Tactical allocation to gold

LBMA conference, Hong Kong

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High quality assets have performed well

Asset quality has been the single greatest factor that can explain asset price changes since 2000

Equities	**Consumer brands, low volatility equities**
Bonds	**“Good” government bonds**
FX	**Swiss Franc, Yen, Singapore Dollar**
Commodities	**Gold**
Property	**Prime real estate**

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Measuring asset quality in equities

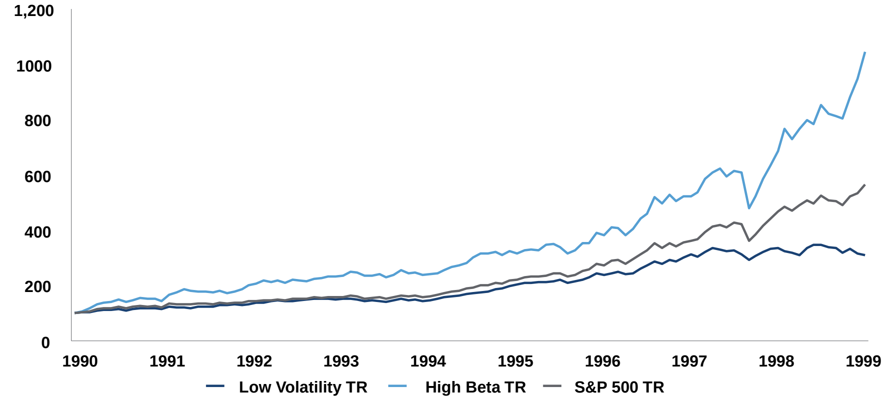
Equities with low volatility have been rewarded since 2000

- Balance sheet strength, stable cash flows, sustainability of profits, robust franchises have been highly sought after
- These fundamental factors have been reflected in price volatility
- We can conclude that high quality equities have low volatility
- This is not only true for the stock market, but for all asset classes

Quality in equities

S&P low volatility equities versus high beta equities

1990 to 2000



Source HSBC, Bloomberg. Date range from 31 December 1999 to 30 November 1990.

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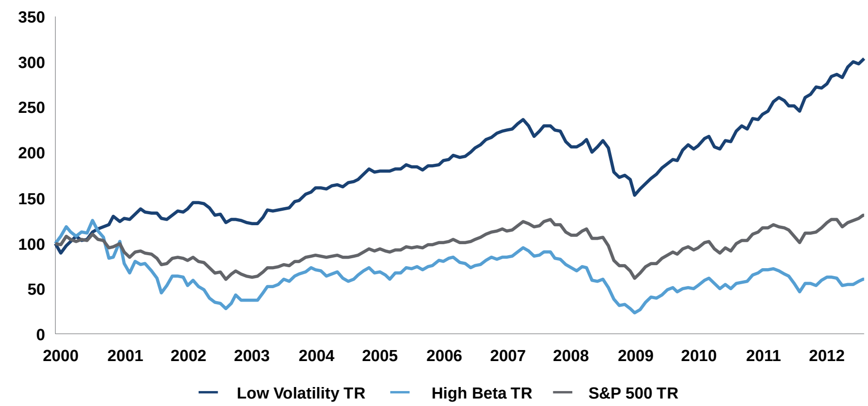
Quality in equities

S&P low volatility equities versus high beta equities since 2000

2000 to 2012

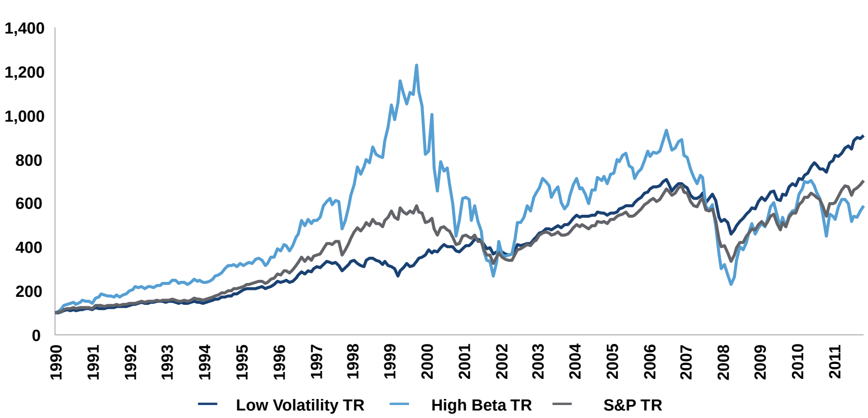


Source HSBC, Bloomberg. Date range from 31 January 2000 to 1 October 2012.

Quality in equities

S&P low volatility equities versus high beta equities since 1990

1990 to 2012



Source HSBC, Bloomberg. Date range from 30 November 1990 to 1 October 2012.

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Quality in commodities

- The least volatile commodities have delivered the highest returns
- A plentiful "above ground" supply broadly correlates with volatility
- Supply days is a best estimate as these figures are impossible to determine with accuracy

Commodity	Volatility	Supply days
Gold	16%	14,381
Silver	29%	5,755
Copper	27%	231
Wheat	31%	82
Soybeans	31%	57
Corn	29%	47
Oil	33%	46
Natural gas	56%	42

Technical analysis of the gold market

- Technical analysis is a trading discipline
  - Trend following works best on less volatile securities
  - Reversion to the mean works best on more volatile securities
- Gold has low volatility → follow the trend
  - Lower volatility allows the trading strategy to slow down
  - Less speed lowers the turnover which cuts trading costs
- Technical strategy for gold
  - Confirm the bull market
  - Determine your "core position" size
  - Implement a tactical overlay to increase that position size periodically

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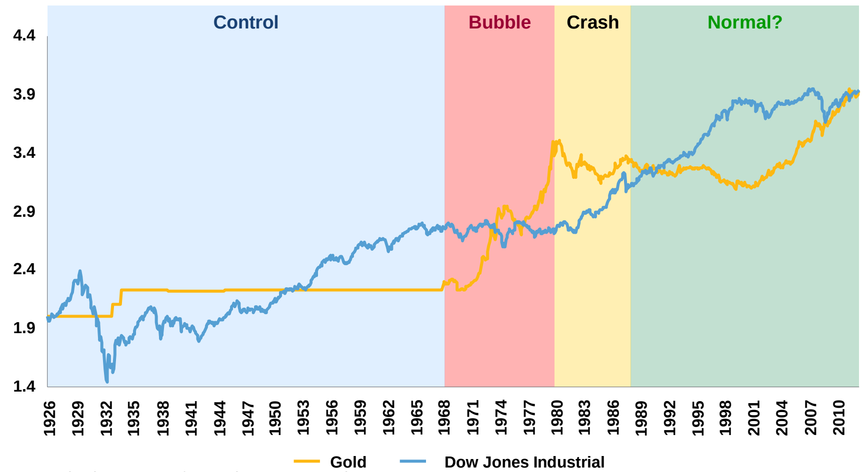
Gold versus Dow Jones since 1926 – capital return

LT returns are misleading as gold only freely traded post 1970



Source HSBC, Bloomberg. Date range from 26 February 1926 to 2 October 2012.

Question for the audience

How many times has the gold price crossed its 200 day moving average since 1988?

A **0 to 25**

B **26 to 50**

C **51 to 75**

D **76 to 100**

E **Above 100**

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Gold and the 200 day moving average – since 1988

The crossover is more frequent than many expect

Source HSBC, Bloomberg.

Gold and the 200 day moving average – since 1988

The crossover is more frequent than many expect

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Gold and the 200 day moving average – since 1988
Consolidation periods are expensive for trend followers

Source HSBC, Bloomberg.

The principles of trading moving averages
Slower data leads to fewer trades and higher returns

Trading results since end 1988

	Moving average crossover		Moving average gradient	
	Return	No of trades	Return	No of trades
Shorter-term data				
200 day	233	213	301	181
40 week	273	105	313	87
10 month	315	47	328	36
Longer-term data				
700 day	377	67	557	47
140 week	418	39	611	21
35 month	527	11	503	13
Buy hold	432	0	432	0

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The tactical and strategic approach
Position size reflects conviction

Large position

No position
For illustrative pursposes only.

The tactical and strategic approach
Position size reflects conviction

Large position

Gold bear market
No position

No position
For illustrative pursposes only.

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Core gold models
to identify a bull market in gold

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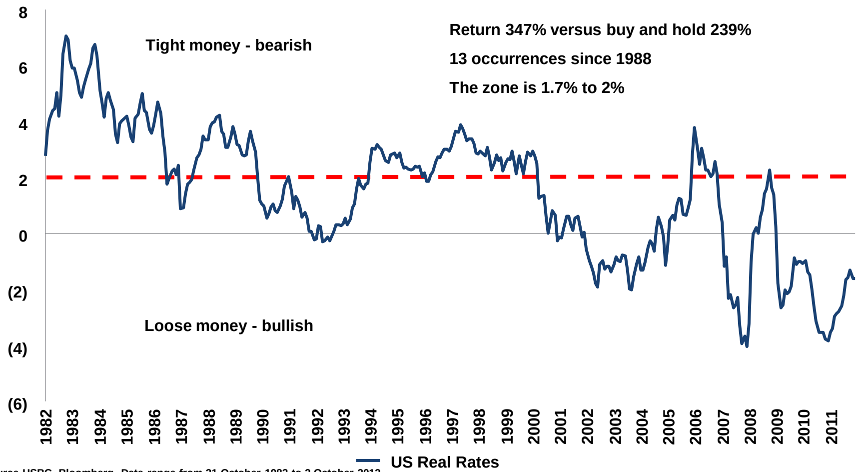
Real interest rates
US real rates since 1982
Gold has performed best when real rates are <2%



Source HSBC, Bloomberg. Date range from 31 October 1982 to 2 October 2012.

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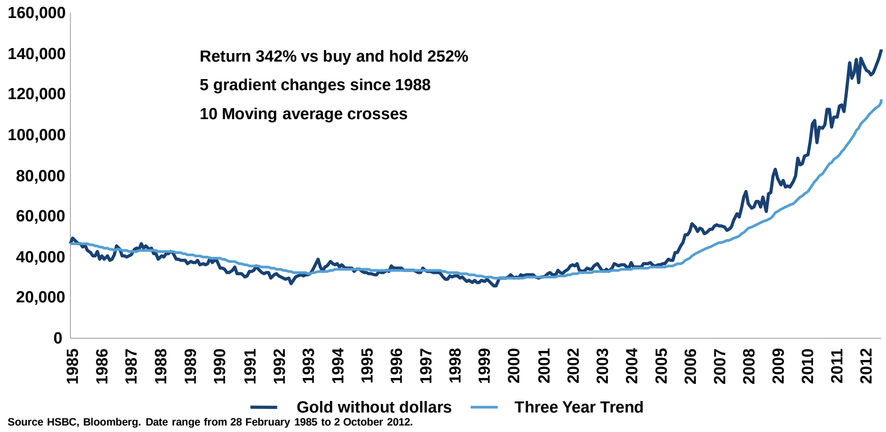
Gold and the long-term trend

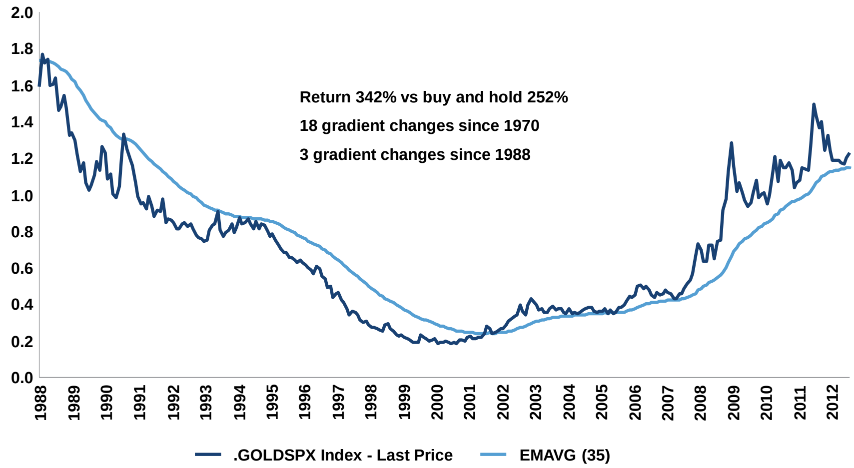
Gold in a global currency basket with a 35-month exponential MA since 1985
Use the gradient and not the crossover



Source HSBC, Bloomberg. Date range from 28 February 1985 to 2 October 2012.

Gold versus the S&P 500

Gold S&P ratio with a 35-month exponential MA since 1988 – Use the gradient and not the crossover



Source HSBC, Bloomberg. Date range from 31 October 1967 to 2 October 2012.

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Core model summary

- Real interest rates are low – bullish since 2009
- The gold trend is strong in a global currency basket – bullish since 2001
- Gold is beating equities – bullish since 2002
- Gold is in a bull market

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Therefore the tactical models can now be implemented

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Tactical models to increase the position size

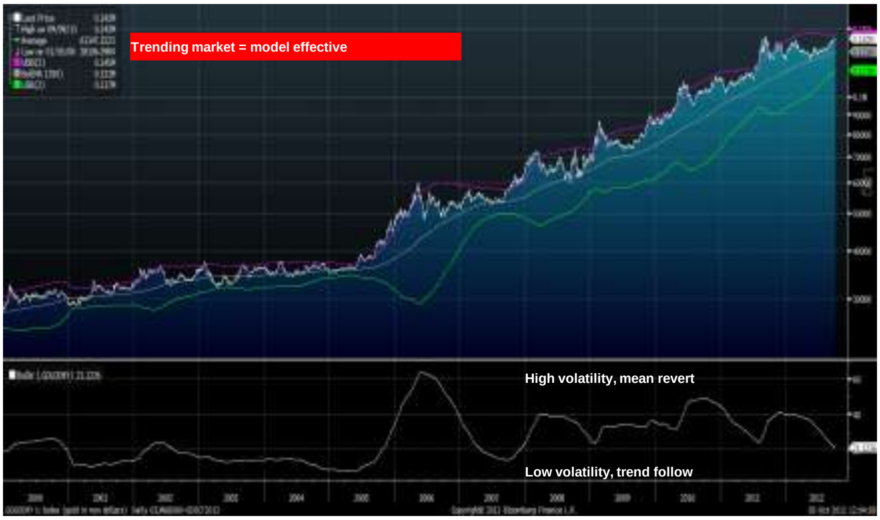
Gold volatility

Gold in global money 1988 to 2000

Source HSBC, Bloomberg.

Gold volatility

Gold in global money 2000 to 2012



Source HSBC, Bloomberg.

The gold silver ratio

Since 1988

- **Useful to identify relative value between gold and silver but even better measure of macro economic risk**
- **When silver is leading leads, gold is more likely to rise**
- **Avoid data mining this series**

Source HSBC, Bloomberg. Date range from 21 October 1988 to 3 October 2012.

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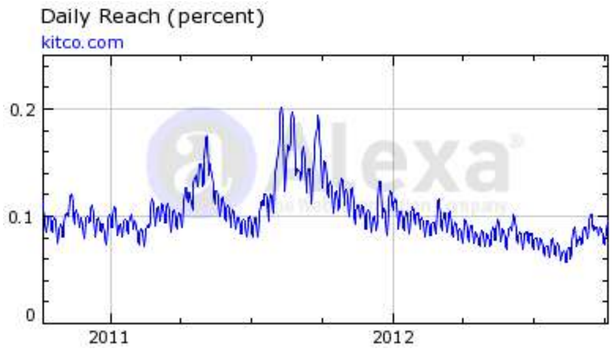
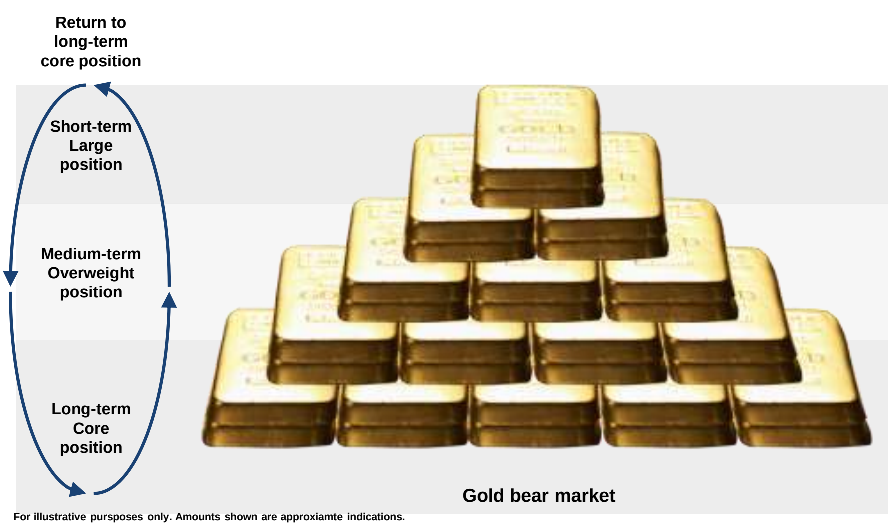
Sentiment
Studying the crowd, not the price

- There are numerous was of approaching this inexact science
- CFTC data is useful as is the Hulbert Sentiment Index
- However the web hits is the most timely and is also the broadest measure



Source www.alexa.com

The tactical and strategic approach
Position size reflects conviction



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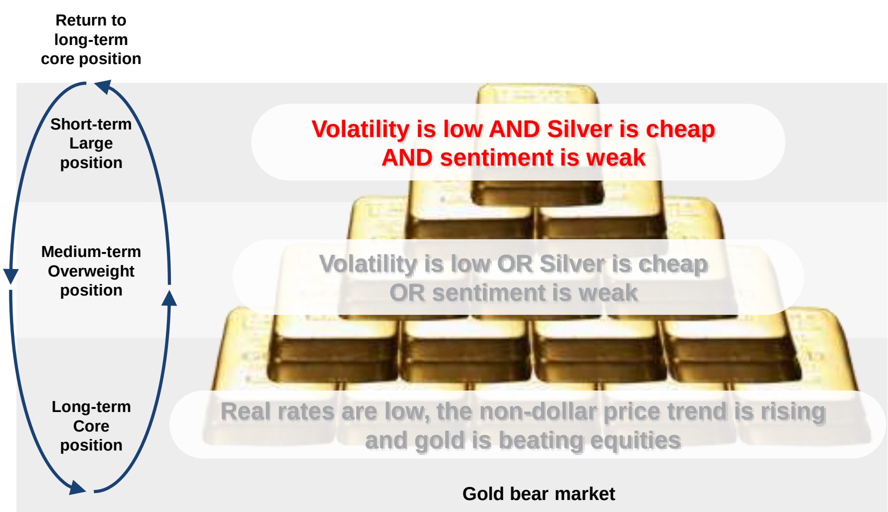

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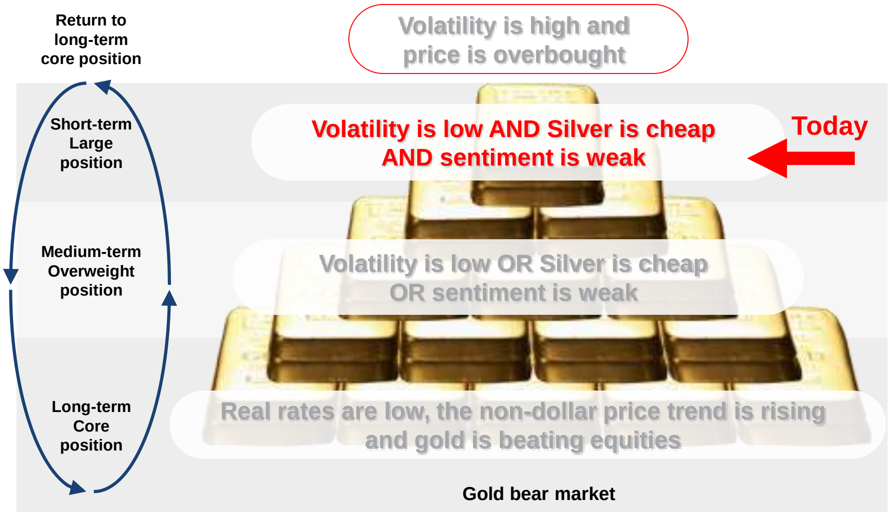

Summary

- High quality assets are beating the market
- Trading rules work best on low volatility assets
- The core models identify a gold bull market:
  - Global real rates are negative
  - The price trend is strong in a basket of currencies
  - Gold is beating equities
- The tactical models are effective in bull markets
  - Volatility is low and the trend is rising
  - Silver has pulled back relative to gold and is now leading
  - Sentiment is subdued
- Position sizing is an efficient way to express your view

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