Peak Values Ltd

Rethinking Asset Allocation

30 September 2020

Investment Committee

Presently, with Gold having retracted a bit from its high, people are wondering whether to invest in the shiny metal or not and, if so, how much of the portfolio should be allocated to it.

In the past, the general wisdom was to diversify your risk; this principle is still valid, albeit with a different allocation between the various asset classes. In the past, a balanced investor allocated 50%-60% of his portfolio in Equities and 40%-50% in Fixed Income products. Perhaps, a small percentage was allocated to metals or alternative investments on the expenses of one of the main two asset classes.

This strategy of having a balanced portfolio was based on the negative correlation between Equities and Bonds. The idea was that should the economy fall into recession, central banks will lower interest rates to stimulate the economy, thus driving Bond prices upwards, and this, in return, will compensate for the fall in equity prices resulting from the fall of corporate earnings.

Everything in this world is changing; the above wisdom has lost part of its investment logic. The wisdom should be questioned for the following reasons:

- Interest rates have been on a very low level for some years now. The 10 Year US Treasury Bill yields now only 0.62%[i], a very low level. Taking inflation into consideration, currently at about 1.3%[ii], means that current yield does not even fully compensate you for the loss in your purchasing power, let alone loss of opportunity, fortune taxes, and financial service costs. That is, by time, you can only buy fewer services or commodities for the same amount of USD spent today. In short, you are getting poorer.
- You may consider reducing the quality of your investments by investing in BBB-rated corporate Bonds, being the lowest threshold before a Bond loses its investment-grade status. By doing so, it is wise to reduce the time horizon as well. The yield of a BBB US Corporate Bond is currently at 2.44%[iii]; in other words, you are descending 3 notches of credit quality, arriving at the edge of junk status, for your good money, to earn a mere extra 1%. You may think what you want, but for me, this strategy does not yield the expected return, nor are you adequately compensated for the risk taken.
- Prior to COVID-19, with the exception of a handful of countries such as Switzerland, all countries have been highly indebted. Experts were warning that this situation is unsustainable with a correction being imminent. In general, debt was taken not to increase investments but instead to finance all sorts of expenditure and recently directly or indirectly related to the COVID pandemic. Corporates did the same as they increased their debt levels to buy their own equities, thus increasing their share prices and not to enhance production capabilities. Mind, exceptions do exist. With countries having limited maneuvering possibilities to raise taxes in order to repay accumulated debt, devaluation is in high score. Devaluation is nothing else but a reduction in the purchasing power.

So the odds favor a reduction in Fixed Income asset allocation, as this allocation doesn't make sense anymore. However, the question that poses itself is: what to do with the money? Increasing equity allocation is a possibility to consider. Particularly now, with Central Banks starting to buy equities to stimulate their economies, thus supporting a price appreciation of this asset class. Something BOJ has been doing for years. Consider that BOJ is a top shareholder in 40% of Japan's listed companies. [iv] The correction we saw in Japan in June and July are warning signs. In short, this approach is not without any risk and with the reward being unknown or can not really be quantified.

The second option is to invest in metals, and here we come to Gold being one of them. We shall restrict ourselves this time to Gold and discuss silver in the next paper.

Experts claim that Gold is a good hedge, but does the claim hold?

The table below compares the development of the DAX Index and Gold in years when the leading German Index had a negative performance. The comparison indicates that not only did Gold compensate for the losses of the index but contributed positively to the overall performance by 24%. Thus your wealth has increased as well in bad times. The table shows as well that the investment of 1 unit in the DAX, on its high on 09.08.1972, and holding to the investment, through all odds, resulted in an increase of the unit by 13 folds should you have exited in the worst times in 2020, on 16th of Mach.

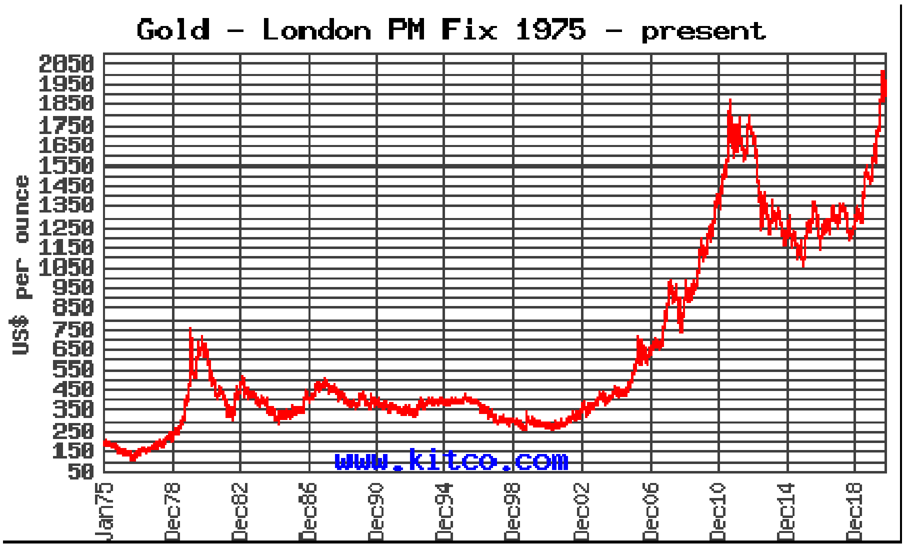
Development of the DAX and Gold in years when the equity market has corrected[v]

High date	DAX high	Date low	DAX low	DAX ∆%	Gold ∆% in €
17.02.2020	13783.89	16.03.2020	8742.25	-36.6%	-7.2%
23.01.2018	13559.60	27.12.2018	10381.51	-23.4%	2.3%
30.11.2015	11382.23	11.02.2016	8752.87	-23.1%	9.3%
02.05.2011	7527.64	12.09.2011	5072.33	-32.6%	27.3%
13.07.2007	8092.77	09.03.2009	369.03	-54.4%	51.2%
07.03.2000	8064.97	12.03.2003	2202.996	-72.7%	2.8%
21.07.1998	6165.52	08.10.1998	3896.08	-36.8%	-6.7%
26.05.1992	1806.66	06.10.1992	1420.30	-21.4%	-7.7%
20.03.1990	1908.83	16.01.1991	1322.68	-30.7%	-8.2%
17.08.1987	1570.30	28.01.1988	931.18	-40.7%	-8.6%
17.04.1986	1586.00	21.07.1986	1257.50	-20.7%	-0.4%
19.10.1978	611.70	09.02.1981	468.30	-23.4%	164.5%
09.08.1972	596.90	06.11.1974	372.30	-37.6%	94.0%
			Average over all periods:	-34.90%	24.0%

Traditionally what spoke against investing in Gold is that it doesn't generate income. As mentioned, times have changed, nor do Bonds generate income nowadays. On the other hand, the effect of inflation has to be considered, particularly that the metal doesn't generate income but only capital gains. Many people have heard the saying that 'an ounce of gold bought a nice 'toga' in the heydays of the Roman Empire and still buys a comparable suit in modern times,' as an example that gold has enduring purchasing power. [vi]

So Gold preserves your purchasing power, is a hedge in a turbulent equity market environment, and has a very limited supply. From this perspective, it makes sense to increase your portfolio's asset allocation in physical Gold. I am stressing on the word physical as you do not want to hold a promise of delivery of the shiny metal; it is better to play it safe and hold it physically in your portfolio.

It is known that a picture says 1,000 words; read the chart below for yourself, showing the development of the metal since January 1975, being roughly the same period in the above table.



Peak Values will be happy to advise you on how to acquire physical gold and have it reflected in your Bank's portfolio statement—enabling you to monitor its development, as you are doing with the rest of your investments. We will be happy as well to advise you on the optimal asset allocation in your portfolio when considering changing it.

As mentioned, in the next paper, we shall be talking about another shiny metal, so stay tuned and stay safe.

Sources:

i. Market Watch on 30.09.20, short Url: https://is.gd/nBbUkl
ii. US Inflation calculator, short Url: https://wp.me/PoZpd-1d
iii. YCharts, US Corporate BBB Effective Yield on 30.09.20, short Url: https://is.gd/1PePqi
iv. NIKKeI Asia 27.06.20 short Url: https://is.gd/bMdQvK
v. The Market, Gold und Silber spielen in der Portfoliokonstruktion eine wichtige Rolle
vi. Gold's purchasing power, short Url: https://glintpay.com/?p=17598

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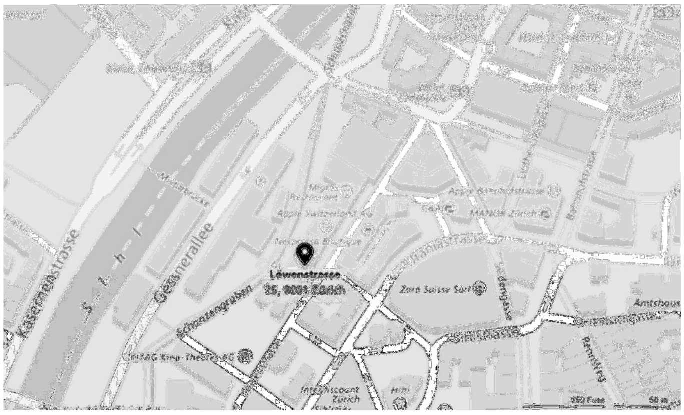

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