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Telling tales about money

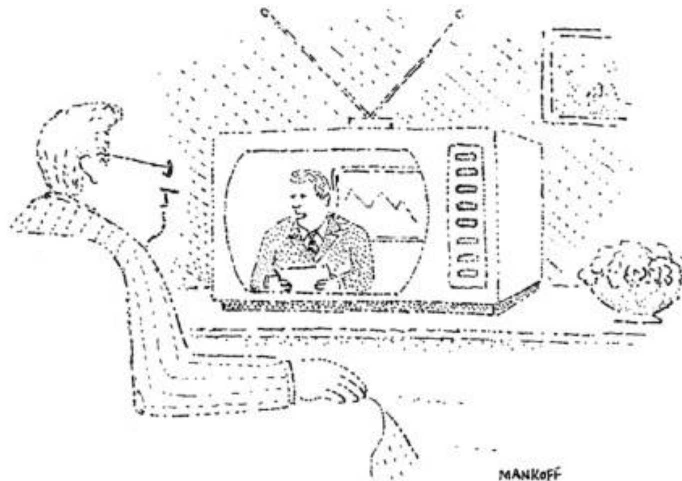
"With the US economy showing signs of recovery and fears about the eurozone sovereign debt crisis easing, investors are putting their money into equities and other assets geared towards economic growth rather than havens such as gold."

- Jack Farchy, Financial Times, 23rd March.

"**Growth gloom bolsters government debt**

Reminders of the risks to the global growth outlook put equities and commodities on the back foot and helped government bonds in the US, Germany and the UK recoup more of their recent losses."

- Dave Shellock, Financial Times, 23rd March.



"On Wall Street today, news of lower interest rates sent the stock market up, but then the expectation that these rates would be inflationary sent the market down, until the realization that lower rates might stimulate the sluggish economy pushed the market up, before it ultimately went down on fears that an overheated economy would lead to a reimposition of higher interest rates."

(Courtesy: Condé Nast)

Screenwriter William Goldman famously began his autobiography, 'Adventures in the Screen Trade', with three telling words: Nobody Knows Anything. The same logic would seem to apply to much conventional reporting of the financial markets. Any investor looking for informed analysis of market developments can therefore save themselves a few minutes every day by choosing not to read any of the 'Companies and Markets' section of the FT, which typically constitutes a fantastic piece of fiction. If there is a more thankless task in finance than trying to explain why certain markets did what they did yesterday, we don't know what it is. (Unless it's working in the PR department at Goldman Sachs.)

But as Soc Gen's Dylan Grice has frequently pointed out, human beings are suckers for stories. We seek meaning from just about everything, and financial markets are no exception. Why else would otherwise rational people shell out £2.50 every weekday just to read a selection of vapid and contradictory speculations about recent market price action ?

At the risk of going out on a limb, here is our own inherently subjective "take" on the current market environment. Investors seem to believe that the euro zone debt metastasis has gone into remission. There is an uneasy calm to both equity and bond markets – it feels like the calm before the storm. Gold prices have softened, offering investors yet another second chance to get back on board what is perhaps the most compelling form of money- and portfolio insurance available. And Goldman Sachs are launching a muppet hunt across their internal emails.

Both Goldman and Barclays have also issued research notes recommending equities over bonds. It is certainly difficult to get excited about G7 government bond markets except from the perspective of shorting them. As managers Stratton Street recently observed, there are over $10 trillion in marketable US government securities out there, and yet their average yield amounts to less than 1%. But it might yet be dangerous to adopt Goldman's binary response which is to advocate blanket support for stocks. This is not a black vs white issue. Just because most government bond markets are uglier than sin does not automatically justify going 'all in' on the stock market – even as deposit rates remain painfully thin. We nurse an ongoing fear that equity markets are being largely supported by the inflationist antics of central banks. That may have led to many investors becoming addicted to the effects of cheap credit, and they may not like it when cheap credit is ultimately withdrawn. But whatever is driving equity sentiment, there are undoubtedly pockets of value for those with the stamina and patience to embrace them. In Don Coxe's latest and typically excellent letter, 'All Clear ?', he highlights the opportunity in precious metals mining companies:

"If there were one over-arching theme at the BMO Global Metals & Mining Conference, it was that the gold miners are upset and even embarrassed that their shares have so dramatically underperformed bullion.

"On the one hand, they were delighted in 2011 when it was reported that since Nixon closed the gold window, a bar of bullion had delivered higher investment returns than the S&P 500 for forty years – ***with dividends reinvested***. But some gold mining CEOs find it an insult that what they mine is more respected than their companies' shares. These people are justly proud of their skill and guts in finding and developing mines, and in extracting increasingly minute percentages of gold from tons of ore in increasingly challenging environments..

"Like them, we are disappointed at this sustained underperformance because it challenges the validity of our core theme for successful investing in mining and oil stocks: Buy companies with the best record for continuously increasing their proven and provable reserves – and resources – in

the ground in politically-stable regions of the world. Don't buy them on current earnings – the earnings will come eventually – it's stuff in the ground that matters.

"***In our view, we have entered the most favourable era for gold prices in our lifetime – and the share prices of the great mining companies will eventually outperform bullion prices***."

Gold remains one of the most widely misunderstood assets in the investible world. Indeed, it may be better to refer to it as a means of saving that does not expose the saver to counterparty or credit risk or to the depradations of the monetary authorities. As Don Coxe makes clear, governments are running deficits "beyond the forecasts of all but the hardiest goldbugs five years ago; central banks are printing money and creating liquidity beyond the forecasts of all but the most paranoid goldbugs a year ago." The choice for the saver is essentially binary: hold money in ever-depreciating paper, or in a tangible vehicle that has the potential to rise dramatically as expressed in paper money terms. Why large cap gold miners are being so undervalued by equity investors is an open question that takes us back to the realms of stories. That the discount exists is undeniable; all that is required to crystallise that value, we believe, is patience.

Another observation of the monetary system (hat-tip to Eric Everard):

"What we see at present is a battle between the central banks and the collapse of the financial system fought on two fronts. On one front, the central banks preside over the creation of additional liquidity for the financial system in order to hold back the tide of debt defaults that would otherwise occur. On the other, they incite investment banks and other willing parties to bet against a rise in the prices of gold, oil, base metals, soft commodities or anything else that might be deemed an indicator of inherent value. Their objective is to deprive the independent observer of any reliable benchmark against which to measure the eroding value, not only of the US dollar, but of all fiat currencies. Equally, they seek to deny the investor the opportunity to hedge against the fragility of the financial system by switching into a freely traded market for non-financial assets."

This quotation from Peter Warburton is extraordinary, in that it was written back in April 2001. If central bank liquidity provision was a problem back then, it's difficult to know how to describe the nature of the problem today.

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