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The merits of a "Super Over" and Gold in portfolios

Recent controversy in the final of the Cricket World Cup has highlighted the need for clearly defined rules, even in the most unlikely of outcomes. The chances of the cricket final between England and New Zealand being tied after 50 overs were slim and tied still after another "Super Over" even slimmer. Without wishing to dwell on the absurd scenario of not having another "Super Over" until a winner is found, as in a tennis tie breaker or football penalty shootout, I do wish to focus on the rather random past six months where US 10 year treasury yields have fallen from 3% back to 2% despite most experts looking for a break higher than at the start of the year.

US 10 year treasury yields

Source: Bloomberg

As depicted by the long-term chart above, the break above 3% on the benchmark 10 year treasury around Christmas was a strong technical signal that the 30 year bull market in falling US interest rates was over and the range we have been in since 2012 was finished. This was clearly incorrect as confirmed by the price action since then.

What does this mean? Fundamental reasons are all based around a US economic slowdown, potential Fed short-term interest rate cuts and other risks in the economy.

Could it possibly mean that the deflationary forces experienced over the past two decades have not finished and falling or perennially low interest rates and inflation are here for a lot longer than expected? The possibility of a Japanese style environment happening in the US, due to insufficient quantitative easing? The reflation phase we have all been expecting being postponed indefinitely?

Which leads us to the protection and diversification benefits of gold in portfolio again. Not since 2012 when the gold/equity ratio reached a stretched point and US 10 year treasuries bottomed around the 1.3% yield, has this debate raged higher in our Investment Committee and morning meetings.

The Bloomberg chart below shows a decisive longer-term breakout of gold in USD terms and a worthy technical rationale for our current overweight position in bullion again. Political risk and uncertainty combined with the possibility of the continuing deflation phase are more fundamental rationales.

Gold price

Source: Bloomberg

As summarised by Richard Harwood in his Weekly View a couple of weeks ago, it's a mixed up, muddled up, shook up world and diversification is king. Even the most unlikely of scenarios can play out and with US 10 year interest rates at these levels and with a significant amount of the World's bonds in negative territory, it is appropriate to have gold back in our asset allocation models. The rules of traditional finance are being rewritten, as should the rules for a tied World Cup cricket match after a tied "Super Over"!

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