HOW GOLD IMPROVES ALTERNATIVE ASSET PERFORMANCE

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Alternative investments began gaining traction during the inflationary times of the late 1970s and early 1980s. Modern Portfolio Theory (MPT), as outlined by Harry Markowitz, did not provide portfolio diversification in this high inflationary environment. MPT again failed during the Great Recession of 2007-09 when stocks, bonds and money markets were highly correlated to the downside. Investment professionals found this period exceptionally challenging. Not only were stocks and bonds headed south, but aggressive Central Bank policies pushed interest rates to near zero creating a negative real rate of return. Where was the professional investor to create alpha? The answer came with the explosive growth of alternative investments such as hedge funds, private equity, commodities, real estate and Gold. Today, we are still in a negative real rate of return environment and this has forced investors into stocks and alternatives.

Alternatives assets are broadly defined as anything but stocks, bonds, money markets or cash. Major alternative asset categories include private equity, hedge funds, commodities, real estate and Gold. Alternatives have become necessary in order to create positive risk adjusted returns. Alternatives should provide professional investors the opportunity to create alpha while providing diversification to mitigate risk (beta).

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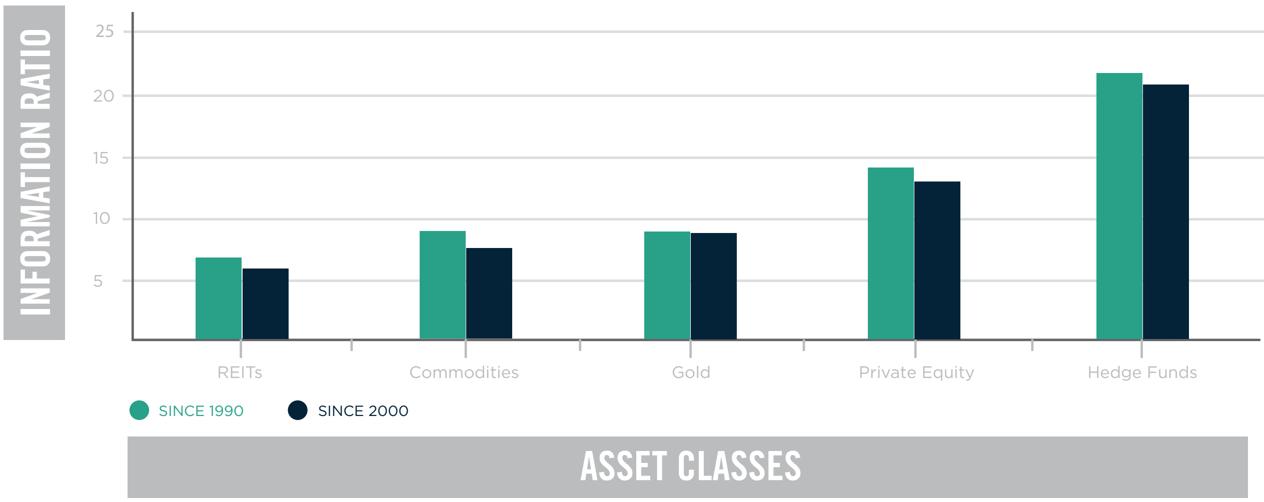
Chart 1: Alternatives have generally provided better risk-adjusted returns than U.S. stocks. Information ratio defined as the annualized return in excess of the MSCI U.S. total return index divided by the corresponding volatility.



Reference Notes are listed at the end of this article | Source: Bloomberg, Cambridge Associates, Dow Jones, HFR, The London Gold Market Fixing Ltd, World Gold Council

Chart 1 indicates that alternatives have created more alpha than U.S. stocks since 1990. Gold returns are right in the middle, trailing hedge funds and private equity and slightly ahead of commodities and REITs. However, alpha tells only half of the story. Chart 2 will look at how these alternative assets mitigated risks (beta) through a low correlation to stocks.

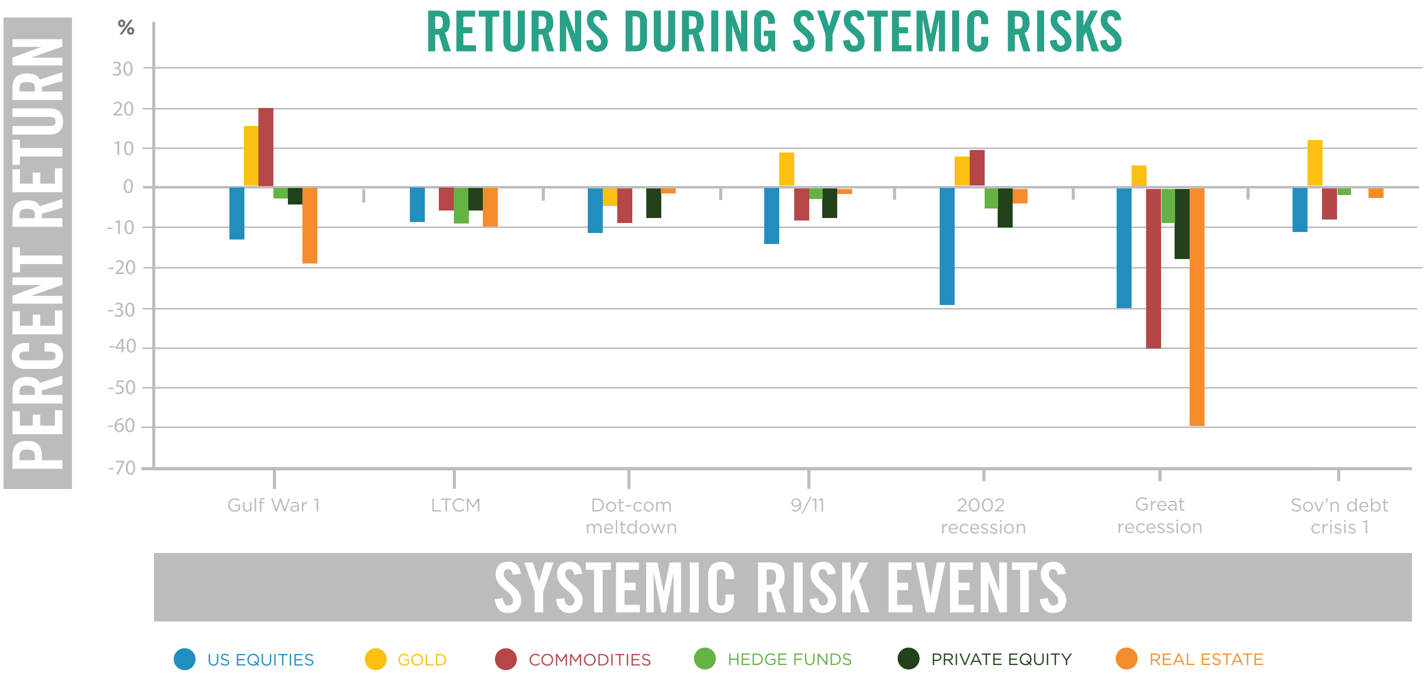
Chart 2: From January 1990 through March 2014, only Gold displayed a low correlation to stocks. Correlations based on monthly returns (quarterly for private equity due to data availability) between January 1990 and March 2014.

Reference Notes are listed at the end of this article | Source: Bloomberg, World Gold Council

Hedge funds and private equity provided excellent returns, but they are highly correlated to stocks. Gold was the only asset that could be categorized as “low correlation.” Gold provided alpha, while at the same time mitigating risks.

Another strong consideration for allocation in Gold is Gold’s performance during tail-risk events. Gold provides “portfolio insurance” from financial tornadoes often referred to as “Black Swans.” These unexpected and unpredicted events cause extreme disruption in the financial markets. Just as you purchase insurance for your home against natural disasters, Gold helps mitigate the risks of financial disasters. Chart 3 takes us from the Gulf War, 9/11 and through the sovereign debt crisis. Only Gold consistently provided protection from these tail-risk events.

Chart 3: Gold has consistently outperformed stocks as well as other alternatives during tail-risk events.



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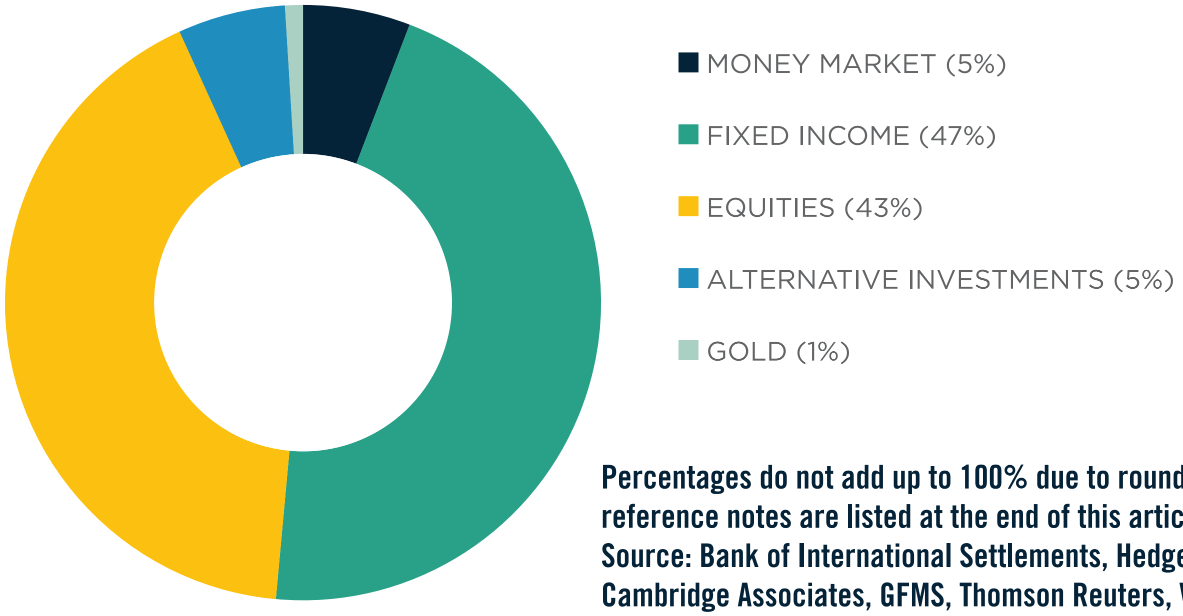
It should be mentioned that despite the recent rapid growth of alternative investments, these only represent 5 percent of the $153 trillion aggregate financial assets in the U.S. This rapid growth will likely continue as many investors are increasing their alternative allocations to 10 – 20 percent or more. Gold currently represents an allocation of only 1 percent, or $1.53 trillion. Many investors are now looking to a 5-10 percent allocation for Gold.

Chart 4: Alternatives are only 5 percent of U.S. $153 trillion financial assets – Gold is only 1 percent



Percentages do not add up to 100% due to rounding. Additional reference notes are listed at the end of this article.
Source: Bank of International Settlements, Hedge Fund Research, Cambridge Associates, GFMS, Thomson Reuters, World Federation of Exchanges, World Gold Council

In conclusion, it is reasonable to expect that growth in alternatives will continue and Gold will be a big part of that growth. Gold purchases have great room to grow in the U.S., especially when you consider the purchasing habits of other countries. The rest of the world has a long history with Gold. Europeans buy much more Gold than Americans. Germany alone, which is the size of Montana, buys more Gold than the U.S., while China and India together represent more than 50 percent of world Gold demand. As J.P. Morgan once said, "Gold is money, everything else is just credit."

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Peter LaTona is the Director of Business Development for APMEX. LaTona has been with APMEX, Inc since 2009. Under his leadership, the APMEX Trading Department was transformed into the Sales Department that exists today. Previously, sales orders by telephone were discouraged. Today, the APMEX Sales Department focuses on educating our clients, providing them with updated market information, extensive product knowledge and a VIP level of concierge–like service. APMEX's highly trained Account Managers are non-commissioned salaried employees, who are here to help customers make informed decisions. LaTona was also instrumental in the creation and growth of the APMEX Precious Metals IRA business. In his current role, LaTona is responsible for relationships with financial advisors and family offices, as well as developing new sales channels.

Prior to joining APMEX Inc, LaTona enjoyed a 27 year sales management career with AT&T. His career began in Miami, Florida and culminated in Oklahoma City as Director of Sales Development. Upon his retirement from AT&T in 2006, LaTona created a sales consulting business and APMEX, Inc became one of his first clients.

REFERENCES:

Chart 1: Alternatives have generally provided better risk-adjusted returns than U.S. stocks
Information ratio is defined as the annualized return in excess of the MSCI U.S. total return index divided by the corresponding volatility. HFRI used as a proxy for hedge funds. Cambridge Associate index represents private equity. U.S. REITs stand for real estate, S&P Goldman Sachs Commodity Index for commodities and London PM fix for Gold. All returns based in U.S. dollars.

Chart 2: Hedge funds, private equity funds and REITs have high correlations to stocks
Correlations based on monthly returns (quarterly for private equity, due to data availability) between January 1990 and March 2014. U.S. equity indices include MSCI U.S., Russell small cap, Russell mid cap, MSCI EAFE and MSCI emerging markets. HFRI used as a proxy for hedge funds. Cambridge Associate index represents private equity. U.S. REITs stand for real estate, S&P Goldman Sachs Commodity Index for commodities and London PM fix for Gold. All returns based in U.S. dollars.

Chart 3: An allocation of 4 percent to Gold for diversified portfolios that include alternatives can improve risk adjusted returns and reduce losses during periods of systemic risk
These results display the optimal portfolios that were found for the Gold: alternative investment, foundation asset report published by the World Gold Council in October 2011.

Chart 4: Only 5 percent of U.S. $153 trillion financial assets are currently in alternatives
The chart values are as of December 2013. Estimates include the global market capitalization of all publicly traded stocks and REITs, the total value of outstanding bonds and money market instruments, total open interest on major commodity futures plus above ground stocks of Precious Metals, the assets under management of private equity and hedge funds and private holdings of Gold bullion. Central bank holdings of gold and bonds were excluded.

This report is based on a report by the World Gold Council: Gold Investor: Risk Management & Capital Preservation, Volume 6

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