Incredible markets.

Charles Gave

In fact, the more I try to understand what is happening in the markets, the more amazed I am.

I find myself face to face with extraordinarily subtle and efficient "ecosystems" which constantly seek to constantly arbitrate the values of time, work and capital in the most efficient way possible. And, time after time, politicians, regulators, civil servants arrive with their big hairy and greasy fingers and fiddle with these infinitely delicate mechanisms to satisfy their whim of the moment (ecology, social justice, protectionism, industrial strategy or whatever else I know). …).

As far as I am concerned, I have always considered that my duty as an analyst is to try to understand how these systems work in order to better support them in their operation.

But, almost never , I suggest improvements, replacements, interventions as I know that any manipulation risks destroying mechanisms of which I sometimes did not even suspect the existence.

And one of these mechanisms appeared to me quite some time ago, and for months I looked at it and said to myself, this *can't be a coincidence, but what good can it possibly do* ?

I think I understand and so I'm going to talk to you again about this phenomenon which left me speechless when I came across it somewhat by chance.

That's what it's about.

1. The most representative index of American capitalism is the American Standards & Poor's, which includes 500 companies.
2. A large number of these companies pay dividends, so by taking the average of all dividends weighted by the weight of each company in the index we can calculate the dollar dividend paid by the index over the past century and half at least.
3. And this dividend appears in red in the graph below.

And that's where the mystery begins.

Since 1923 (a century), if I calculate the gold value of the dividend paid by the S&P 500 in gold and not in dollars, this dividend always amounts to...1 gram of gold.

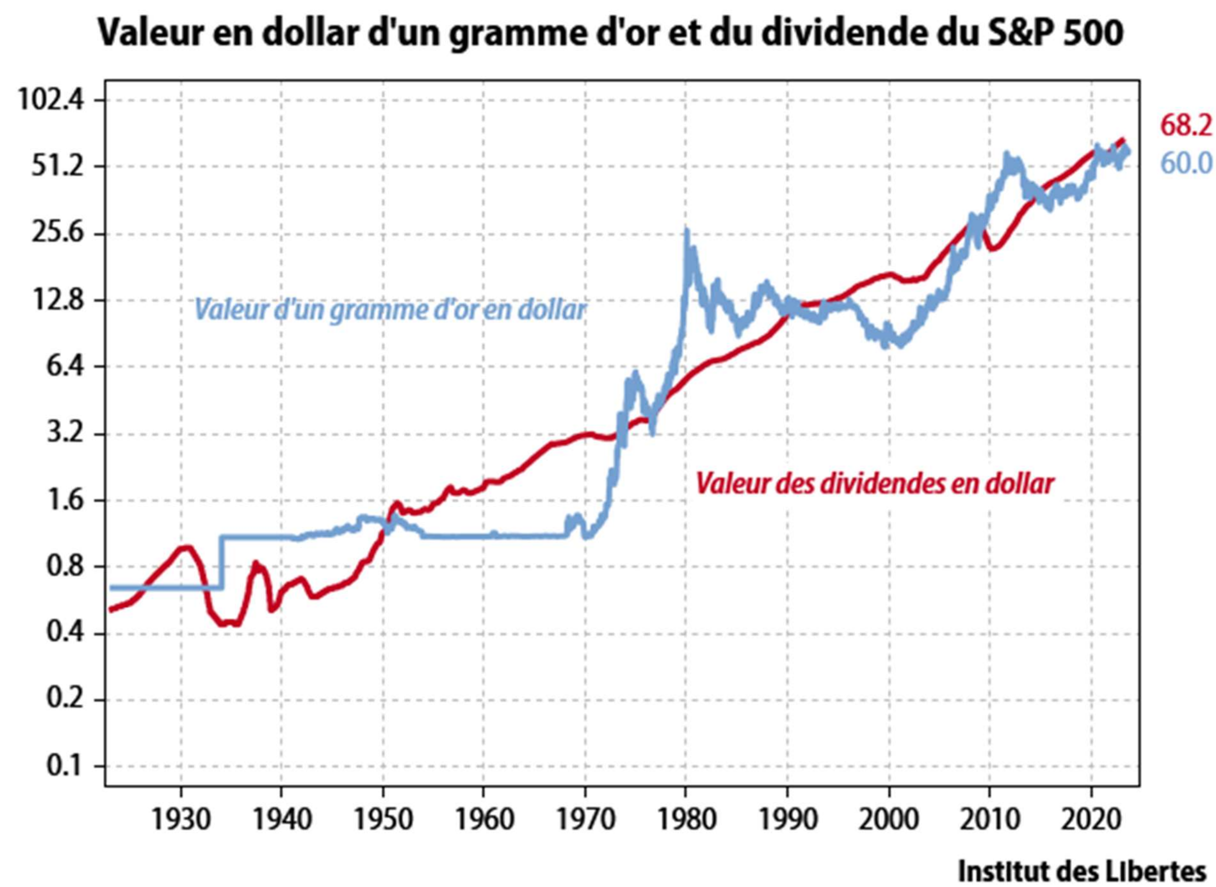
Sure, sometimes we stray from that “price,” but we always seem to come back to it.

As a result, the ratio of dollar values between dividends and gold most of the time wanders between 0.5 and 1.5.

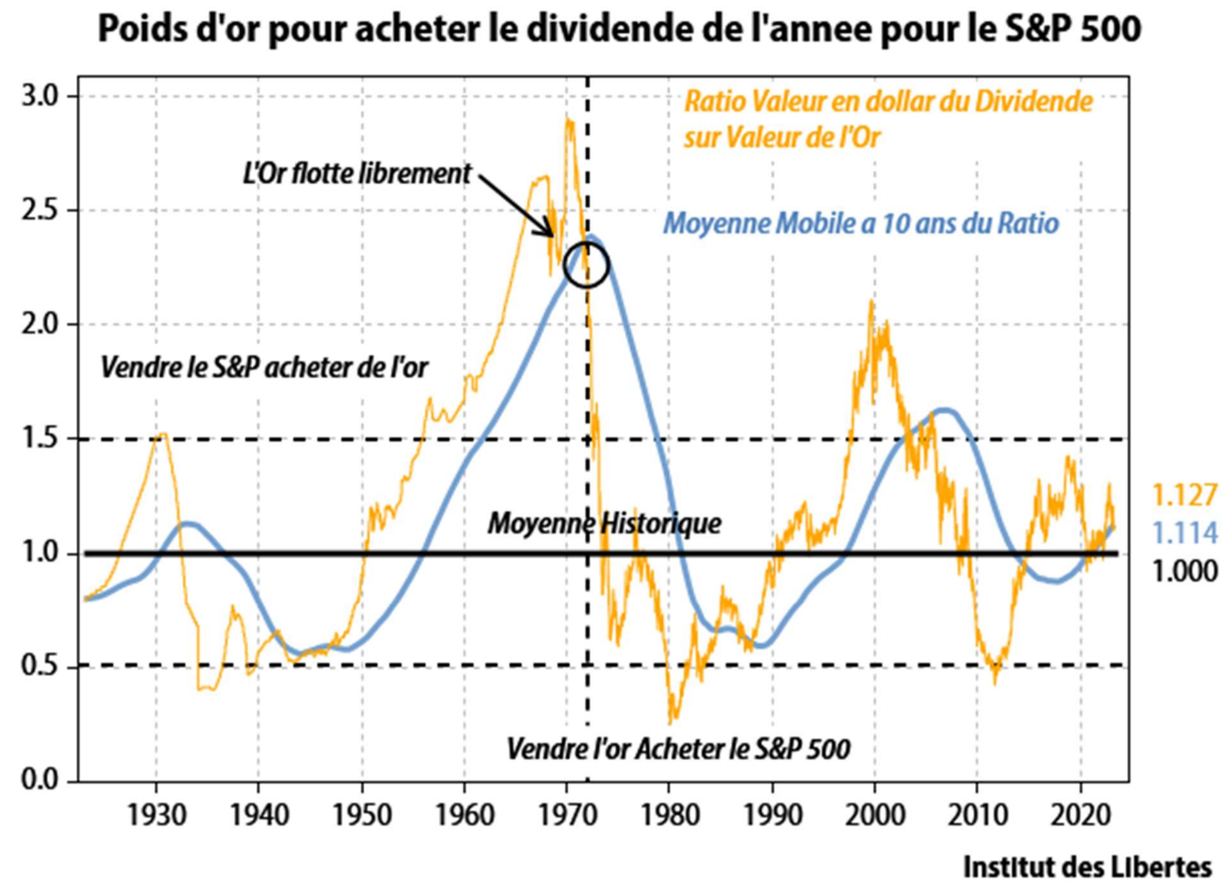
The mean reversion effect therefore seems to be very strong.

And for months, I racked my brain, saying to myself: “But why? »

I think I found the explanation.



But the following graph is even more astonishing.



As the reader can see, in a century, the ratio of dividends to gold has returned to 1 ten times, after having deviated in one direction or the other.

It can't be a coincidence .

And in the following paragraphs, I will expand on the explanation I found.

But if anyone finds a better one, I'd be very interested to know about it.

Explanation

One of the problems of capitalism is preventing those who have money from hoarding it and therefore burying their talents.

Let's take an example: I inherit 100 kilos of gold, which is worth 60 dollars per gram. $60*100000=$6 million.

I have a choice to make.

First hypothesis: I am forty years old, no heir and I think, always optimistic, that I would live to be a hundred.

In this case, I can sell 1/60 of my gold at the beginning of each year and live comfortably with these sales.

After all, $6,000,000/60 – $100,000 per year.

And so, if I am satisfied with $100,000 per year, as gold does better or as well as inflation in the long term, I lead a quiet life as an annuitant.

The only problem occurs if I live 110 years since, for the last ten years, my capital will be exhausted, which risks making my end of life a little sad.

The second solution is to sell my gold and put all of my capital in the S&P 500.

Today, the immediate yield of the S&P 500 is 1.7%.

My six million dollars therefore bring me 0.017* 6000000= $102000/year, which is approximately what I would receive if I sold my gold.

The two solutions are therefore equivalent in terms of immediate profitability and historical protection against price increases.

What I did, however, is obvious: I stopped being an annuitant and became an investor, and as a result, my risks increased significantly.

What are these risks?

There is one and only one: that the dividends paid by the companies that make up the S&P 500 index do not collapse, as happened from 1929 to 1934.

And so, for those who think that capitalism is finally going to experience its great final crisis, it is better to have gold.

But in the event that this dear system of exploitation of man by man were to survive as it has always done throughout history, well, I could live to be two hundred years old without any problem, my capital remaining mine .

Which is not nothing.

But the value of my capital can vary very greatly, which I don't care about as only the dividend payments matter to me.

Today, transforming my gold into shares is almost indifferent to me.

Let's imagine that in the coming months, the stock market falls by 50%, that gold stays where it is, that the yield therefore increases from 1.7% to 3.4% and that the ratio goes from 1 to 1.5

At that point, I can sell half of my gold and buy the equivalent in shares, which allows me to double my annual income.

If the ratio passes, after a fall in gold from 1 to 0.5, on the other hand, I must sell my shares to buy gold.

And this is undoubtedly why the ratio has oscillated between 1.5 and 0.5 for a century and a half.

Conclusion

We are around 1, for those who have gold, it is urgent to do nothing.

On the other hand, if the market begins to fall, we must not forget to transform all or part of this order into productive capital when the latter becomes undervalued.

Basically, the ratio of dividends to gold tells us when we should bury our talent, and when we should dig it up.