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M investment commentary monthly

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Following a dip in mid-month and a subsequent bounce, November was generally a positive month for asset markets.By the end of the month there was less anxiety on the three global issues that investors are fixated on:

1. US fiscal cliff. The consensus in the market is that it will be avoided in one way, shape or form.

2. Eurozone debt crisis. Greece is being given more time, at least, to pretend it is able to repay the "unrepayable".

3. Chinese growth. The latest economic numbers have been encouraging.

These relatively positive developments, together with continuing tailwinds from Central Bank policies are tilting investors towards positioning for further gains in risk assets. Nevertheless, it takes two sides to make a market – a buyer and a seller. This week's Barron's presented markedly opposing views in two different editorials. The first refers to the opinion of a well known market bull - Jim Paulsen, the Chief Investment Officer at Wells Capital Management. The second quotes John Hussman, a respected fund manager.

Who will be proven right?

The Bull Case

Jim Paulsen's *optimistic mostly because the U.S. economy is now, as he puts it, "gearing" again, with the recovery from the Great Recession broadening and therefore less susceptible to shocks or reversals.*
He goes down a checklist of favourable economic developments. Over the past year, job growth has picked up, and unemployment has fallen by the largest amounts during the entire recovery. Consumer confidence, after waffling during much of the recovery, recently hit a four-year high. U.S. bank lending has reversed its decline and since mid-2011 has been growing.

Household net worth is now just 7% below its all-time high after being down some 25% in 2009. Housing starts and home prices are finally ascending. State tax collections recently hit a record high. Low interest rates have helped drive down household debt from a record high 19% of disposable income in 2007 to a near-record low of 16%".

Likewise, he's heartened by signs that the pre-eminent overseas market, China, seems to be reviving from its recent funk.
He even sees some positive developments in Europe that will transform the euro zone from a severe risk to global economic growth to a mere chronic problem.

Thankfully, European authorities finally have somewhat abandoned the Calvinist policies of punitive fiscal austerity and extreme monetary tightness that threatened to strangle the Continent.

As a result, cliff or no cliff, Paulsen sees U.S. gross domestic product growth in 2013 of 3%, some 50% higher than consensus forecasts. Moreover, he thinks that the S&P 500 will climb for the fifth year in a row. The higher prices will come, as they have in 2012, more from an increase in price-earnings valuations than from actual earnings growth.

So, just maybe, things aren't as dire as they seem as we lurch into the holiday season.

The Bear Case

Fund manager **John Hussman**, *who has compiled quite a record over the years, explains why he is unapologetically negative on the market. John acknowledges the usual concerns- the fiscal cliff, a possible flare-up of European banking and sovereign-debt strains etc, etc. But he asserts, the primary reason he's defensive is that stocks are overvalued .*

Contd.

John is a mix of market technician and historian, as well as a seasoned strategist, and we can't do full justice to his cautionary arguments in the space we have left. Among other tell-tale elements, he notes that market conditions have moved in a two-step sequence from overvalued to overbought. Toss in "an army of other hostile indicators," along with a "breakdown in market internals and trend-following measures," and you have fair warning. Once in place, he says, that sequence has generally produced very negative outcomes. He adds that his estimates of prospective stock-market return/risk remains among the most negative he's observed after examining a century of market data.

So just maybe, things are pretty dire as we enter the holiday season.

Thoughts on Gold

We are often asked about our opinion on gold. We usually reply by quoting Martin Taylor, that he places 5% of his Nevsky Fund in gold so that investors do not ask him about his opinion.

All the unit-linked portfolios we manage do indeed have an exposure to gold.

For the larger portfolios, and for those that do not have exposure, we have recently decided to add 5% to many of them (we should note that some of our clients, in keeping with Warren Buffet's view, do not like gold at all, so we shall not impose it on them).

The chart below caught our attention. It shows Chinese net imports of gold from Hong Kong.

With Chinese gold reserves at less than 2% of their foreign currency reserves, one could argue that there is a lot of room for increasing this amount. This could dramatically increase the demand for gold. Note that in the US, Germany, France and Italy each hold more than 70% of their forex reserves in gold.