PRICE VALUE PARTNERS

Pet Rock Star **8th June 2020**

"About one hundred years ago, John Ruskin told the story of a man who boarded a ship carrying his entire wealth in a large bag of gold coins. A terrible storm came up a few days into the voyage and the alarm went off to abandon ship. Strapping the bag around his waist, the man went up on deck, jumped overboard, and promptly sank to the bottom of the sea. Asks Ruskin: 'Now, as he was sinking, had he the gold ? Or had the gold him ?'"

- Peter L. Bernstein, *The Power of Gold: the history of an obsession*.

There are two distinct pleasures at this time of year. One is to see, and hear, the swifts back from Africa, weaving through the summer air, diving, wheeling and screeching like sooty little Spitfires. The other is to welcome the annual release of Incrementum AG's magisterial research note on the most misunderstood asset in the world, In Gold We Trust.

This year's edition, running to an epic 356 pages, does not disappoint. Authors Ronni Stoeferle and Mark Valek have surpassed themselves. And in light of the most surreal depression in history – a "voluntary" suppression of economic activity caused by a grisly coalition of panicking politicians, priapic epidemiologists and ghoulish media – 2020 may yet be the year in which gold takes on ***all*** comers in the financial markets, and still manages to win.

Notwithstanding the fact that we have been investing (not speculating, ***investing***, in the Benjamin Graham sense of the word) in gold and gold-related equities for two decades, we were still taken aback by some of Incrementum's data.

Take the table below, for example.

It turns out that since 2001, gold in just about every currency has delivered, on average, annual gains of between 9% and 13%. Not bad for a pet rock.

Those returns have come without any credit, interest rate or counterparty risk. Indeed, part of the whole point of owning gold is that it entirely removes credit, interest rate or counterparty risk. Take that, banks !

The problem, if you can call it that, with gold is that it does tend to provoke fierce emotions in people, as the Ruskin quote attests. But let's not pretend that certain stocks don't do that, either.

Gold performance since 2001 in various currencies (%)

	EUR	USD	GBP	AUD	CAD	CNY	JPY	CHF	INR	Average
2001	8.1%	2.5%	5.4%	11.3%	8.8%	2.5%	17.4%	5.0%	5.8%	7.4%
2002	5.9%	24.7%	12.7%	13.5%	23.7%	24.8%	13.0%	3.9%	24.0%	16.2%
2003	-0.5%	19.6%	7.9%	-10.5%	-2.2%	19.5%	7.9%	7.0%	13.5%	6.9%
2004	-2.7%	5.3%	-2.3%	1.8%	-1.9%	5.3%	0.7%	-3.4%	0.6%	0.5%
2005	36.8%	20.0%	33.0%	28.9%	15.4%	17.0%	37.6%	37.8%	24.2%	26.1%
2006	10.6%	23.0%	8.1%	13.7%	23.0%	19.1%	24.3%	14.1%	20.9%	17.2%
2007	18.4%	30.9%	29.2%	18.3%	12.1%	22.3%	22.9%	21.7%	16.5%	21.7%
2008	10.5%	5.6%	43.2%	31.3%	30.1%	-2.4%	-14.4%	-0.1%	28.8%	15.5%
2009	20.7%	23.4%	12.7%	-3.0%	5.9%	23.6%	26.8%	20.1%	19.3%	16.5%
2010	38.8%	29.5%	34.3%	13.5%	22.3%	24.9%	13.0%	16.7%	23.7%	25.2%
2011	14.2%	10.1%	10.5%	10.2%	13.5%	5.9%	4.5%	11.2%	31.1%	11.2%
2012	4.9%	7.0%	2.2%	5.4%	4.3%	6.2%	20.7%	4.2%	10.3%	7.5%
2013	-31.2%	-28.3%	-29.4%	-16.2%	-23.0%	-30.2%	-12.8%	-30.1%	-18.7%	-24.1%
2014	12.1%	-1.5%	5.0%	7.7%	7.9%	1.2%	12.3%	9.9%	0.8%	6.2%
2015	-0.3%	-10.4%	-5.2%	0.4%	7.5%	-6.2%	-10.1%	-9.9%	-5.9%	-3.8%
2016	12.4%	9.1%	30.2%	10.5%	5.9%	16.8%	5.8%	10.8%	11.9%	12.3%
2017	-1.0%	13.6%	3.2%	4.6%	6.0%	6.4%	8.9%	8.1%	6.4%	6.3%
2018	2.7%	-2.1%	3.8%	8.5%	6.3%	3.5%	-4.7%	-1.2%	6.6%	2.6%
2019	22.7%	18.9%	14.2%	19.3%	13.0%	20.3%	17.7%	17.1%	21.6%	18.3%
2020 ytd	17.6%	14.3%	24.4%	22.7%	23.0%	17.0%	13.2%	14.8%	22.0%	18.7%
Average	9.7%	10.7%	12.0%	9.5%	10.0%	9.7%	10.1%	7.8%	13.0%	10.3%

Source: Goldprice.org, Incrementum AG, figures as of May 22, 2020

So gold has "worked" for the last two decades. So what ?

Its finest hour may yet be to come.

What Sean Corrigan has nicely styled 'The Great Suppression' has done two things. It has forcibly shut down most of the global economy for what now appears to no good reason. (It now appears, according to the US Centres for Disease Control, that the infection fatality rate of Covid-19 is around 0.26%, or barely more lethal than a bad flu. Did that warrant shutting down the entire economy and ushering in higher death rates for all those unfortunates with dangerous but non-Covid conditions ? Even given the transcendent power of hindsight, it would have made more sense to quarantine the genuinely vulnerable, and allow the rest of the population to weigh the risks for themselves.) Secondly, it has unleashed the sort of monetary and fiscal stimulus that makes the QE unveiled during the Global Financial Crisis look like some sort of rounding error near zero. As James Ferguson points out for the MacroStrategy Partnership, the Fed's QE response to coronavirus has been, in the course of just two months, equivalent to more than half of what was done over a period of 6 years during and after the Global Financial Crisis.

Precious metals prices, being precious, have responded in exactly the way you would have expected them to, in the light of such an inflationary explosion. (Classical economists define inflation as an increase in the money supply – what is popularly regarded as inflation, in the form of higher goods and services prices, is essentially a second-order effect.)

But we have always focused – for the purposes of asset class diversification and robust portfolio protection – on the monetary metals, gold and silver. So we discriminate between precious metals that have historically always ***been*** money, and precious metals that may be scarce but which are also more vulnerable to the vicissitudes of the industrial cycle. So in our world, we have always valued gold and silver as pre-eminent money hedges. And we supplement the somewhat blunt tool of bullion with shares in reasonably priced gold and silver miners in politically stable jurisdictions where those companies are generating meaningful cash flows at current bullion prices but operating with little or no attendant debt.

As we observe in our book, *Investing through the looking glass*:

> Money, of whatever form, has uses. Traditional economists assign money three characteristics. It is a unit of account – we can price things with it. It is a medium of exchange – we can use it as a helpful replacement to the barter system, exchanging one good for another. And it is a store of value – it retains its purchasing power over time.
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> Our modern electronic money still retains the first two characteristics. But as for the third! Since the establishment of the Federal Reserve in 1913, the US dollar, for example, has lost roughly 98% of its purchasing power. The pound sterling has fared no better. Indeed every unbacked paper currency in history has ultimately failed. The dollar will be no different. It is only a question of time.
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> Gold and silver developed as money in a free market. Throughout human history we have used all kinds of things as money – cattle, shells, nails, tobacco, cotton, even giant stone slabs. But gold and silver always won out over the competition. People tended over time to favour the precious metals as money because of their scarcity, durability, malleability and beauty. Their use arose without coercion. Gold is the money of freedom.
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> Gold is also scarce. And it is horribly expensive, in both capital and human terms, to dig out of the earth and process. To produce one ounce of fine gold requires 38 man hours, 1400 gallons of water, enough electricity to run a large house for ten days, up to 565 cubic feet of air under straining pressure, and quantities of chemicals including cyanide, acids, lead, borax and lime.
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> Being chemically inert, gold lasts. Peter L. Bernstein (in his somewhat sceptical treatise *The Power of Gold: The History of an Obsession*) points out that you can find a tooth

> bridge made of gold for an Egyptian 4500 years ago. Its condition is good enough that you could pop it into your mouth today.
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> And it is wonderfully malleable. If you have just an ounce of gold, you can beat it into a sheet covering one hundred square feet. Or if you prefer, you could draw it into a wire 50 miles in length.
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> Clearly, gold is also a thing of beauty. "Oh, most excellent gold!" said Columbus on his first voyage to America. "Who has gold has a treasure [that] even helps souls to paradise."
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> But gold is heavy, dense and impractical to carry around. So using paper certificates to represent gold held safely in reserve was a logical next step. The problem arose when greedy bankers realised that they could print more certificates than they had gold in reserve to back them.
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> The language associated with gold is invariably derogatory today. Those of us who see any role for gold in the modern world are dismissed as *goldbugs*. [Our] response is to label those sceptics *paperbugs*: they have to believe that unbacked fiat money will last. History, however, is on [our] side.
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> In recent monetary history 1971 amounts to Year Zero for gold, because as we saw earlier that is when President Nixon finally took the US dollar off the gold standard. This has led to a 40-year-plus experiment in money that remains unprecedented. When Robert Mundell was made a Nobel Laureate in Economics in 1999, he pointed out that the "absence of gold as an intrinsic part of our monetary system today makes our century, the one that has just passed, unique in several thousand years."
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> Robert Mundell could see the way the world was going. In March 1997, two years before receiving his Laureate, Mundell would remark, ominously, "Gold will be part of the international monetary system in the twenty-first century." The author Nathan Lewis agrees. The title of his 2007 book on the subject? *Gold: The Once and Future Money*.

The value of gold is partly contextual. Amidst financial stability and in an environment of sound money, it is barely needed. Amidst acute financial uncertainty, a second Great Depression, wild and building inflationary pressure, and during what are probably the terminal stages of an unsustainable build-up of global debt, it may be the single most compelling asset to own – whether in the form of a source of prospective profits, or simply as a means of ensuring that investors have some form of capital left when the dust finally settles. Gold, in short, may yet have its best days to come. It is still not too late, in our view, to board this train.

Tim Price is co-manager of the VT Price Value Portfolio and author of 'Investing through the Looking Glass: a rational guide to irrational financial markets'. You can access a full archive of these weekly investment commentaries here. You can listen to our regular 'State of the Markets' podcasts, with Paul Rodriguez of ThinkTrading.com, here. Email us: info@pricevaluepartners.com.

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