enjoyed relatively stable political, economic and monetary conditions. This is no longer the case after huge upheavals around the world and we must acknowledge that such stability is not necessarily the given we've become accustomed to in recent decades.

For students of data or historical returns, gold has shown no correlation with other asset classes over the long term and during times of severe market shock gold has typically exhibited a negative correlation to equity markets, thus, it remains a useful diversification tool. While diversification does not guarantee profits, used carefully it can lead to more robust portfolios with lower correlation to the broader markets and hence protecting investors during market turbulence. Severe market stress usually occurs infrequently but still regularly enough to justify an allocation to gold in our portfolios.

The **Marketplace**

- Brent crude fell 1.7% to $61.50 a barrel.
- The US-China trade war is still at an impasse.
- Gold rose 1.2% last week to $1297 an ounce.
- A mixed week for world indices.

Market **Focus**

US

- The federal government shutdown continued into its 37th day today. The Republicans and the Democrats are reportedly close to agreeing a lift on the situation.
- US equities ended the week flat after four weeks of continued gains.
- The commerce secretary Wilbur Ross indicated the US and China were ‘miles and miles away’ from reaching an agreement on trade.

UK

- Government borrowing exceeded forecasts in December, rising by £3bn versus an expected fall of £1.9bn. A smaller EU rebate is seen as the cause.
- Wage growth is at its strongest level in a decade at 3.3% annualised. Unemployment was at 4% which is the lowest level since the mid-1970s.
- UK equities fell by 2.3% on the week.

Europe

- Eurozone activity is at its slowest pace in 5 years. Mario Draghi, the president of the ECB has indicated he intends to keep monetary policy loose.
- German business sentiment is at its weakest level in three years with the corporate confidence index falling to 99.1 in January from 101 in December.
- European equities rose slightly on the week despite the negative backdrop with the major gauge rising 0.2%.

Rest of The World

- China’s VP said at Davos that trade barriers, unilateralism, protectionism and populism are *“posing serious challenges to the international order”*.
- Venezuela notionally has two presidents with Juan Guaido claiming the backing of the people whilst Nicolas Maduro still controls the state apparatus.
- Japanese equities rose 0.5% on the week.
- Turkish stocks continued strong gains rising 3.4% on the week to give an annual gain of 11.5% in 2019.

Past performance is not indicative of future returns.

Source: Bloomberg. Returns in local currency unless otherwise stated.

Asset Class/Region	Currency	Currency returns			
		Week ending 25 Jan. 2019	Month to date	YTD 2019	12 months
Developed Market Equities					
United States	USD	-0.2%	6.4%	7.3%	-4.8%
United Kingdom	GBP	-2.3%	1.3%	1.2%	-6.9%
Continental Europe	EUR	0.4%	6.1%	6.6%	-8.3%
Japan	JPY	0.5%	4.8%	4.8%	-15.1%
Asia Pacific (ex Japan)	USD	1.2%	5.9%	6.3%	-14.8%
Australia	AUD	0.4%	4.6%	4.4%	1.9%
Global	USD	0.1%	6.3%	7.1%	-8.7%
Emerging markets equities					
Emerging Europe	USD	1.5%	9.8%	10.2%	-13.4%
Emerging Asia	USD	1.6%	5.7%	6.1%	-17.5%
Emerging Latin America	USD	0.3%	12.2%	12.1%	-7.4%
BRICs	USD	1.1%	7.6%	8.1%	-16.3%
MENA countries	USD	0.0%	5.3%	6.2%	6.4%
South Africa	USD	2.2%	9.5%	9.8%	-24.1%
India	USD	-0.6%	-2.4%	-2.1%	-11.5%
Global emerging markets	USD	1.4%	6.9%	7.3%	-16.3%
Bonds					
US Treasuries	USD	0.3%	-0.2%	0.1%	1.6%
US Treasuries (inflation protected)	USD	0.0%	0.1%	0.3%	-0.8%
US Corporate (investment grade)	USD	0.7%	1.3%	1.6%	-0.6%
US High Yield	USD	0.0%	3.8%	4.0%	0.8%
UK Gilts	GBP	0.8%	0.3%	0.2%	2.5%
UK Corporate (investment grade)	GBP	0.7%	0.8%	0.8%	-0.9%
Euro Government Bonds	EUR	0.6%	0.9%	0.9%	1.9%
Euro Corporate (investment grade)	EUR	0.4%	0.6%	0.6%	-0.6%
Euro High Yield	EUR	0.1%	1.7%	1.7%	-2.9%
Japanese Government	JPY	0.2%	0.5%	0.5%	1.8%
Australian Government	AUD	0.9%	1.0%	1.2%	7.1%
Global Government Bonds	USD	0.6%	0.5%	0.8%	-1.9%
Global Bonds	USD	0.6%	0.6%	0.8%	-2.3%
Global Convertible Bonds	USD	0.9%	3.3%	3.6%	-5.7%
Emerging Market Bonds	USD	0.9%	4.2%	4.1%	-1.0%

Source: Bloomberg. Past performance is not indicative of future returns

Asset Class/Region	Currency	Currency returns			
		Week ending 25 Jan. 2019	Month to date	YTD 2019	12 months
Property					
US Property Securities	USD	1.1%	7.7%	8.0%	5.3%
Australian Property Securities	AUD	2.2%	6.6%	3.8%	7.9%
Asia Property Securities	USD	1.2%	7.0%	7.9%	-7.6%
Global Property Securities	USD	1.4%	7.3%	7.8%	-2.3%
Currencies					
Euro	USD	0.4%	-0.4%	-0.3%	-8.7%
UK Pound Sterling	USD	2.2%	3.4%	3.8%	-7.6%
Japanese Yen	USD	0.1%	-0.1%	0.6%	-1.0%
Australian Dollar	USD	0.1%	1.9%	1.9%	-11.2%
South African Rand	USD	1.8%	5.8%	5.6%	-12.9%
Swiss Franc	USD	0.2%	-1.0%	-0.9%	-5.8%
Chinese Yuan	USD	0.4%	1.9%	1.9%	-6.3%
Commodities & Alternatives					
Commodities	USD	-0.2%	7.0%	6.9%	-6.2%
Agricultural Commodities	USD	0.1%	2.3%	2.3%	-5.0%
Oil	USD	-1.7%	14.6%	18.1%	-12.5%
Gold	USD	1.2%	1.3%	1.5%	-4.8%
Hedge funds	USD	0.0%	1.6%	2.0%	-7.7%

Source: Bloomberg. Past performance is not indicative of future returns

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