IMPERIUM CAPITAL
momentum

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Yellow metal, green lights

– Andrew Hardy, CFA

Gold has outshone most other investments in 2020, having broken through to new all-time highs in July, surpassing levels last reached nearly 10 years ago. Year to date the bullion price has increased by 27%, trumping all broad equity markets and most other assets – only the tech heavy NASDAQ index has kept pace. Over five years, gold has risen by over 70%. Today's market and economic conditions go a long way towards justifying these gains though and we remain committed holders within our multi-asset portfolios.

Arguably gold has been in a bubble for thousands of years. With no income yield, its price is sustained by the expectation that there will be someone else willing to purchase it from the owner, generally at a higher price than it was acquired for (a.k.a. the greater fool theory). Although difficult to model or predict, that largely speculative investment angle is a far more significant driver of the gold price than the marginal usage in jewellery or industry. But having been prized since the early days of civilisation, it seems unlikely that gold will lose its allure anytime soon. Value is in the eye of the beholder.

> Since 1971, when the Bretton Woods system came to an end, the real gold price is up 7 times

'Gold bugs' see the yellow metal going much higher from here with the most bullish scenarios built around fiat money debasement and a return to some sort of gold standard to keep central banks in check. The more mainstream view is that it is a good store of value, particularly in real terms i.e. adjusted for the effects of inflation, as has been the case over many centuries. Deutsche Bank* recently compiled some interesting long-term return statistics; since 1971, when the Bretton Woods system came to an end, the real gold price is up 7 times, compared to oil and silver which have only doubled. Longer term returns are less spectacular: over the preceding 111 years back to 1860, gold fell by three quarters in real terms - enough to test the patience of even the most ardent gold bulls, but well ahead of inflation over the last 160 years nonetheless.

> This year real yields have sunk to their lowest levels on record, which readily supports gold's ascent

The most reliable estimators of the fair value of gold are based around real interest rates. It stands to reason that since gold pays no income, the opportunity cost of holding it decreases as yields decline, therefore price moves inversely with real yields. This year real yields have sunk to their lowest levels on record, at around -1.0% on ten-year US inflation linked bonds, which readily supports gold's ascent. Similarly, the yellow metal tends to do well as inflation expectations increase; while such measures collapsed earlier this year, most are now back to where they were at the beginning of the year and remain on a rising trajectory. Other factors that are generally believed to support the gold price include heightened risk aversion – tick; a weaker dollar – tick; and increases in money supply – big tick. Thus 2020 has provided near perfect conditions for a sharply rising gold price.

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Considering the path from here, a plausible bullish scenario is based around central bank policy remaining ultra-loose around the world, potentially compressing real yields yet further and eventually prompting a further pick-up in inflation. Supporting this, the recent adjustment to the Federal Reserve mandate gives a clear indication of what we should expect to see more of from central banks in years to come; a willingness (if not desire) to allow inflation to overshoot in the short term, in order to support growth and reduce debt burdens. Such conditions could lead to a much greater speculative premium to fair value than we see today.

The main downside risk that could tarnish gold arises if central bank policy instead tightens relative to the market's ultra-loose expectations: it nearly halved in the years following the euro crisis once the Fed began moving away from unlimited asset purchases. Or falling inflation expectations could push real yields higher to put a dent in the price. However, such developments look unlikely, for the time being.

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Forecasting aside, gold has been a good store of value over the long term and as this year has proven, it is a reliable hedge in times of heightened uncertainty. From a portfolio management point of view, it also has little to no correlation with other asset classes and so acts as a powerful diversifier. We have held physical gold across our portfolios for several years and fully intend to maintain our allocations at these levels.

* Deutsche Bank Chart of the Day, by Jim Reid. 22nd July 2020.

The **Marketplace**

- After their best month since April, US equities fell back last week
- The CDC in the US has warned health officials to be ready to distribute a vaccine by the 1st November to at-risk individuals
- Brent crude fell -5.3% ending the week at $42.7 a barrel
- Gold fell -1.6% to end the week at $1933.9 an ounce

Market **Focus**

US

- The ISM manufacturing indicator rose to 56.0 in August (against 54.2 expected) and the ISM services indicator was 56.9 (against 57.0 expected)
- The ADP's private payrolls report showed that firms added 428k jobs in August, beneath the 1m reading expected
- House Speaker Pelosi and Treasury Secretary Mnuchin are to work to avoid a government shutdown in October and to not hold up a vital spending bill
- Weekly initial jobless claims for the week ending 29th August came in at 881k, a post-pandemic low
- Unemployment fell to 8.4% in August from 10.2% in July
- US equities fell -2.3% and government bonds returned 0.1% last week

Europe

- Euro Area CPI was -0.2%, beneath expectations of +0.2%, and the core inflation reading fell to 0.4%
- Russia became the 4th country to report over a million cases of Covid-19, joining the US, India and Brazil
- The Euro Area composite PMI flash reading was 51.6, a fall from 54.9 in the previous month
- European equities fell -1.5%

UK

- The EU's chief Brexit negotiator Michel Barnier criticised the UK's stance in negotiations, including guarantees on open and fair competition and reluctance to include "any meaningful horizontal dispute settlement mechanisms"
- The government's 'Eat Out to Help Out' scheme has already led to £522m being committed, against the estimated £500m, and will increase further as establishments have more time to claim money back
- UK equities fell -2.5%

Asia/Rest of The World

- India's rise in new Covid cases is over 70k on a daily basis, and it also now has the third highest level of fatalities at over 64k
- China's official manufacturing PMI for August came in at 51.0 (against 51.2 expected) and its services PMI was 55.2 (against 54.2 expected)
- Japan's manufacturing PMI for August came in at 47.2 and its services PMI was 45.0

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 4 Sept. 2020	Month to date	YTD 2020	12 months
Developed Market Equities					
United States	USD	-2.3%	-2.1%	7.1%	18.2%
United Kingdom	GBP	-2.5%	-2.5%	-22.3%	-19.4%
Continental Europe	EUR	-1.5%	-0.7%	-7.7%	-0.5%
Japan	JPY	0.7%	-0.1%	-4.8%	10.0%
Asia Pacific (ex Japan)	USD	-2.2%	-1.0%	4.1%	16.3%
Australia	AUD	-2.1%	-2.0%	-9.3%	-6.4%
Global	USD	-2.3%	-2.3%	3.0%	13.5%
Emerging markets equities					
Emerging Europe	USD	-4.3%	-3.3%	-25.4%	-14.4%
Emerging Asia	USD	-2.0%	-0.3%	8.9%	24.4%
Emerging Latin America	USD	0.6%	3.8%	-30.0%	-21.0%
BRICs	USD	-2.2%	-0.5%	4.6%	18.8%
China	USD	-2.5%	-1.1%	18.4%	33.7%
MENA countries	USD	0.5%	0.8%	-9.2%	-6.5%
South Africa	USD	-5.4%	-1.7%	-22.0%	-15.4%
India	USD	-2.7%	-0.3%	-8.7%	3.8%
Global emerging markets	USD	-2.0%	-0.2%	0.3%	13.6%
Bonds					
US Treasuries	USD	0.1%	-0.2%	9.0%	6.7%
US Treasuries (inflation protected)	USD	-0.2%	-0.8%	9.3%	8.6%
US Corporate (investment grade)	USD	0.4%	0.0%	6.9%	7.2%
US High Yield	USD	0.0%	-0.1%	1.5%	4.5%
UK Gilts	GBP	1.0%	1.0%	7.7%	3.7%
UK Corporate (investment grade)	GBP	0.7%	0.7%	5.0%	5.0%
Euro Government Bonds	EUR	0.4%	0.6%	2.9%	-0.6%
Euro Corporate (investment grade)	EUR	0.3%	0.4%	0.8%	-0.2%
Euro High Yield	EUR	0.4%	0.4%	-1.8%	-0.3%
Japanese Government	JPY	0.2%	0.0%	-1.2%	-3.9%
Australian Government	AUD	0.7%	0.6%	4.2%	1.9%
Global Government Bonds	USD	-0.2%	-0.4%	7.0%	4.8%
Global Bonds	USD	-0.1%	-0.3%	6.5%	5.6%
Global Convertible Bonds	USD	-1.3%	-1.2%	11.7%	17.6%
Emerging Market Bonds	USD	0.8%	0.6%	4.0%	6.5%

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

Asset Class/Region	Currency	Currency returns			
		Week ending 4 Sept. 2020	Month to date	YTD 2020	12 months
Property					
US Property Securities	USD	-0.5%	0.6%	-14.5%	-14.5%
Australian Property Securities	AUD	-0.2%	-1.6%	-17.7%	-21.0%
Asia Property Securities	USD	-1.1%	-0.9%	-16.6%	-11.8%
Global Property Securities	USD	-1.1%	-0.5%	-15.4%	-11.7%
Currencies					
Euro	USD	-0.5%	-0.9%	5.4%	7.3%
UK Pound Sterling	USD	-0.6%	-1.0%	-0.1%	8.5%
Japanese Yen	USD	-0.8%	-0.4%	2.2%	0.0%
Australian Dollar	USD	-0.9%	-1.5%	3.7%	7.1%
South African Rand	USD	-0.1%	2.0%	-15.8%	-11.0%
Swiss Franc	USD	-1.0%	-1.2%	5.7%	7.4%
Chinese Yuan	USD	0.3%	0.1%	1.8%	4.4%
Commodities & Alternatives					
Commodities	USD	-2.7%	-2.5%	-18.4%	-13.2%
Agricultural Commodities	USD	-0.3%	-0.4%	-3.0%	8.3%
Oil	USD	-5.3%	-5.8%	-35.4%	-29.7%
Gold	USD	-1.6%	-1.9%	27.0%	25.0%
Hedge funds	USD	0.1%	0.0%	1.8%	4.6%

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

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