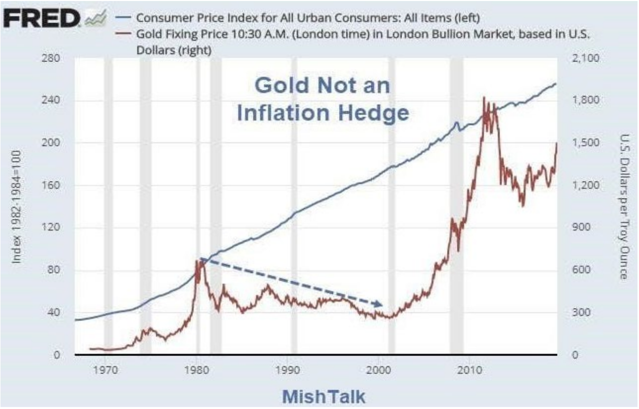
MitonOptimal

More reasons to own Gold in a diversified portfolio

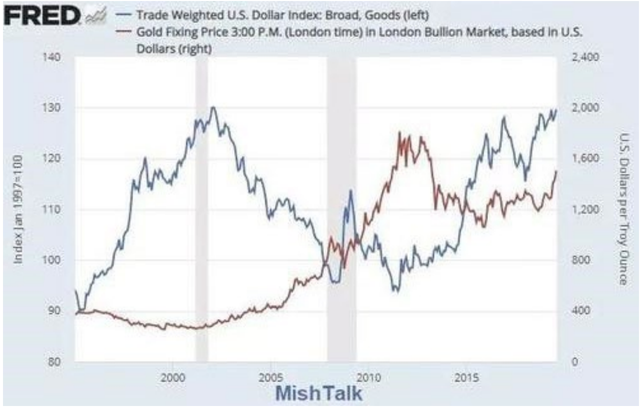
We have held Gold Bullion ETFs in most of our offshore model portfolios for some time now, but new factors have motivated us recently to include Gold into our SA and global portfolios. Traditionalists would argue that the purpose of holding Gold Bullion - which is normally held as an Exchange Traded Fund (ETF) as a proxy for Gold - is to act as a non-correlated instrument, a hedge against inflation and/or a weaker US dollar (as it is priced in US Dollars). Many market participants also hold Gold Bullion to hedge against global geo-political risks or to act as a store of value.

To that point, the chart below showing Gold vs CPI would argue that Gold is not an inflation hedge. It only really does well in a hyperinflationary environment.

Gold vs CPI



Trade-Weighted US Dollar Index vs Gold



Source: FRED

The second chart, showing the Trade-Weighted US Dollar Index vs Gold, would also negate the traditionalists' view that it always does well in a weaker US Dollar environment.

Although these historic charts do indicate some correlation, we do not think global inflationary pressures are a short-term threat, nor do we have a strong view on a weaker US Dollar.

Gold pays no interest and/or no dividends, which makes it impossible to value against securities that produce earnings, distribute dividends or any interest-bearing instrument.

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In the last couple of months, the following arguments convinced us to increase exposure to Gold in our global and SA domestic portfolios:

1. US$ 16 trillion of negative yielding government debt

In December 2018, 52% of the central banks examined by Fitch were in a monetary tightening phase and only 3% were easing. Deterioration in global growth prospects, rising uncertainty about the future direction of trade policy and a slowdown in global manufacturing and trade have now contributed to a widespread shift in central bank policy. These shifts to cut interest rates and capital market reaction have moved US$ 16 trillion of government debt into negative yield territory as indicated by the table below:

Yield across different maturity buckets within GBI Broad Index

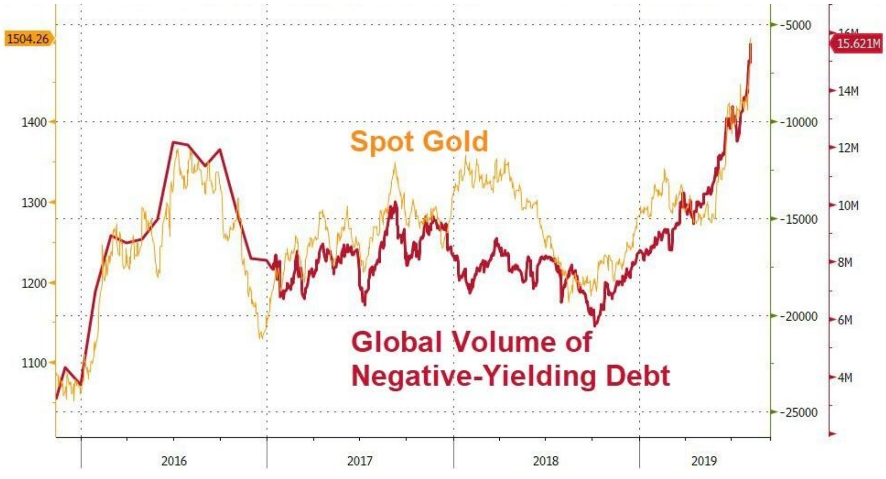
15-Aug-19	1-3 Years	3-5 Years	5-7 Years	7-10 Years	10-15 Years	15+ Years
Denmark	-0.919	-0.910	-0.868	-0.789	-0.665	-0.498
Germany	-0.926	-0.949	-0.907	-0.810	-0.644	-0.364
Netherlands	-0.899	-0.877	-0.763	-0.656	-0.471	-0.306
Finland	-0.832	-0.813	-0.701	-0.540	-0.345	-0.084
Sweden	-0.725	-0.738	-0.664	-0.552	-0.339	0.020
France	-0.828	-0.832	-0.704	-0.519	-0.284	0.218
Austria	-0.816	-0.811	-0.712	-0.573	-0.198	0.304
Belgium	-0.802	-0.788	-0.641	-0.468	-0.197	0.269
Japan	-0.279	-0.317	-0.353	-0.298	-0.149	0.092
Ireland	-0.671	-0.628	-0.438	-0.211	0.003	0.490
Spain	-0.562	-0.453	-0.292	-0.099	0.163	0.749
UK	0.379	0.323	0.314	0.358	0.520	0.890
US	1.507	1.439	1.457	1.498	1.526	1.912
Italy	0.147	0.556	0.883	1.115	1.570	2.146

Source: JP Morgan

In %, as of close of business on August 15, 2019

The argument against Gold (having no interest or dividend value relative to other assets) has no standing when such a large amount of government debt offers no yield at all! It is therefore no surprise to see the high correlation between an escalating aggregate of negative yielding bonds and the Gold price (see chart below).

Correlation between the market cap of negative yielding bonds and Gold



Source: Bloomberg

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2. It is money after all

Many investors argue that Gold is the alternative currency of the World. Others would argue Bitcoin and other crypto-currencies are competing with Gold as the World's alternative currency. The writer believes that crypto-currencies would have had a place in a portfolio if we had only one crypto-currency and not in excess of 300 (diluting its authenticity).

As the four largest global currencies have grown excessive government balance sheets due to money printing/ quantitative easing, the race between the US Dollar, Euro, Japanese Yen and British Pound Sterling is on to weaken currencies in order to deflate 'naturally' their debt bubbles.

Gold, as a store of value, therefore provides investors with more credibility as it has no deficits to deal with.

3. Measure of faith in central banks

In addition to being money for thousands of years, the price of Gold is primarily a measure of faith in central banks. If you believe that central banks have everything under control, do not buy Gold.

But before everyone rushes off to sell their equity portfolios for Gold…we continue to believe that equities hold significant value for long-term investors due to their ability to generate cash flow and earnings growth in a low interest rate environment. We therefore continue to hold more global equities relative to Gold in our portfolios.

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