



## Goldfinger

# Weekly Digest

24 June 2019

– Richard Stutley, CFA

Prince Charles met English actor Daniel Craig on the set of the latest Bond movie last week. A man who knows something about investments (the Prince's Trust achieved a compound annual growth rate in excess of 25% between 1986 and 1996<sup>1</sup>) and one who's title character knows something about gold (in 1985's Goldfinger, the eponymous villain tries to ionise the gold reserves at Fort Knox in order to create scarcity and drive up prices). No doubt, therefore, both men will have discussed gold's moves last week: the precious metal performed well, rising just shy of 5% to reach a six year high, following dovish noises from central bankers and mounting tensions between Iran and the US. We have held gold in our portfolios over the past two and half years and remain holders today: during uncertain times we think the precious metal has a role to play in portfolios.

Like all prices, the cost of gold is a function of supply and demand. Unlike many things, however, supply is dominated almost entirely by existing supply, given the durable nature of gold and the scarcity of new seams. Hence price is largely a demand story and herein there is an observed relationship between gold and real interest rates, the latter representing the value of paper currency. As real interest rates rise, so does the opportunity cost of holding gold, given that it doesn't deliver any income to the holder. As real interest rates fall, the opportunity cost falls away.

This inverse relationship between real interest rates and gold has held pretty well in recent years, hence higher real interest rates imply a lower gold price. Given that most future scenarios we foresee involve a gradual rise in real interest rates, with rates currently closer to their floor than central bank targets, let alone any kind of ceiling, this poses a risk to our holding.

We believe that gold, nonetheless, continues to justify a role in portfolios today. In constructing portfolios we pay attention to the short term as well as the long term, and hence we want a diversified basket of complementary/uncorrelated investments. While most scenarios see a gradual increase in real interest rates, there are lower probability tail events in which rates move the other way for a period, either as a result of looser monetary policy or the sudden return of inflation. In these scenarios we would expect gold to perform much better than most other investments, hence a small allocation is warranted, while our sizing of the position reflects the fact that these are low probability tail events.

The world is carefully poised currently. Central bankers are doing what they can to bolster inflation, but signs that the transmission mechanism is not working imply a greater role for fiscal policy. Economic data, including the US manufacturing ISM, has weakened, while the US-Sino trade war remains a major threat to global growth. Contrast this with positive economic impetus from steadily rising employment, higher wages, and a confident consumer, and it is difficult to predict the way forward from here, or how markets will appraise these risks in the short term. In this environment it is important to own a diversified portfolio with some insurance against tail risks. We design portfolios to meet specific client outcomes over time, while also trying to make the journey as palatable as possible. From Princes to paupers and spies to savers, we think gold is worthy of consideration as a long term portfolio diversifier.

<sup>1</sup> Morton, J., (1999). Investing with the Grand Masters. Great Britain: Pearson Education.

## The Marketplace

- Dovish tilt by global major central banks led by the US Federal Reserve
- Tensions rose between the US and Iran, resulting in a rally in global oil prices
- Brent Crude rallied 5.1%, ending the week at \$65.2 per barrel
- Gold prices gained 3.5%, ending the week at \$1394.3 per ounce

## Market Focus

### US

- Prospects for a Federal Reserve interest rate cut at its July meeting and hopes that the US and China will reengage in trade talks at next week's G20 summit, helped drive US equities higher
- The US large-cap benchmark index ended the week up +2.2% and touched a new all-time high closing level on Thursday
- The US dollar fell +1.4% against other currencies last week, its biggest weekly drop since mid-February
- Geopolitical tensions in the Middle East continued to escalate, driving global oil prices higher. On Thursday, Iran shot down an unmanned US military drone in what the US says was international airspace
- US Corporate Bonds outperformed Treasuries over the past week, returning +1% and +0.2%, respectively

### Europe

- At the annual European Central Bank forum in Portugal, ECB President Mario Draghi called for 'additional stimulus' in the absence of any improvement in weak growth and tepid inflation

- Following the dovish comments made by ECB President Draghi, the yield on 10 year bonds in sixteen European member states hit all-time lows. The yield on 10-year German government bonds fell to a new all-time low of -0.315%, while the French 10-year bond fell to 0%
- Continental European equities gained +2.0% on the week
- The euro appreciated +1.2% against the US dollar

### UK

- The pound strengthened +0.9% against the US dollar on the week, buoyed by the Bank of England's decision to hold interest rates steady. The central bank also reduced its growth forecast to 0% in the second quarter of 2019, down from 0.2% previously
- In political news, the run for Prime Minister is now between Boris Johnson and Jeremy Hunt. They will face a vote of the 160,000 Conservative members, the results of which are due the week of 22nd July
- UK equities rose +0.9% by the end of the week

### Asia/Rest of The World

- The Bank of Japan kept monetary policy unchanged, along with its guidance and its current rate of asset purchases
- Japan's exports fell for the sixth consecutive month, down 7.8% in May year-over-year, driven by the decline in capital goods, auto parts and steel
- Chinese equities rose +4.2% on the week, supported by investor optimism that a meeting between US President Trump and the Chinese President Xi will result in both countries resuming trade talks

Asset Class/Region	Currency	Currency returns			
		Week ending 21 June 2019	Month to date	YTD 2019	12 months
<b>Developed Market Equities</b>					
United States	USD	2.2%	7.3%	18.5%	8.8%
United Kingdom	GBP	0.9%	3.6%	12.6%	2.5%
Continental Europe	EUR	2.0%	5.0%	17.3%	5.6%
Japan	JPY	-0.1%	2.3%	4.7%	-9.6%
Asia Pacific (ex Japan)	USD	3.7%	5.5%	11.3%	-1.5%
Australia	AUD	1.5%	4.0%	20.1%	11.4%
Global	USD	2.2%	6.5%	16.9%	5.5%
<b>Emerging markets equities</b>					
Emerging Europe	USD	2.4%	6.3%	18.9%	18.4%
Emerging Asia	USD	3.9%	5.5%	8.9%	-4.9%
Emerging Latin America	USD	4.5%	7.4%	14.0%	23.5%
BRICs	USD	4.1%	5.9%	13.3%	1.0%
MENA countries	USD	0.3%	3.5%	10.1%	8.0%
South Africa	USD	5.3%	7.1%	12.1%	2.8%
India	USD	-0.4%	-1.4%	8.8%	7.8%
Global emerging markets	USD	3.8%	5.8%	10.2%	0.1%
<b>Bonds</b>					
US Treasuries	USD	0.2%	0.5%	4.9%	7.4%
US Treasuries (inflation protected)	USD	1.0%	0.6%	6.2%	5.3%
US Corporate (investment grade)	USD	1.0%	1.7%	9.1%	10.3%
US High Yield	USD	1.0%	2.3%	10.0%	6.9%
UK Gilts	GBP	-0.1%	0.4%	5.3%	5.6%
UK Corporate (investment grade)	GBP	0.4%	1.5%	6.9%	5.9%
Euro Government Bonds	EUR	0.5%	1.8%	5.5%	6.3%
Euro Corporate (investment grade)	EUR	0.7%	1.4%	5.2%	4.2%
Euro High Yield	EUR	1.2%	2.2%	7.6%	4.4%
Japanese Government	JPY	0.5%	1.0%	3.2%	3.6%
Australian Government	AUD	0.6%	1.5%	8.1%	12.3%
Global Government Bonds	USD	0.8%	1.7%	4.9%	5.5%
Global Bonds	USD	0.8%	1.7%	5.1%	5.6%
Global Convertible Bonds	USD	1.4%	2.9%	7.1%	1.1%
Emerging Market Bonds	USD	1.6%	4.2%	11.0%	11.9%

Asset Class/Region	Currency	Currency returns			
		Week ending 21 June 2019	Month to date	YTD 2019	12 months
<b>Property</b>					
US Property Securities	USD	0.3%	3.4%	19.7%	13.7%
Australian Property Securities	AUD	0.6%	5.0%	19.5%	14.1%
Asia Property Securities	USD	2.4%	5.1%	13.4%	7.9%
Global Property Securities	USD	0.9%	3.4%	16.1%	8.9%
<b>Currencies</b>					
Euro	USD	1.2%	1.6%	-1.0%	-2.3%
UK Pound Sterling	USD	0.9%	0.6%	-0.3%	-4.1%
Japanese Yen	USD	1.0%	1.0%	2.0%	2.3%
Australian Dollar	USD	0.9%	-0.1%	-1.7%	-6.1%
South African Rand	USD	3.2%	1.7%	0.1%	-5.4%
Swiss Franc	USD	2.2%	2.5%	0.5%	1.4%
Chinese Yuan	USD	0.8%	0.5%	0.1%	-5.3%
<b>Commodities &amp; Alternatives</b>					
Commodities	USD	2.0%	2.3%	6.7%	-5.2%
Agricultural Commodities	USD	-0.9%	0.7%	-0.3%	-5.6%
Oil	USD	5.1%	1.1%	21.2%	-10.7%
Gold	USD	3.5%	6.9%	8.8%	9.9%
Hedge funds	USD	0.6%	2.0%	4.2%	-2.0%

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