MV Capital Management Midweek Market Commentary

A Tale of Two Ex-Havens

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“Safe haven” is the term we use to describe the things in our portfolios that help us sleep better at night. The imagery is rich – amidst the violent tempests of unruly seas there are quiet, sheltered harbors that protect us from Poseidon’s ravages. Or so the thinking goes. Here is a cautionary tale about safe havens and not-so-safe havens.

In the summer of 2011 asset markets were aboil with unusually high levels of volatility. The Eurozone was mired in the latest act of its Greek tragedy, and in the US our redoubtable government policymakers were speeding recklessly towards a possible default as they ineptly debated and negotiated what should have been a routine adjustment upwards of the debt ceiling. In this environment two asset classes found particular favor among haven-seeking investors: gold, and the Japanese yen.

The yen reached an all-time high – 76 yen to the dollar – in October of that year (consider that when the yen was first floated after the breakdown of the Bretton Woods agreement in 1971 its value was 360 to the dollar). Gold grazed the $1900 level at the same time – good enough for an all-time nominal high, though short of the real level of $2,470 (in today’s dollars) reached in January 1980. When stocks and non-precious metals commodities plunged, gold and the yen soared. How the mighty have fallen.

For the year 2013 to date the Japanese yen has plunged by 12% against the dollar, largely a function of the radically new easy money policy embarked on by Prime Minister Shinzo Abe and the new guard at the Bank of Japan. The yen is now around 98 to the dollar – it has fallen nearly 30% from that 2011 high point. Meanwhile gold is in freefall. It is down 10% just in the last week and has also given up more than 25% of its value since those “haven” days of 2011.

Herein lies the cautionary tale. A true safe haven is an asset that is hardwired to deliver predictable, stable returns over a decently long period of time. A government or AAA-rated corporate bond can – to the extent that anything can in our new financial order – be deemed a safe haven asset because if you hold it to maturity you will know exactly how much income you will receive, and when you will receive it, in all scenarios except for that of a default. As long as the US government or Procter & Gamble don’t go bankrupt there is no mystery about what these assets will deliver to you as cash flows.

But currencies and precious metals don’t work that way. They are traded in spot markets and futures markets based on the collective views of thousands of currency and commodity traders about the direction of Japanese interest rates, or the rate of new industrial complex developments in China, or the inflation forecast for Brazil. There is no inherent value – no floor below which these assets cannot fall. As the market cycle of the last eighteen months tells us, these fluctuations can be immense. They are not going to help us sleep better at night, and they are very clearly not safe havens. For asset allocation and portfolio selection purposes we should not treat them as such.

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