► On Target

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28 Reasons to Buy Physical Gold

The price of gold has surged past $2,000 an ounce and hit a new all-time high. It's being driven by demand from investors fearful that the avalanche of stimulus by governments and central banks to fight the Covid-19 pandemic, debasing paper currencies, may ignite inflation. They're also concerned about simmering geopolitical tensions, exploding government debt burdens, and lofty stock-market valuations.

Holdings in gold-backed exchange-traded funds have jumped more than 50 per cent in the last 12 months and have now reached 3,366 tons, matching the gold reserves of the world's second biggest, those of Germany's central bank.

I have long argued that gold should be a part of everyone's investment portfolio. Here is an excellent summary of its merits from Singapore dealer BullionStar…

Throughout human history, gold has constantly emerged as an unparalleled form of savings, investment and wealth preservation. Due to its unique characteristics and features, gold has inherent value and cannot be debased. When holding physical gold, there is no counterparty risk or default risk. Wealth in the form of gold can also be held and stored anonymously.

From its ability to retain its purchasing power over time, to its safe haven status in times of financial turmoil and uncertainty, to gold's ability to diversify investment risk, there are many and varied reasons to own gold in the form of investment grade gold bars and gold coins.

Here's a list of the key reasons to buy and hold physical gold…

► **It's tangible, with inherent value.** Physical gold is real and tangible. It is indestructible, impossible to create artificially, and difficult to counterfeit. Mining physical gold is arduous and costly, therefore it has inherent value and worth. In contrast, paper money doesn't have any inherent value.

► **No counterparty risk.** Physical gold is an asset that isn't someone else's liability; when you hold and own gold bars and gold coins outright, there is no counterparty. In contrast, paper gold (gold futures, gold certificates, gold-backed ETFs) do all involve counterparty risk.

► **Scarcity**. Gold deposits are relatively scarce across the world and difficult to mine and extract. New supply of physical gold is therefore limited and explains why gold is a precious asset. Gold's scarcity reinforces its inherent value.

► **Cannot be debased.** Because of its physical characteristics and features, gold cannot be debased, and its supply is immune to political meddling. Compare this to “printed” and electronic money whose supplies are constantly being debased and destroyed via deficit government spending, central bank quantitative easing and financial system bailouts.

► **A 6000-year history.** Gold has played a central role in society for thousands of years from the early civilizations of ancient Egypt, right up to the contemporary era. Gold has facilitated international trade throughout history, has been directly responsible for the economic expansion and prosperity of numerous civilizations throughout history. It has even been, due to gold exploration and mining, the direct catalyst for the growth of some of today's best-known cities such as San Francisco, Johannesburg and Sydney.

► **Store of value.** Gold is a pre-eminent store of value. Physical gold, in the form of gold bars or gold coins, retains its purchasing power over long periods of time despite general increases in the prices of goods and services.

In contrast, fiat currencies – government-issued money not backed by a physical commodity with intrinsic value such as precious metals -- are not stores of value. Their purchasing power is eroded by inflation… the general increase in prices. Fiat currencies have a long history of either becoming totally worthless and going out of circulation, or else becoming completely debased while remaining in circulation. Since the creation of the US Federal Reserve in 1913, the US dollar has lost over 98 per cent of its value – its purchasing power -- relative to gold.

► **A long-term inflation hedge.** Physical gold's ability to retain its purchasing power over time is sometimes referred to as the "Golden Constant". This reflects the fact that gold's purchasing power is constant over long periods of time. This 'constant' exists because the gold price adjusts to changes in inflation and future inflation expectations. Physical gold is a long-term hedge against inflation.

► **A 2500-year track record as money.** Because of its ability to retain value and act as a store of value, physical gold has been used as money for thousands of years. Gold coins were first issued in the Lydian civilization in what is now modern Turkey. Subsequently gold was used as a stable form of money in Persia, ancient Greece, ancient Rome, the Spanish and Portuguese empires, the British empire, and right through to the various international gold standards of the 20th century.

For 97 per cent of the last 2500 years gold has been chosen by numerous sophisticated civilizations as the form of money par excellence and an anchor of stability. It was only in August 1971 that the US suspended the convertibility of the US dollar into gold… a move which triggered the debt-fuelled global expansion that is still having repercussions.

► **A safe haven**. Physical gold acts as a safe haven asset in times of conflict, war and geopolitical turmoil. During the financial market stresses and heightened uncertainties caused by wars, conflicts and turmoil, the counterparty risk of most financial assets spikes. But since physical gold does not have any counterparty risk, investors rush to it during these periods so as to preserve their wealth. This is analogous to sheltering in a safe harbour. Gold can thus be seen as a form of financial insurance against catastrophe.

► **Portable anonymous wealth.** Gold bars combine high value with high portability. In times of conflict and war, gold bars and gold coins are ideal for transporting wealth and savings across borders and within conflict zones in an anonymous fashion.

► **Universal acceptance**. Gold is universally accepted as money, with the highly liquid global market always providing ample sales opportunities for gold bars and gold coins. This means that whichever city you are in across the world, you can always sell or trade your gold bars and gold coins.

► **Emergency money.** Military personnel are often issued with gold coins that they carry with them in conflict zones as a form of emergency universal money. For example, the British ministry of defence often issued RAF pilots and SAS soldiers with gold sovereign coins to carry on their persons during combat missions and activities.

► **Outside the banking system.** In the current era of global financial repression, physical gold is one of the few assets outside the financial system. Gold is not now issued as currency by any monetary authority or central bank or government. Gold is independent of the banking system. Fully owned physical gold, if stored in a non-bank vault or held in your possession, is outside the banking system.

► **No default risk.** Unlike a government bond, there is also no default risk with gold because it is not issued by any authority that could default. Gold bars and gold coins are no-one else's liability. Physical gold cannot go bankrupt or become insolvent. Therefore, there is no need to have to trust any other party when holding physical gold.

► **Portfolio diversification.** Adding an investment in gold to an existing portfolio of other investment assets such as stocks and bonds reduces the volatility (risk) of the investment portfolio and can increase returns. This is because the gold price has a low to negative correlation with the prices of most other financial assets, because gold is less influenced by business cycles than most other assets.

Numerous empirical studies by financial academics, as well as industry bodies, have validated gold's role as a strategic portfolio diversifier.

► **Currency hedge.** There is generally an inverse relationship between the gold price and the US dollar. The gold price generally moves in opposite directions to the dollar. Therefore, holding gold can act as a currency hedge and help manage the currency risk of portfolios.

► **Metallic properties.** Gold has many and varied metallic properties. These provide gold with many technological and commercial applications and uses, which in turn contribute as demand drivers in addition to investment and monetary demand for gold.

Gold is highly ductile (can be drawn into very thin wire). It is also highly malleable (can be hammered and flattened into very thin film). Gold is a very good conductor of electricity and heat. It does not corrode or tarnish. It is chemically unreactive and non-toxic to the human body. It has a high lustre and shine, and an attractive yellow glow.

These properties explain gold's use in electrical and electronic wiring and circuits (for example, computers and Internet switches), its use in the medical and dental fields, its use in solar panels and space travel, and gold's traditional uses in jewellery, decoration and ornamentation. With new technological uses being found for gold all the time, gold's demand pattern is diversified and underpinned by its commercial importance.

► **Physical gold - a tiny fraction of paper gold.** The London wholesale gold market and the US-based gold futures market generate huge trading volumes of paper gold that dwarf the size of the physical gold market. However, these markets only trade derivatives on gold (futures and unallocated positions), representing fractionally-backed and unbacked claims on gold that could never be convertible into physical gold by claim holders.

In a scenario under which these paper gold markets became unsustainable, the prices of paper gold and physical gold would diverge, with the paper gold markets ceasing to trade and collapsing, and only physical gold retaining any real value. Physical gold is therefore an insurance against the collapse of the world's vast paper gold markets.

► **Not an ETF.** Physical gold provides all the benefits that gold-backed Exchange Traded Funds (ETFs) do not. ETFs provide exposure to the gold price, not to gold itself. Holding physical gold is by definition direct exposure to gold. With most gold-backed ETFs you cannot convert the units into gold and take delivery of the gold, and in many cases the locations of the vaults are not even known. If holding physical allocated gold bars or gold coins in a vault, such as with BullionStar in Singapore, you can always take delivery.

Gold ETFs have many counterparty risks since there are many moving parts in an ETF such as a trustee, a custodian, and a sponsor/issuer. Physical gold has no such counterparty risks. When you hold a gold-backed ETF, the quantity of gold backing the ETF declines over time due to management fees being offset against the gold holdings. When you hold physical gold, you always remain with 100 per cent of the actual gold you first purchased. There is no erosion of holdings.

► **Anonymous storage.** Gold can be stored anonymously, either in your possession within your house or property, or in a vault in a jurisdiction, such as Singapore, that has no reporting requirements. Since gold has a high value to weight ratio, storing gold does not take up much space.

► **Independent of Internet.** Owning physical gold is not reliant on having Internet access and access to electronic wallets and cryptocurrency exchanges. Furthermore, gold cannot be stolen by hacking an electronic address or by transferring or deleting a number in a computer.

► **Real gold is measured by weight.** Physical gold is measured in weight, not through a number set by a politician or central banker. When you buy a kilo gold bar, a 10 Tola gold bar or a one-ounce gold coin, you will always have that bar or coin, irrespective of the fluctuations of currencies. While thinking of the value of physical gold in terms of a fiat currency might be convenient, a better way is to think of a gold holding in terms of the weight you own.

► **Collectibles**. Buying investment gold bars and bullion gold coins allows you to build a diverse collection of bars and coins that are at the same time a fascinating pastime as well as a form of investment and saving.

Bullion gold coins from the world's major mints are beautiful and often have a connection to history. Investment gold bars from the world's major gold refineries are distinctively different from one another and you can vary a collection by cast or minted bars, and a selection of weights.

► **Physical gold feels like real wealth.** When you hold a handful of one-ounce gold coins in your hand, you intrinsically know that you are holding real wealth; they're something that is scarce and that has been costly to produce.

► **Loan collateral.** Gold can be used as loan collateral. Since gold is highly liquid and valuable, it can be lent and used as a form of financing, and as a way of generating interest. The wholesale gold lending market between central banks and bullion banks is highly active. Likewise, retail gold holders can also in various ways lend their gold to receive financing or interest, with new innovations to do this arising all the time.

► **Central banks hold gold.** Although the world's central banks like to downplay the importance of gold because it competes with their fiat currencies, most of them continue to hold substantial amounts of physical gold bars and gold coins in their vaults. They hold this gold as a reserve asset on their balance sheets, valuing this gold at market prices.

Like private gold investors, central banks hold physical gold because it is highly liquid, it lacks counterparty risk, and because gold is a safe haven or 'war chest' asset that acts as a financial insurance in times of crisis. Central banks also hold gold for the unpublished reason that if and when gold re-emerges at the centre of a new monetary system, these very same central banks will not be caught out having no gold.

► **For gifting.** Gold coins and small gold bars make great gifts. Gold is a traditional gift in many societies around the world. Gifting a gold coin or small gold bar to mark a birth, anniversary, wedding or other special occasion is an ideal present that will be highly appreciated by the recipient.

► **For inheritance.** Gold bars and gold coins are a great form of inheritance for your children and family members. Because gold is real, tangible, valuable, and has a highly liquid trading market, it is an ideal asset for inter-generational wealth transfers. Because it's fabricated in convenient weight denominations, such as troy ounces and kilograms, it can be distributed equitably among recipients, as often specified in wills and trusts.

After the recent price acceleration we can expect the gold market to pause. That will offer investors an opportunity to buy in, or to buy more.

Update on the Pandemic

The "experts" and their media propagandists continue to drown us with a daily flood of facts about the pandemic chosen to disguise the important realities -- that most of what's been done has been misguided, foolish and economically catastrophic.

One example is the focus on the number of infections, not what matters – number of Covid-19 deaths and their relation to populations. Dr Anthony Fauci, the most publicized expert, likes to scare Americans into doing everything he tells them to do by suggesting the current pandemic is just like the Spanish flu of 1918. But that killed 655 per hundred thousand of the US population. To date the Covid-19 death-toll is only 43 per hundred thousand.

Some of the biggest countries are recording amazingly low figures. In India the virus has killed only two people per hundred thousand. In Brazil less than 4 per cent of those infected are dying. Nowhere is Covid-19 much worse than a bad outbreak of flu. That's why I call the extreme policies of lockdowns and border closures the Self-Inflicted Disaster.

You may remember that I suggested months ago that the extraordinarily low infection rates and deaths in East Asia could be because people of Mongoloid race have strong genetic resistance to the virus. Till now nobody has wanted to say that could be so, because of fear of being accused of racism.

However now I see that the *New York Times*, in an article about Thailand's amazing success fighting Covid-19, suggests there could indeed be a genetic component in the immune systems of Thais and other peoples of the Mekong River region. Thailand has experienced only 58 deaths from the virus; Vietnam none at all; China's southwestern province of Yunnan fewer than 190 cases.

Meanwhile the world as a whole suffers economic damage imposed by governments on a cataclysmic scale out of all proportion to the scale of the threat they sought to combat.

Tim Price, the British investment commentator, suggests that events this year could have unfurled in a different way if Covid-19 had first emerged not in China, an insanitary, chthonic, authoritarian third world country, but in an orderly democratic one like Switzerland. "Chances are surely that Swiss citizens would not have been welded inside their homes while its government colluded to ensure the deaths of as many inhabitants of the rest of the world as possible."

Matt Ridley, the commentator on scientific affairs, warns that even if there's a second wave of Covid-19 infections in Britain this autumn/winter, imposing another national lockdown "would be a huge mistake, given the harm the first one has done to everything from cancer diagnosis to mental health… let alone employment."

Finally, the issue of whether or not children should return to school continues to rage on with little consideration given to the key facts. For example, that in the US in the February-April period only 15 children died from Covid-19… but 13,000 children died from other diseases, accidents and other causes.

Threats to Big Tech

Facebook, Apple, Amazon, Alphabet (Google), Netflix and Microsoft account for a combined 23 per cent of S&P 500 total market capitalization and 15 per cent of S&P 500 consensus forecast earnings for this year.

But, says Jefferies' Chris Wood, targeted taxation and regulation of this 'Big Tech' group is coming. They are issues on which the socialist Left and the Free Market agree, in the same way that both wanted to nationalize the bailed-out banks in 2008. This means that such policies can potentially be implemented whoever wins in November.

What could the policies look like?

On the taxation front, it could be as simple as a windfall profits tax. Amazon paid only $162 million in federal income tax last year while Walmart, its largest competitor, paid $2.76 billion.

On the regulation front, what Chris calls "a long overdue reform" is to make social media platforms responsible for their content in the same way as media companies have always been responsible for content.

Another long overdue reform is anti-trust action by, for example, forcing divestment of WhatsApp and Instagram in the case of Facebook or YouTube in the case of Google. Students of American history will know that there is a long and proud history of anti-trust activism.

Time to Look East

Asia's emerging economies could be major beneficiaries of the current global crisis and therefore a good place to go for investment profits says Roderick Snell of the highly-rated British fund manager Baillie Gifford.

The region has seen the most effective response to the pandemic – no coronavirus deaths in Vietnam and hardly any in Taiwan, for example. Financial and monetary stimulus programmes have been modest compared to the avalanche of cash in developed economies. "Such profligacy will be a major financial burden for years to come, leading to slower growth and potentially weaker currencies. The majority of Asia ex Japan looks attractively placed in comparison."

As the global economy's supply chains shift and localize, Asian companies will have to focus on regional demand, for example adoption of the on-line economy across Southeast Asia, and to new ways of doing business such as increasing use of cloud infrastructure in China.

"We still see good earnings growth from the majority of our holdings and valuations are at a significant discount to slower-growing developed markets. For investors, we see the sun rising favourably in the East."

Perhaps the most important change the fund manager has seen during the crisis is an acceleration in the adoption of technology, improving economies of scale and strengthening of competitive moats around some leading tech firms. Snell identifies Meituan Dianping, the on-line food delivery business; Dong Talk, the world's largest collaboration service for companies; and SEA Ltd, the ASEAN e-commerce and gaming firm.

"Surging demand initiated by Covid-19 has dramatically shortened the time required for companies to scale up and achieve dominance. The winners will establish themselves over the next couple of years rather than decades."

The fund manager predicts: "Profits will accrue to an increasingly small number of existing players. An enduring feature of this crisis is likely to be the strong getting stronger."

The Long-Term Outlook for Earnings

A lost decade for US equity investors is predicted by Bridgewater, the giant hedge fund. Risks to corporate margins are high and rising.

Looking beyond the current, pandemic-driven downturn in profits, recent developments make it more likely that margins will come under pressure. Several of the key secular trends that have delivered a surge in profits in recent decades have gone into reverse.

"Globalization, perhaps the largest driver of developed-world profitability over the past few decades, has already peaked. Now the US-China conflict and global pandemic are further accelerating moves by multinationals to re-shore and duplicate supply chains, with a focus on reliability as opposed to cost optimization."

Secondly, there's the emergence of rising anti-corporate sentiment at a time of record budget deficits. That creates a substantial risk of higher taxes and more regulation, leading to lower concentration and pricing power.

However the good news is that the main positive tailwind of the past decades – automation -- may continue.

Margins have collapsed massively as a consequence of anti-virus measures. But experience of recoveries from recessions over the last three decades is that margins are likely to rebound rapidly to a new higher level as growth in employment and wages lag.

Most of the displacement of routine jobs – the ones which automation replaces – occurs during recessions. The turmoil that results allows companies to make more of the structural changes that are otherwise difficult in normal times.

China's Foreign Relations

To counter the threat posed by those who view China as an enemy, such as the national security zealots in Washington, Beijing will continue to open up its economy to American and other foreign direct investors, predicts Jefferies' Chris Wood. This is reflected in the recent trend of allowing wholly-owned car plants, as in the cases of BMW and Tesla

There is much talk of a growing diversification of production out of China, the result of greater appreciation of the practical risks associated with extended just-in-time supply lines as a consequence of the lockdowns. "This is certainly likely to prove a bigger driver of relocation out of China than the Trump administration's tariffs."

However, this trend should be kept in perspective. "China remains by far the most efficient place to manufacture in the world," given the quality of its logistics and infrastructure, and its economies of scale.

It also offers access to its massive domestic market. Published data suggest that American companies sell nearly three times more in China than they export to it.

Germany and Poland

The North Atlantic Treaty Organization is slowly disintegrating as member-states' sense of unity erodes. One example is how Germany and Poland differ in their evolving relationships with the US.

Germany increasingly resents being treated as a client state. It is furious over America's aggressive moves to prevent completion of the North Stream 2 Russian pipeline to advance the interests of American gas exports. There are mounting differences over military links – the US is cutting by one-third its forces based in Germany, which in turn refuses to buy F-35 fighters.

Poland, in contrast, is doing all it can to strengthen military ties with the US. Its recent weapons procurement has been focused on American systems – Patriot, Javelin, HIMARS (artillery), F-35. It would like any forces leaving Germany to be moved east into Poland. There's even speculation that America could shift its tactical nuclear missiles from Germany to Poland.

Apocalypse Never

Activist Michael Shellenberger – his credentials include being named by *Time* as one of its Heroes of the Environment – now says the public have been misled about climate change for decades. Some examples…

► Climate change is not making natural disasters worse. Fires have declined around the world by 25 per cent since 2003.

► Rising oceans aren't necessarily going to be a bad thing. Adapting to life below sea level made the Netherlands rich, not poor.

► Carbon emissions are declining in most rich nations. They've been falling in Britain, Germany and France, for example, since the 1970s.

► Using wood for fuel pollutes the air and adds to carbon emissions; is far worse for people and wildlife than using fossil fuels

► Greenpeace didn't save the whales. What did was switching from whale oil to petroleum and palm oil.

Tailpieces

Europe: Currently it's the region drawing renewed interest of equity investors, the *FT*'s Michael Mackenzie reports. Having contained Covid-19 it has engineered a relatively smooth reopening of economic activity, and the promise of greater fiscal unity has finally appeared with the agreement of a seven-year budget for the European Union and a €750 billion grant-and-loan plan to counter the pandemic devastation.

There's a reduced threat of weakness in the currency – the euro has been strengthening for several months. European companies are showing signs of outpacing US rivals in terms of earnings growth. German stocks have done better this year than the rest of Europe, or the UK.

Tax: The European Commission is planning “an unprecedented legal assault” on European Union member-nations such as Ireland, the Netherlands, Belgium and Luxembourg over their advantageous corporate tax regimes.

Previous attempts to prevent countries competing with low rates of tax have been frustrated by the requirement that such challenges have needed to receive unanimous support – impossible because tax-cutting nations wouldn’t vote against their own interests.

Now the Commission is exploring ways to use a treaty instrument never used before that would require only a qualified support; not unanimity.

Doing it at home: There are going to be companies that capture an enduring advantage from the coronavirus. But for others, it will only be short-term in nature.

A Californian friend says one thing he knows from numerous Zoom meetings he’s taken part in is they are no replacement for personal contact. His teenage children, who were subjected to six weeks of school over Zoom, hate the platform and will ditch it at the first opportunity. That does not suggest long-term stickiness for the platform.

Silver: Unlike gold, this precious metal still has a long day to go to recover its previous high in 2011, but it’s similarly rising strongly. Investors have picked silver as a way to play the boom in “green” assets, says GMO’s Colin Hamilton. Industrial applications, including electronics and photovoltaic cells used in solar panels, account for about 55 per cent of demand for the metal.

Climate change: The European Union has more than halved its planned allocation to the proposed Just Transition Fund to ease the burden of going green. Hardest hit will be Poland, which gets seven-tenths of its electricity from coal-fired stations.

Wise words: *Learn from yesterday, live for today, hope for tomorrow; the important thing is not to stop questioning.* Albert Einstein

Martin

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