

Shares and bonds generally too expensive – gold and cash are king

An opinion of Uwe Günther

If the financial markets are going crazy, they usually say: “Everything is different this time”. But a real paradigm shift is currently taking place on the stock exchanges: Cash and gold have become attractive as value storage.

When the Internet bubble formed at the end of the 90s, companies and analysts were suddenly counting on price-sales ratios and burn rates. Traditional benchmarks such as the good old price-earning ratio were suddenly no longer to apply in light of the technological revolution through the Internet. It is well-known how the story turned out: The German stock market collapsed by more than 70 per cent measured against the Dax.

A similar development was repeated in the USA in the years up until 2007. In this case, it was the real estate prices that increased seemingly without end and apparently made more and more Americans rich. When the mortgage bubble burst, Dow Jones collapsed by more than 50 per cent.

In both cases the assessment that this time everything is different turned out to be a costly mistake. Both from 2000 to 2003 and from 2007 to 2009 a tremendous number of debtor-creditor relationships collapsed like a house of cards. Debtors were no longer willing or in the position to fulfil their obligations or to acquire further debts. Conversely, creditors were no longer willing or in the position to extend or even increase existing loans. This happens if credit-financed investments or consumer spending departs too far from the economic reality.

Diversification no longer works

Today the situation looks similar once again. Sure, the vocabulary is new. The analyses and commentaries are now providing terms like “shares without alternative”, “the new normal” or “quantitative easing”. But in fact not much has changed. The debt accumulation machinery is once more operating at full speed and most market participants are hoping, on the basis of supposedly changed determining factors, that the bubbles on the financial markets will not burst again.

But you can't rule out the possibility that shares will continue to improve and that we will experience a final panic buying. After all, the banks are using their cumulative marketing strength to drive the last investors into the alleged equities without alternative. Yet the air has meanwhile become thin. German standard stocks have increased by 13 per cent since the beginning of the year and we have all earned again splendidly. That is more than what almost all banking analysts had predicted for the entire year. Since the last adjustment in Autumn 2011, the market prices have actually more than doubled – shares have therefore become more than 100 per cent more expensive in only three and a half years. In view of this fact, it is advisable to take profits or reverse share quotas.

Despite all parallels with the past, an enormously important context has changed fundamentally. The old and long-established advice to diversify assets no longer works – at least no longer so easily and reliably as before. In the past decade it was almost

always the case that bonds offered a sensible alternative if shares were (too) expensive. Incidentally, it usually applied the other way round as well! Investors could switch between the large asset classes, i.e. shares and bonds, as needed without any problems.

For example at the beginning of 2000. At that time, when the Dax increased with about 8000 points to its then record high, the state paid 5.2 per cent interest for ten-year government bonds. Investors could take wonderful profits in light of the record level for shares and invest the money at decent conditions on the bond market. On the other hand, equities crashed by 67 per cent in the three years after achievement of the peak at that time.

At the end of 2007, a similar situation occurred. After years, the Dax once again bettered the marks of 8000 counters. Share investors of whom there were enough were offering ten-year government bond coupons of 4.3 per cent. In this case the change from shares to bonds also did not hurt financially. Especially considering the fact that the Dax lost around 14 per cent in value from the end of 2007 until the end of 2010.

Since the German DAX is virtually a mirror of the American S&P 500 share index, the situation was almost identical.

Bonds not really an alternative – but neither are shares any more

Today, however, the financial markets are in a fundamentally different set-up. Shares have once again increased strongly, possibly to a record-breaking level, and are encouraging profit-taking. However, this time bonds offer no serious return alternative – at least in terms of return. For German government bonds of shorter repayment periods, the return has sunk into the negative area as is known. Anyone who continues to charge automatically into the stock market now with the shaky argument of “zero interest rates” is ignoring the lessons from 400 years of stock exchange history. And anyone who forgets experiences may they do so again!

Apart from the stamped-out investment paths there are, however, still sensible investment opportunities: Cash would be the first one. Cash is currently considerably better than its reputation. Since the beginning of the year prices are no longer increasing in Germany, but rather they are decreasing. The purchasing power of cash is therefore increasing. It should not then be difficult for investors to retain liquidity to a considerable extent

and to rely on probably being able to purchase shares and bonds considerably more favourably in the coming years than is possible today. In terms of currencies, besides the euro, the US dollar is especially a possibility. The Norwegian krone and Australian dollar also come into consideration as a complement. In this case there are possibilities of exchange rate profit.

The currency of gold is also advisable. Interestingly, Swiss banks often do not even classify it as a precious metal but rather as a currency. Once the central banks virtually removed interest rates, the opportunity costs of interest-free gold also sank to nil. Were the share and bond markets to finally implement their overdue adjustment, the precious metal would be allowed to be approved again as one of the absolute best forms of value storage. Numerous central banks have been net purchasers of gold for about five years. Private investors are therefore in prominent company.

Anyone who would like to balance nothing, should at least consistently follow the stop marks for share positions in the current phase. Protections may also be implemented by the purchase of put options, factor-short certificates or mini-futures. Apart from that we currently advise on long-short strategies, cat-bond funds, i.e. catastrophe bonds, and other market-neutral investments.

The principle of the ancient Greek Pericles still applies today: **“It is not our task to predict the future, but rather to be prepared for it.**

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