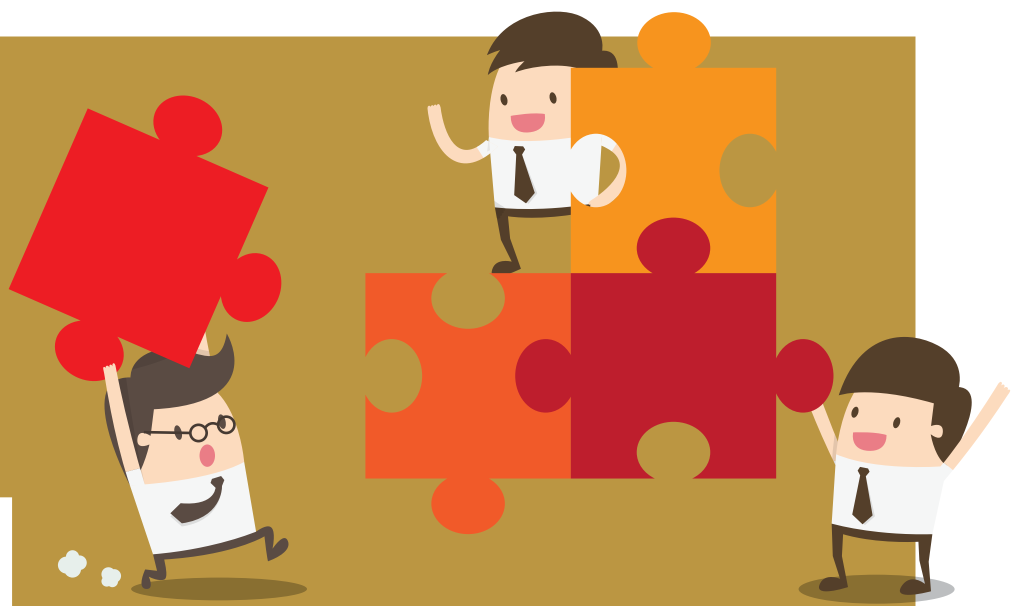


Gold

A Puzzle Piece for Diversification

With the exception of death and taxes, it is often mentioned that nothing else in this world offers permanency – and the same can be said for the investment realm. The rise and fall of markets have been very much evident throughout the decades, and we've seen bulls turn into bears without the slightest hint. Hence the reason why market movements are referred to as cycles – it doesn't stay the same!

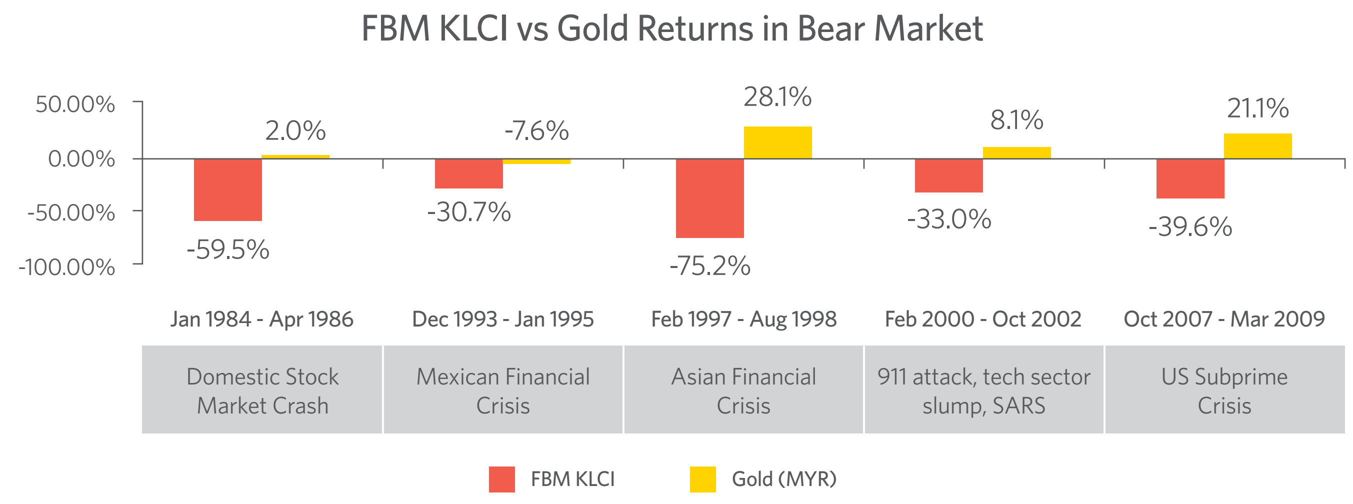
Most markets typically have similar cyclical traits; they move up, peak, move down and eventually bottom. When one cycle ends, the next one begins. As simple as it may sound, timing the market is still a herculean task. So do we just accept the losses when the next economic downturn hits? That's an obvious no. We can however look toward diversification and the correlation of our assets for answers.

> Gold shines brightest in the dark

When economies slide be it due to slowing growth or geopolitical rifts, investments are likely to be impacted. However, the way to soften – or potentially eliminate – such downsides to one's portfolio is to diversify into asset classes that are inversely, or less, correlated. This means that you would want to own assets that tend to move opposite of most other investments. And one of the best examples out there would be gold.

The royal metal marches to the beat of its own drums – its price doesn't usually follow other asset classes during normal times of growths. Nonetheless, gold's correlation with stocks and other asset decreases significantly in times of market turbulence. In other words, gold is likely to move upwards when the economy contracts.

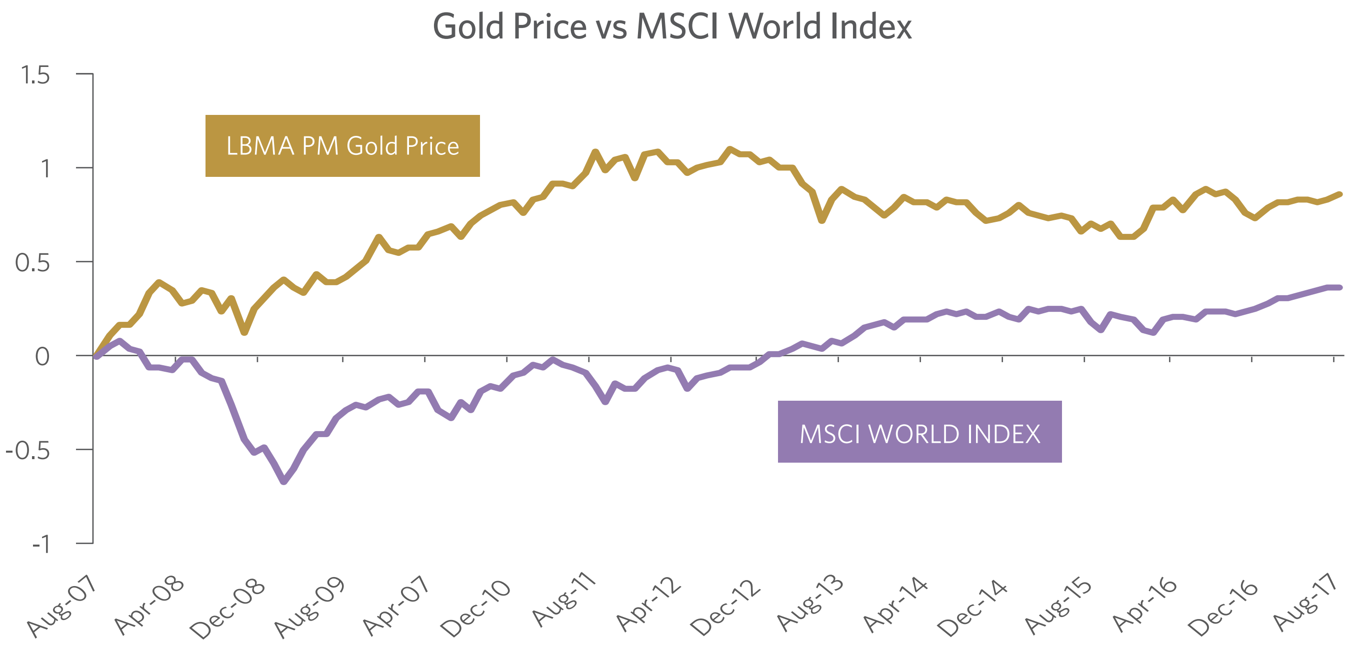
To provide some perspective, let us examine the chart below to see how gold has fared against domestic equities throughout some of the bearish periods experienced by the Malaysian market.



Source: Bloomberg and Lipper as at 31 August 2017

In four out of the five bearish occasions, gold were in the green. And two out of those times it surged more than 20.0%. This evidently depicts an almost opposite movement between the performance of gold and domestic stocks – with the FBM KLCI being on the uninspiring end.

Still not convinced? Let us expand further onto a global scale. Here's another chart to consider – the LBMA PM Gold Price versus the MSCI World Index over the past 10 years.



Source: Bloomberg as at 31 August 2017

As we know it, the Great Recession during the late 2000s and early 2010s was also an especially stressful period for stocks. But noticed how gold moved inversely as compared to the MSCI World Index? The same period, again, reflected a tailwind for the precious metal – in which prices soared significantly even in the midst of a very financially nervous environment.

Of course, the contrarian trait of gold as compared to other assets is also due to the fact that it is not at risk of becoming worthless, unlike fiat currencies or other assets bearing credit risk. More importantly, the precious metal has weathered through more than a couple of recessions and has successfully preserved its value; thus earning its place as a natural refuge and an asset of choice for investors to combat economic stress.

> Old but gold

While some may argue that the value of gold is very much conceptual – only reflected in its noble history and name as the world's unofficial currency for investors fleeing from risks. But its low correlation with most of the other asset classes out there is undeniable, which makes it an essential component of a diversified portfolio.

Bear in mind, this doesn't mean that the royal metal should be favoured over the likes of stocks and bonds. As changing market conditions are part and parcel of the investment realm, the idea is to have meaningful allocation into gold to shield the rest of your portfolio in the case of an unexpected market correction.

Consider this. Your investment in stocks aid in capital appreciation, while bonds for a consistent income stream. Gold on the other hand acts as an insurance for your portfolio – you don't buy them when an accident occurs, you buy them *in case* things turn south. It complements well, don't you think?