As Good as Gold: Why Asia's Wealth Managers Should Champion Physical Gold

Asia has long had a love affair with gold, but never has it been so straightforward for the region's wealthy and the wealth managers they work with to buy and hold physical gold. Hubbis and INTL FCStone gathered a group of wealth management experts to a private thought-leadership discussion in Singapore in late December to hear their views on financial markets and the outlook for 2019, as well as to discuss the vital role that gold, as a non-correlated asset outside the global financial system, can play in diversifying portfolios.

Executive summary

Markets down, but not out

Mainstream financial market indices around the world turned negative from February this year. After 2017, when markets performed extremely well, but expectations had been low, 2018 had performed on the downside when expectations had been rather more optimistic.

Risk has risen and is higher

Realised volatility in Asia's equity markets was less than 10% in 2017, in other words remarkably low. This year realised volatility - a proxy for risk - has ratcheted upwards and stands at twice the 2017 level.

Diversification and re-allocation required

As risk rises, allocations to equities must adjust downwards, and cash is favoured by many as a holding asset. The US dollar and Swiss franc remain more appealing than, for example, the other mainstream currencies, especially the Euro and pound sterling.

Private bank advice lags behind

There was a feeling that the advice from private banks is still tardy and insufficient, as even when market conditions are weak many relationship managers (RMs) are still recommending high allocations and new products to investors. Cash has become an asset in its own right, due to the short-term yields available and the inverted yield curve. Commodities such as precious metals and especially gold offer security, assets beyond the financial system and a hedge against dollar weakness.

Or are things really broken?

Several guests expressed more dire concerns that the global financial markets are not yet reflecting the real weakness in the world's banking and financial system, as quantitative easing ends, as central banks try desperately to shrink and tidy up their balance sheets and as interest rates come to the end of their multi-decade lows. They recommend a flight to safety in the form of the dollar and potentially physical gold.

Reducing exposures

Guests recommended that wealth advisers worth their paychecks should be advising their high-net-worth (HNW) clients to watch the risk in the markets and to adapt their portfolios by reducing risk assets and diversifying, including into non-correlated assets such as gold.

More professional solutions required

There should be an emphasis on strategic asset allocation with a tactical asset allocation overlay by using more sophisticated and cost-effective products.

Gold is shining a beacon

Gold, as a physical asset that is very lowly correlated to the mainstream financial assets, is an ideal portfolio diversification. Looking at the risk in the global financial system, gold is a liquid asset with no credit risk and no exposure to the financial institutions, or to political interference. Even a gold ETF still has custodians and trustees and lots of footprints in the financial system. But physical gold can be entirely beyond the financial system.

Gold: solid fundamentals

A guest reported the findings from a recent major bullion conference in the USA where the consensus amongst the more than 700 senior level delegates was for a price of USD1532 by October 2019, sharply up from the roughly USD1200 at the

time of the roundtable discussion. One of the big factors behind the forecast is central bank buying - before the GFC, the central banks were net sellers of gold to the tune of about 500 tonnes a year, whereas for 2018 as a whole they are set to be net buyers of about 450 tonnes of gold.

Ease of access to gold, storage beyond the global financial system

Physical gold is the ultimate insurance of holding an asset beyond the financial system. Gold trading is technology-enabled and there is plentiful liquidity. Buying, transporting and storing can all take place beyond the confines of the global financial system.

Nuggets available

In September 2018, Hubbis, in collaboration with INTL FCStone, published a White Paper entitled "Going for Gold: The Appeal of Gold for the Asian Wealth Market" that contains plenty of information and many nuggets of advice in the physical gold market. The premise throughout is that whatever the state of the global financial markets and economies or even geopolitical concerns, there are very solid reasons why investors should be holding between 5% and 15% of any sensibly-assembled investment portfolio in physical gold.

THE PRIVATE, OFF-THE-RECORD discussion attended by senior management at multi-family offices and independent wealth managers in Singapore began with the guests looking back on 2018 and focusing on the outlook for the global financial markets in 2019, with the backdrop of analysing the risks and what role gold can play in protecting the downside for investment portfolios for Asia's wealthy investors.

"Gold is a diversification play," came the view of one expert. "Investors cannot simply move to cash, or one asset class irrespective of what is happening in the marketplace. As an example, this year presented a classic case, with one of our Asian equities' portfolios 40% in cash in March. We could have gone into gold, but we felt the markets would turn, and two weeks ago we went back in and are now 9% cash. More luck than strategic judgement, if we are honest. As to gold, we have a number of conservative strategies with a significant allocation to gold and we will continue to do that, based on the underlying risk profile of the client and the discretionary mandate we have."

Another expert, a specialist in risk management strategies, remarked that it is striking how quickly people forget their bad expected return forecasts. "For example," he recalled, "the feeling when Trump came in was that he would be bad for markets, then in 2017 there was huge uncertainty and political noise globally, yet 2017 was a bumper year for equities. Then most people came into 2018 bullish, yet most of the major world indices have gone down."

Asia's higher volatility

"Our approach," he continued, "is to advise our clients to assess long-term risk and allocate accordingly, but then to be ready to respond to structural changes. So, in Asia last year realised volatility was 10% or less, which is an all-time low for Asia, so allocations were high equity, even for a moderate risk investor. Then February this year arrives, risk leaps upwards and allocation to our fund drops 30% as a result, moving to cash. That represented our quantitative and specific response to what we viewed as the risk in the market."

He gave further examples dating back to the global financial crisis. He cited the case of a non-profit endowment fund at that time in

Hubbis - INTL FCStone roundtable in Singapore

2008 that had strayed far away from risk assessment and management and which did not react to changing volatility and whose performance therefore slumped.

"We therefore strongly advocate real, robust diversification and to respond rapidly to structural changes in volatility," he continued. "That helps eliminate tail risk and if you do that across your portfolio asset class by asset class, at a portfolio level, you will end up with a much better-behaved portfolio."

He explained that this is the sort of advice he would hope to have from his own private banker, but in reality, that seldom happens. "But instead," he said, "they all too often offer some sort of optimal allocation that hardly changes and then they are on the phone trying to sell some latest product. And they are far too demanding on the fee front, as well. That model simply has to change."

Another guest stepped in with some perspectives of his own. "Commodities can play a key role in a diversified portfolio," he observed. "Traditional financial assets are held solely for the expected return. That is not the case with commodities or foreign exchange [FX] so it is in some ways trickier to achieve consistent allocation to those assets. That is why you need good advice on those."

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A rocky horror show?

A more radical view came from another guest. "I have a rather extreme view here," he said. "I was horrified by the markets in 2007 and sold everything, buying back in later, after the storm. Today I think things are again rather a horror show in the markets and I cannot see any way we can dig ourselves out."

When pressed to elucidate on this view, he cited a list of warning signals. "The banks are bust, they are completely broken," he stated. "Who wants to buy the banks, even with their low market valuations? The Italian banking system is broken. We have more of a right-wing bent in European governments than since the mid-1930s. Brexit is a fiasco. The only currency that works is the dollar, I cannot see the Euro surviving. As you can see, I am very bleak about all this. I have sold all equities. Everything is in cash."

Hoarding cash

He was then questioned on what allocations he has now taken and why. "One could go into bonds, but there is FX exposure there. There is no elasticity left in the central banking universe, so, for example, the European Central Bank (ECB) is up to the gills in BBB paper, certainly not AAA. So, when the big European, especially German,

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banking names come knocking on the door, there are big problems. The Greek economy is tiny compared to even a part of Germany, that is the scale of the crisis ahead."

Accordingly, this expert likes cash. "It is, to a certain extent, a physical commodity, but I prefer the US dollar over anything, even the Swiss franc since they removed the peg. We are a 'dollarized' universe. We are talking to individuals and institutions that have cashed up to see through the next two years. Real assets are going to be cheap because global economies are going to absolutely flounder. Property, for example, Australia is about to wobble. Markets are really at a tipping point in my view right now."

An upside-down world

Another perspective came from one guest who fears a 30% retreat from what has been a decade-long bull market and a 30-year plus bull market in interest rates.

"The world," he stated, "looks like an inverted pyramid. Some 75% to 80% of the world's economies - the US, Europe, Japan, and China - are struggling to pay back their loans when the rates are close

to zero. We had a vast amount of money printing and therefore asset prices have gone up. None of us in this room are old enough to have seen a true interest rate cycle and when taxes are so high."

"The best scenario," he continued, "would be I think when things don't actually collapse but fall gradually, so people have some time to respond. I don't know which way it is going to go but rather than thinking about asset allocation, I believe we should, therefore, be thinking about strategies allocation. So, if your fund had the flexibility to sit on 40% cash it is better to allocate to that than to an ETF which is bound to invest 100%. This is not a world where you sell a thematic idea or asset allocation."

Conversations required

Another view came from a guest who is not a professional investor. "A growth investor nine or 10 years ago when the markets had fallen very dramatically would have been right to then have a high allocation to equities. But 10 years into a cycle, would they or should they still be so exposed? Perhaps a growth investor at this point in the cycle is actually 30% or 40% equities. These are important conversations to have with clients."

He turned then to fixed income. "There are parallels to the carry trades that presaged the global financial crisis," he said. When you see what is being sold to leverage on bonds, it is worrying. Leveraging up, for example, on Chinese real estate companies is worrying. And there is little, or no diversification and people forget that basically, the only reason for the bull market of the past decade is the money printing by the central banks. That is not a real bull market. We don't know where this is going, but the probability is that it will be ugly. So, that leads to the idea of 100% cash, but then what currency and what institutions?"

But he also conceded that if everyone took that approach, disaster would ensue. "The cost of going to cash means selling the equities, paying the commission and the dealing spreads. And then 6 or 12 months later the opportunities arrive again. So, we need to go back to more effective and sophisticated ways of hedging. There is a tremendous opportunity for the more sophisticated firms to present solutions to their clients, how to hedge and how to use more cost-effective and liquid products to gain tactical advantages. From a tactical point of view, don't sell the equities, for example, just sell the futures tactically. Or, if you want to move your duration on the bonds buy the futures or sell the futures to move your duration on the bonds which is something the banks are just incapable of doing."

Wealth advisers need to offer professional solutions

In summary, he stated that the ability to manage this strategic asset allocation with the tactical asset allocation overlay by using more sophisticated and cost-effective products is an area that everyone in wealth management should be focusing on.

With that, the discussion turned back to physical gold, with INTL's Huxley giving his perspectives. "I have found it fascinating to hear these views," he said, "and focusing on gold, it is this diversification theme that comes to the fore, as it is so very lowly correlated to many

of the mainstream financial assets. Going back all the way to 1971, gold is up about 10% per annum, outperforming bonds and other commodities. Looking at the risk in the global financial system, gold is a liquid asset with no credit risk and no exposure to the financial institutions, or to political interference. Even a gold ETF still has custodians and trustees and lots of footprints in the financial system. But physical gold can be entirely beyond the financial system."

Expressing global concerns via gold

Huxley noted that all the concerns elucidated at the discussion can be addressed through gold. "The US Dollar has been the safe haven asset for some time, but now we have a solid floor for gold at around $1200 an ounce and with interest rates still trending upwards, there is an argument that the Federal Reserve can only disappoint, impacting the dollar and therefore playing further into the hold gold thesis."

He also noted that there is a large short position in the gold market. "Spikes could, therefore, occur as people are forced to buy back their positions, quite possible given the amount of political, geopolitical and financial market uncertainties out there."

As to price, Huxley explained that he had recently attended a major bullion conference in the USA and the consensus amongst the more than 700 senior level delegates was for a price of USD1532 by October 2019. "While I am not sure I completely buy into that figure," he said, "it is a very bullish prediction that should not be ignored. One of the big factors behind the forecast is central bank buying - with a finite amount of gold produced each year, strong buying by Russia, Turkey, Hungary, India, amongst others, is a major factor. Before the GFC, the central banks were net sellers of gold to the tune of about 500 tonnes a year. In 2018 the indications are they will be net buyers of about 450 tonnes of gold. And more are joining the platform to bolster their gold reserves."

Ease of access to bullion

Huxley then shifted further to the logic and logistics of purchasing and holding the bullion. "Physical gold is the ultimate insurance of holding an asset beyond the financial system. Gold is technology-enabled and there is plentiful liquidity for example through our INTL platform. Our fees for buying, at around 0.2%, are far below the roughly 3% that some of the major global private banks charge. Frankly, it has never been easier to buy for a very low cost and with plentiful liquidity."

And as to logistics, Huxley explained that only in Singapore, for example, there are all the big logistics and vaulting companies or providers.

"There is a whole infrastructure here," he explained, "the banks, a London Bullion Market Association refinery and so forth. We can buy literally hundreds of million dollars of gold on a daily basis, the buyers can then hold the gold directly in the vaults where it can then be delivered and stored at the click of buttons or call. Of course, there are costs associated with storage and so forth, but these are reasonable and manageable. And if you want to sell, it is very easy to liquidate. Access to gold has never been more efficient or more transparent."

Read all about it....

The discussion closed with Huxley referring the guests to a White Paper entitled 'Going for Gold: The Appeal of Gold for the Asian Wealth Market' that Hubbis published in collaboration with INTL FCStone in early September 2018.

"There is a lot of good insights and a lot of helpful information in there that is entirely relevant as we head towards 2019," he concluded. "And certainly, from what I have heard today - especially the more worrying predictions - there are plenty of reasons why investors should be moving toward the sort of range we mentioned earlier, depending on overall global conditions, of between 5% and 15% of a sensibly assembled investment portfolio." ■

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