

Market Commentary

April 2016

2016 started with big drawdowns in most global stock Indices. There were several factors that may have contributed to this move lower. The Fed had raised rates in December 2015 for the first time in seven years and was expected to raise rates four more times in 2016. As US GDP and especially manufacturing indicators were weaker than expected, it was feared that the FED had waited too long to make its first move and was now acting during a period of economic softness, which could put the brakes on the economy at a very unfavourable time. The Chinese foreign exchange volatility caused uncertainty about the future of their policy so continued devaluation started to be priced in by markets. This at a time when economic numbers from China were weak added fuel to the fire. In Europe, ECB President Mario Draghi had not provided as much additional stimulus as the market expected in 2015 and it was feared that he might disappoint further in 2016. Continued weakness in the price of oil added to the negative market sentiment. Oil prices fell below USD 30 and were in danger of breaching the USD 25 mark in January.

The first quarter ended more favourably than it had started as oil prices recovered from their lows, the FED refrained from further rate increases and turned more dovish in its outlook and Mr. Draghi provided a major stimulus package which exceeded market expectations. The Chinese and Japanese have also made announcements in support of their economies and it appears that currency devaluation is not the focus of monetary policy in China. With all of this turmoil and uncertainty as well as additional money printing, the big winner in the first quarter of 2016 was gold. We had detailed our positive gold outlook in our report at the end of 2015 and are pleased that our clients have benefited from their gold holdings in this very challenging environment.



Fig. 1: Gold ETF Flows 2006 to Q1 2016

Source: Bloomberg

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Due to the positive performance of gold holdings as well as that of several of our stock picks, client portfolios have done substantially better than the global market indices this quarter. Several stocks like Syngenta, LVMH, Coca Cola, ABB and AT&T have produced positive performances in an environment in which US markets were flat and European markets down 8-10%. In our Q3 2015 market commentary we stated that "Gold has been rising on weak equity market days and shows signs of having formed a base from which to rally. Several countries, including Russia and China have been steadily increasing their gold reserves. These indications of rising demand in the physical market are in stark contrast to the very negative (short) positions of speculators on the paper market. We believe that this discrepancy will result in higher gold prices." In the first quarter of 2016 the inflow into gold ETFs were the highest since 2009 (Fig1) and many speculative short positions were forced to close. As a result the price of gold was up over 15%, making it the strongest quarter for gold in 30 years.

In its report the world gold council states that “over 30 percent of Sovereign debt is now trading at sub zero yields globally. A further 40% has yields below 1%.” This situation is one investors have no experience of and as they digest the implications for their asset allocations, gold has become more appealing. Gold usually fares well in a low or negative real interest environment. The opportunity cost of holding gold versus cash or bonds is very low and gold tends to preserve purchasing power when negative real interest rates (nominal rates- Inflation) are eating away at the purchasing power of cash. Now we are in a situation in which we not only have negative real interest rates but negative nominal rates as well!

If as suggested in our report “investing in a ZIRP world”, one considers gold as a store of value (money) or as an alternative to paper currency bearing zero or sub zero interest, its place in a diversified portfolio is supported even further. Large volumes of fiat currency have been “printed” through quantitative easing over the past seven years, while the supply of gold rises just about 1.5% per year. In our opinion this in itself makes it a better store of value than fiat currencies. If however, one adds the zero or even sub zero interest rates earned on savings if fiat currency is kept in cash or held in the sovereign bonds mentioned above, the argument for gold becomes even more compelling. Unlike fiat currencies and bonds, gold does not depend on the solvency of governments or institutions or the whims of central banks and carries no counter party risks or liabilities as a result.

General Thoughts

The equity market has been very volatile this quarter but stock picking has been more successful as investors are not blindly chasing trends as much as in previous years. This can be seen from the positive performance of some of the stocks in our portfolio mentioned earlier in this report. We believe that this continues to be a stock pickers market and that volatility will produce more losses than gains for those trying to grab a trend and run with it. Our strategy is to hold stocks which provide good value and reduce volatility by holding gold as a portfolio stabiliser, a role it has fulfilled very well this year.

In our third quarter 2015 commentary we mentioned that “We continue to hold gold in all portfolios as we see signs of strong demand in the physical market starting to influence pricing in the paper market. Gold was a source of stability in the recent market turbulence and we believe that it will continue to fulfil this role if volatility returns”. This is exactly what has happened in the first quarter of 2016 and though it is possible that there is some price consolidation at current levels we believe that the trend for gold is positive.

Gillian Hollenstein

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