Investment Strategy January 2018

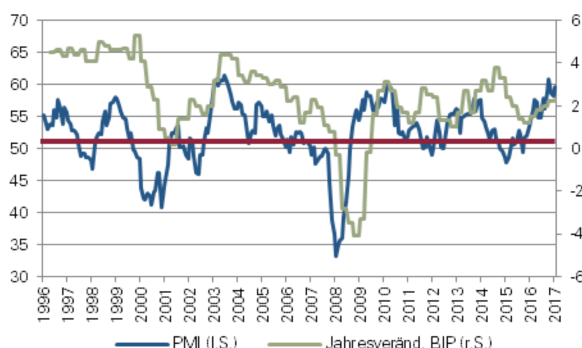
Purchasing Manger Indices are valuable early indicators. They point towards an ongoing positive economic environment. Gold is precisely now a reasonable portfolio addition.

Macroeconomic Environment

Solid Purchasing Manager Indexes

Purchasing Managers Indices (PMI) are considered to be important leading indicators for assessing the economic trend. We have referred to the development of the global PMI on several occasions in previous notes. The publication of the PMI in the United States started in 1931 and was only interrupted during the second world war. The range of values of the index can be between 0 and 100. Since 1948, the values fluctuated between 30 and 77 points. The interpretation is relatively simple: values above 50 points indicate rising industrial production and a positive economic trend, while values below 50 points indicate a declining trend. Values around 50 indicate stagnation. The lead time to actual industrial production is about three to six months. PMI are determined through surveys of companies from various industries. The question asked is whether a certain measure (for example incoming orders) is greater, equal or smaller than in the previous month. The various criteria are weighted, seasonally adjusted and presented as an index. The values appear monthly; this is in contrast to macroeconomic aggregates, such as gross domestic product, which appear only quarterly and with a delay of up to three months.

Significant lead-time of PMI figures against economic data for both up- and down-swings (GDP figures with 3 month time lag)



Thanks to the available long-term time series and the lead character (so called leading indicator), PMI enjoy a high standing on the financial and capital markets. The markets are correspondingly sensitive to unexpected changes in the indices. Today, PMI are available for a number of countries and regions and for the service sector as well. As a result, PMI data provides highly valuable support to investors for assessing the current and future economic situation and potential impact on the financial and capital markets.

This is very desirable in the current environment. The present economic upswing in the USA has been going on since 2009, making it one of the longest in US economic history. The upswings, which began in 1960, 1982 or 1991 lasted to a similar extent or slightly longer. However, the growth rate of this upswing does not yet come up to the growth rates achieved in previous periods. The chances are therefore good that the economy can continue to grow for a while, and in a positive case even with increasing momentum. This is also indicated by the solid PMI, which are well above the 50 mark globally, with 57.5 for Europe, 54.1 for the United States, 65.2 for Switzerland, and 53 for China and India. Momentum in emerging market economies has been steadily increasing over the last months.

This year, the communication and actions of central banks will be at least as important as the development of the PMI. The regime of ultra-expansionary monetary policy is slowly beginning to change. The impact on the markets will become more relevant towards the middle of the year. For the time being, we remain cautiously optimistic, both for the economy and for the stock markets. We therefore leave our at least slightly overweight position in equities but reduce credit and duration risks in bonds as systemic risks (including illiquidity risks) in this segment increase.

Gold

Better times ahead for the yellow metal

The last cycle in gold ended during 2011. After a multiplication of the gold price in the first years of the new millennium, a bear market set in after 2011, which let the price of gold fall about 40% of the reached highs. We see that gold is heading for better times again. A first step was taken in 2017.

Long-term uptrend in gold is intact. The bear market was abandoned.

Gold plays a key role in our asset allocation. We are convinced of physical gold as a means of long-term value preservation, even during extreme periods characterised, for example, by a great loss of confidence in the financial and capital markets or the central banks. But gold also contributes as a growth component in a portfolio. Historical gold price performance stands up to a comparison with equities or bonds.

Gold can be viewed as a transnational and government independent means of payment. It is divisible, indestructible and transportable and the market is global. Gold itself retains its real value through periods of high inflation and serves as first-rate liquidity in phases of deflation. While gold that was mined hundreds of years ago still has value, the number of paper currencies that came and disappeared is barely countable. Today, gold is hardly ever used as a means of payment mainly for reasons of practicability, but its function as a store of value remains unbroken. The ability to liquidate gold under virtually all circumstances within a very short time at a reasonable price plays a key role in this. Furthermore, gold bears no default risks in contrast to stocks or bonds.

Supply and demand are as follows, with the tonnage data referring to the last 12 months as of the end of September 2017:

Supply	**Tonnes**	**Demand**	**Tonnes**
Mine production	3'211	Jewellery	2'072
Recycling	1'137	Bullion & coins	1'130
		ETF	6
		Technology	329
		Central banks	408
Total	**4'348**		**3'945**
		Surplus	403

Source: www.gold.org / World Gold Council

Mine production is relatively stable showing a slight upward trend. The largest producing countries are currently China, Australia and Russia. The largest reserves are in Australia, Russia and South Africa. Recycling is price-dependent but rising in the long run. The demand for gold is much more volatile and leads to large fluctuations in the annual surplus or deficit. Gold demand for the purpose of jewellery is fairly stable, but it suffered a setback in 2016, mainly as a result of lower demand from emerging markets in Asia, especially China and India. We expect these countries to be in a new economic upswing and demand for gold to rise again over the next few years. For example, there is already a positive trend in China and the consequences of the tax reform in India are diminishing. With the digitalisation of many sectors of the economy, demand from technology is likely to remain at least stable.

Much more important is the demand from central banks. The financial crisis has led to very aggressive intervention by the central banks of industrialised countries. This now seems to have prompted emerging market central banks to increase their gold holdings and virtually all the demand of central banks currently comes from emerging markets. European central banks have at least stopped reducing their gold holdings. We assume that the demand from emerging market central banks has not been exhausted. Lastly, there is demand from the segment of private investors in the form of bullion, coins or financial products backed by gold (such as ETF). This demand has stabilized following a sharp decline during 2013-2015. Against the background of the imminent regime change of the central banks away from the very expansionary policy and the associated risk of policy errors, which can lead - for example - to excessive inflation, demand will probably rise from this segment as well. Not at all solved is the debt situation of many states, where the record-low interest rates and the bond purchases of the central banks have so far simply bought time. This could play a role in the asset allocation of the so-called "sovereign wealth funds", which have estimated assets of USD 7.4 trillion and where gold could gain more attention going forward.

The gold price has recently performed on a rather strong note despite rising interest rates in the USA. We consider this a positive sign. As a base investment within a diversified portfolio, physical gold in the form of bullion or coins still seems to make the most sense. Gold mining stocks are an appropriate portfolio addition as valuations are currently cheap and producers have greatly improved their balance sheets and cash flows throughout the crisis.

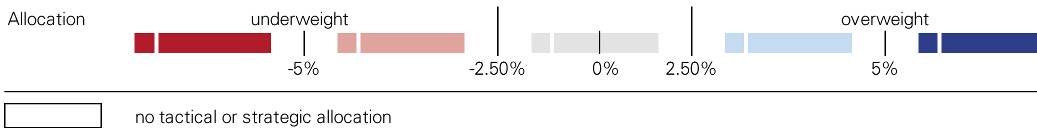
Asset Allocation (with change vis-à-vis previous month)

Equity allocation = at least slightly overweight

Small square = previous month; large bar = target quota

	Bank von Roll Balanced CHF	Bank von Roll Balanced EUR	Bank von Roll Balanced USD
Cash			
Fixed Income			
CHF bonds			
USD bonds			
EUR bonds			
Government bonds			
Corporate bonds (investm. Grade)			
Corporate bonds (high yield)			
Emerging Markets bonds			
Equities			
Switzerland			
USA			
Europe			
Japan			
Emerging markets	Asia	Asia	Asia
Gold and Alternative Strategies*			
Currencies			
Dollar			
Euro			
Other	SEK	SEK	SEK
CHF			

Basis:Balanced portfolio for a CHF investor



no tactical or strategic allocation

*) contains Gold, commodities, real-estate, hedge funds, private equity etc.

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