

# Perception versus reality >>>>>>

In a time where investment funds are trying to work out best strategies, **Ian Williams**, CEO of Charteris Treasury Portfolio Managers, looks at how reality may not match perceptions in the market place

**W**here there is a market, there is risk involved, regardless of sector. How does an investor (private or institutional) assess risk in the recent and current environments when many of the previous variables for evaluating risk seem to have been turned on their head and goes against more “traditionalist” opinion as to what constitutes risk? Risk has not gone away, it never did.

For example, G7 government bonds, in theory, are a “low risk” investment, but is this really correct? In the past they have been seen as a very safe asset, after all a government cannot go bust so they do not default in nominal terms; but inflation erodes the value of Gilts.

UK 50yr Gilts yield 4 per cent and UK inflation is running at between 4-5 per cent (at the time of writing).

Also, the UK currently has a public sector deficit of £150 billion (which has somehow to be financed by the sale of Gilts on negative real yields). The UK’s debt is a higher percentage of GDP than the USA’s.

Gold meanwhile is viewed as a “high risk” speculative asset, but again, is this also correct?

I would argue not only it isn’t correct, but holding Gold is safer and the more sensible asset to hold in one’s portfolio.

Central banks, led by the US Federal Reserve, have been printing money like confetti since the crash in 2008, to part finance gargantuan fiscal deficits. This has raised the spectre of an ‘easy money’ policy being followed for the foreseeable future with no great desire by Ben Bernanke to reign in the current level of excess.

Against this backdrop most sane investors would rather hold gold or gold assets rather than US T-bonds or Gilts which are on negative real yields.

This is the positions/viewpoints that China, India and other emerging market countries have made. They have taken the economic decision to own something ‘real’ rather than US paper assets.

This leaves the Equity markets somewhere in the middle as a ‘medium risk’ investment. On any long term valuation model equities are very very cheap relative to government bonds. Many FTSE 100 companies give a dividend yield in excess of that obtainable from Gilts. Furthermore, the income received from equities is not fixed as it is with Gilts.

So why would any investor (private or institutional) prefer a 2-4 per cent fixed yield on a Gilt versus a 3-6 per cent yield in a blue chip FTSE 100 equity when the income stream from the equities will also increase over time?

This takes us back to the perception of risk in that Gilts are still perceived to be a lower risk asset than either equities, gold

or other commodities.

The last time the Gilt/Equity ratio was at these levels was in the mid-1950’s. The perception in the 1950’s was that Gilts were low risk and equities were high risk and this was proved to be woefully incorrect.

Any investor selling Gilts and buying equities or commodity assets in the 1950’s would have made a fortune as the subsequent inflation of the 1960’s and 1970’s eroded the value of Gilts and saw the price of inflation proofed assets such as equities and gold can go much much higher.

Institutions have to now face these market conditions. They have to restructure their clients’ portfolios accordingly and re-evaluate what constitutes ‘lower’, ‘medium’ and ‘high’ risk. Institutional investors are having to change their in-house methodology to market risk and how they trade the market.

The current cycle in today’s market has taken us back to the relative valuation levels of the 1950’s – it is our perception that the investment results will be identical to that of the 1960’s and 1970’s with real assets such as gold and equities outperforming bonds, gilts or treasuries. ●



**IAN WILLIAMS**, Charteris Treasury Portfolio Managers >>>>

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