SARANAC PARTNERS

The April Outlook

Market stance

ELEVATED POLITICAL RISK

Multi-asset portfolios remain conservatively positioned, with a lower equity weight and more diversifying assets than usual

Commentary

- Global economic policy uncertainty is high, and policy is increasingly dysfunctional
- These stresses largely originate in the US, given tariff and labour repatriation policies
- US business and consumer confidence is falling, although the economy is not in recession

Upshot

- The US is at the epicentre of a weakening global economy

FIXED INCOME

The Fed is likely to cut US policy rates, despite a problematic inflation outlook

Commentary

- Credit yields remain attractive, as corporate balance sheets are robust
- The steep yield curve in Europe has made Eurozone bonds more attractive
- We have become more cautious on high yield bonds

Upshot

- Saranac's fixed income exposure is higher than usual

EQUITY MARKETS

Equity markets are falling on economic and political risks, although global equities are down only slightly

Commentary

- The main theme this year has been the significant weakness in US megacap stocks, and stronger performance outside the US
- Equity valuations are now less stretched, but multiples are still above long-term averages
- Earnings are at risk given the potential for economic weakness, and the uncertain macro environment could depress valuations

Upshot

- Saranac continues to run lower levels of equity risk than usual

COMMODITIES

The gold price has surged, reflecting economic and political uncertainty and rising inflation risks

Commentary

- Gold has materially outperformed equities so far this year
- Jewellery demand is fading, but demand from central banks and private investors is firm
- Gold mining output is only rising slowly in response to the higher price

Upshot

- Gold remains an effective diversifier from high levels of US political risk – better than bitcoin

The Long Read

The Gold Rally is Sustainable

Rising political risks associated with the Trump Presidency present a challenge to investors within and beyond the US, given high exposure to US assets. In this article, we probe these political risks more closely. The challenge for investors is that the political environment is highly uncertain. The Administration may be forced to change policy at some stage. In addition, politics is not destiny, and other factors (e.g. stronger productivity growth) may prove dominant over time. In these circumstances, portfolio diversification is important, and gold has been very effective in this context. We expect it to remain so.

Why gold has continued to rally

1. Stronger investment demand has offset weaker demand for jewellery.
2. Limited supply increases, as mining output is only rising slowly.
3. It has been a good hedge against rising US political and economic risks.
4. The price already reflects a higher level of bond yields.

Why gold's role as a good portfolio diversifier is likely to continue

1. Central bank demand will remain firm, as the political background favours allocations away from US assets.
2. Gold is still only a very small proportion of many private sector portfolios.
3. Concerns over the dollar, US fiscal risk and inflation will remain elevated.
4. It provides better diversification than bitcoin or gold equities.

Revolutionary Times in Financial Markets? And What to do About Them

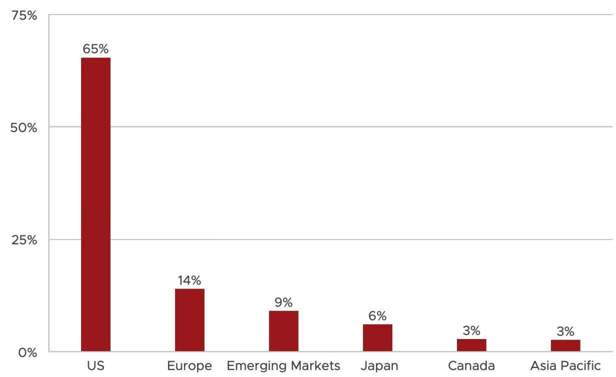
The first weeks of the Trump Presidency have been 'interesting' in the Chinese sense of the term. The previous consensus that his second term would deliver rising equity markets on the back of tax cuts and widespread deregulation has dissipated. It has given way to concerns in many quarters that the combination of economic nationalism and widespread policy incoherence and ineptitude might rather deliver the opposite.

The underperformance of US assets in recent weeks could, on this view, be the precursor to a more extended period of relative weakness, particularly given the high initial exposure to US assets in many globally-oriented portfolios around the world.

For example, US equities comprise around 70% of conventional global equity benchmarks (chart 1). Saranac regards these concerns as legitimate, and multi-asset portfolios have included positions designed to attenuate some of these extremes.

CHART 1

Global Equity Market Capitalisation by Region: the US Dominates



Source: MSCI

If US assets have outperformed for decades in part because the US was the stable Liberal

The Long Read

This argument strikes us as interesting and plausible, but at the same time sadly not inevitably correct. In this respect it is better to approach the issue not as far-sighted political gurus (if such a category even exists) but as pragmatic and hard headed investors who are also mindful of what they don't know, and what no-one else knows either. From this perspective, a number of issues arise.

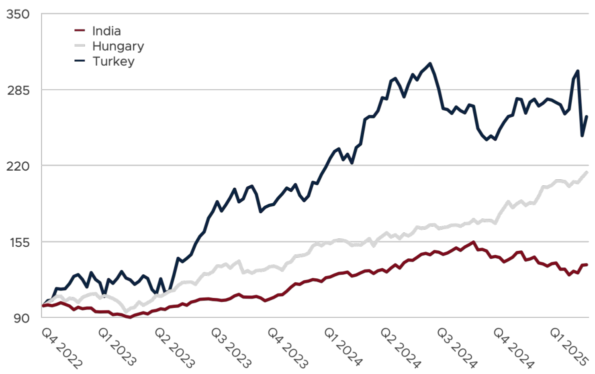
First, while the much cited 'Trump put' has to date been a damp squib, at some stage market weakness could force to a recalibration of the Administration's policies.

Second, even if the US does go down a more authoritarian and nationalist route, this may not prove to be problematic for equity markets. The performance of Indian, Hungarian and Turkish equity markets in recent years support this view: all have delivered positive returns in local currencies (chart 2).

Democracy par excellence, and if this structure is now being tarnished, a much less supportive investment environment could emerge in the medium-term.

CHART 2

Positive Equity Returns in 'Nationalist Authoritarian' Countries (local currencies)

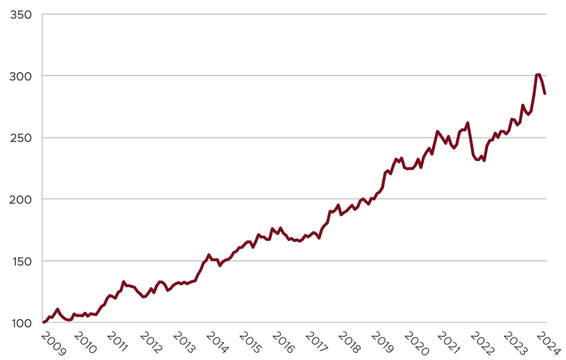


Source: Bloomberg, MSCI

Third, the current focus on the US political background ignores the much wider range of influences which will also affect the US and other global markets going forward. In this respect, politics is not destiny. The fact that US equity market has outperformed in recent decades across a very wide range of different political and economic environments (chart 3) suggests that a theme which has high short-term media visibility may not actually be the main driver of market performance. For example, there have been tentative signs of a pick-up in underlying productivity growth in the US, which may reflect greater technological sophistication. If sustained, this could well prove to be a more influential market theme than broader political developments or press conferences in the Oval office – but as a slower-moving and less transparent market driver, it may never receive equivalent coverage.

CHART 3

Relative Performance of US/Non-US Equities: Persistent US Outperformance



Source: Bloomberg, MSCI

In these circumstances, rather than position portfolios to be the 'best' that a single tentative political theme requires, which could blow up if that theme is not in fact dominant, we believe a superior approach is to accept that the current conjuncture is unusual, with the future more opaque than usual. In short, there is a wider range of plausible outturns. The correct diagnosis is to acknowledge that a more material degree of diversification in multi-asset portfolios is required. Examples of this in Saranac portfolios include equity hedges, inflation-linked bonds, a tilt away from US equities, and structured product and hedge fund allocations targeted to be largely uncorrelated with conventional asset-class returns.

The Long Read

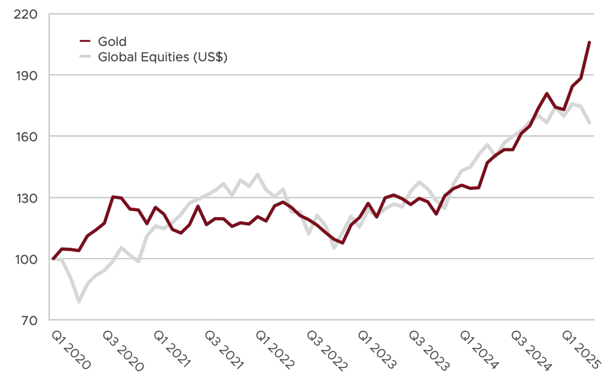
Gold a genuine diversifier, not a speculative asset

I. Gold as a divsersifier

Our focus in this article is on another important diversifying asset in Saranac portfolios, namely gold. A review is timely. This allocation has made a significant difference to multi-asset performance in recent years. It has (unusually) outperformed global equities since 2021 (chart 4), which have also delivered strong returns, and with lower volatility. A further important feature has been that it has delivered these returns on average at different times than equity markets. The correlation between gold and equities has been slightly positive in this period, but a more important test has been what the gold price has done in periods when equity markets have fallen.

CHART 4

Gold has Outperformed Global Equities

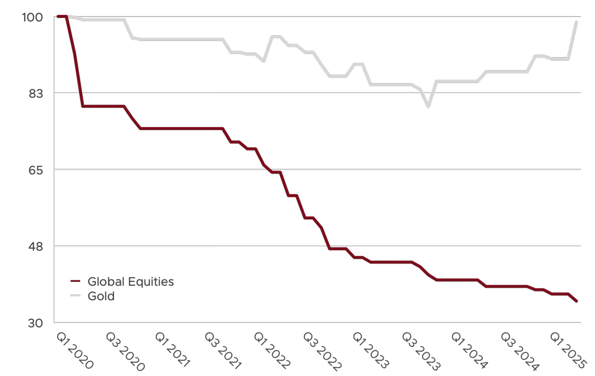


Source: Bloomberg, MSCI

The continuing rise in the gold price in recent weeks as equity markets have struggled point to gold's diversification properties, a relationship in evidence over longer time periods. Chart 5 shows the cumulative returns to equities and gold in those months in the past five years or so when global equites have fallen by 1% or more. It is evident that gold has usually been a strong performer in relative and sometimes in absolute terms. To what extent can this helpful performance continue, given that the gold price has surged almost 90% since autumn 2022, of which ~15% has come so far in 2025. This rise has occurred at a time when the performance of other commodities has been generally lacklustre.

CHART 5

Cumulative returns to Global Equities and Gold in months when Equities Fall



Source: Bloomberg, Saranac

II. Gold supply and demand – a conventional analysis

One possible challenge refers to the dynamics of the gold market. Over very long periods of time, the returns to many commodities has been broadly in line with inflation, albeit with material and long-lived cycles around this long-term trend. In a 'conventional' commodity cycle, a significant price rise is met with reductions in demand and increases in supply, which depress the price. A significant price decline depresses demand and constrains supply, which supports the price.

Where is the current gold price in this context? The strong price rise in recent years has made gold mining highly profitable: the average cost of extraction is around $1500/oz, and the cost of the most expensive producer (which has a stronger influence on the price) is around $2000. Capacity utilisation in global mining is probably 80-90%, and at current prices mining would only become unprofitable if the last couple of per cent of spare capacity were to be deployed. So the incentive is clearly in place for production to expand.

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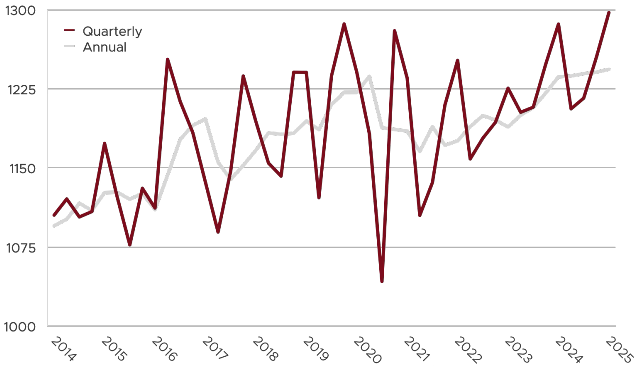
However, this is happening only slowly - it can take years to open a new mine or develop an existing one.

Since 2021, the annual rate of increase in mining output has been under 1%, and over five years the increase in global output has been negligible, in contrast to the ~30% cumulative increase in the previous decade (chart 6). So there is little sign of a rapid supply response to higher prices. In fact gold recycling is now a larger source of supply than newly-mined gold. In aggregate, the very limited supply response suggests that one source of weakness in the gold price has yet to emerge.

CHART 6

Gold Supply (metric tonne)

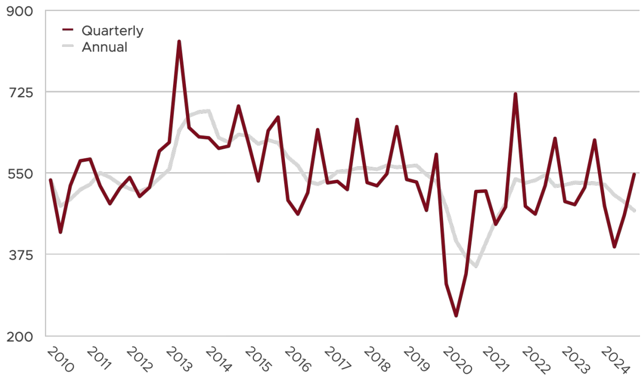


Source: World Gold Council

While supply conditions remain favourable, erosion in demand for final use has become more evident in response to the higher price. Jewellery demand, which has amounted to ~50% of total demand, is clearly weakening. Gold demand for industrial use has been less price sensitive, but is doing little more than treading water. The material gold price rise can be seen as inducing the standard response in constraining demand, and therefore limiting the scope for additional price rises (chart 7).

CHART 7

Demand for Gold Jewellery is fading (metric tonnes)



Source: World Gold Council

III. Central banks and private sector demand

However, in recent years there has been an important, and in our view durable, change in the structure of demand for gold, with increasing exposure taken by financial investors. This has two components. First, central bank purchases have increased significantly if erratically in recent years, from under 10% of total demand in 2021 to over 25% more recently. Chinese purchases have been widely reported, but this move has been widespread (chart 8). To some extent there is a straightforward diversification theme, but there is an increasingly relevant political motivation: if a significant portion of a country's assets is in the US, and the US is seen as increasingly antagonistic to a wide range of countries, including allies, even a modest erosion in trust could lead to material and sustained asset reallocations. On average, gold is still a small proportion of total central bank reserves, and it is possible that higher purchases could be a multi-year phenomenon rather than one-off allocation. For example, Chinese gold reserves are still well below 10% of the total.

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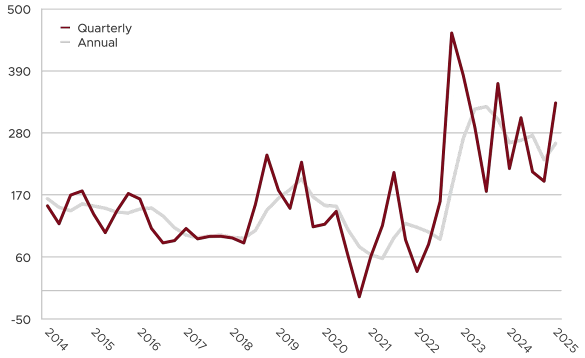
CHART 8

Gold Demand from Central Banks (metric tonnes)

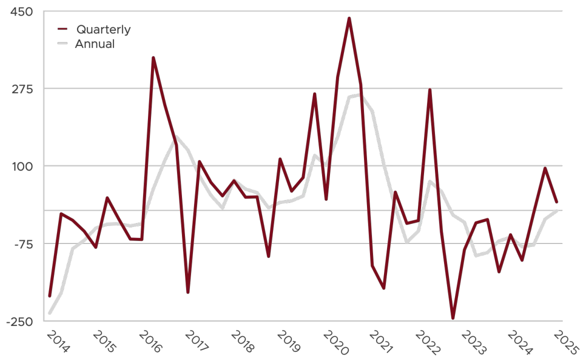


Source: World Gold Council

There has also been some increase in gold demand from private sector investors, as demonstrated by ETF flows (chart 9). The source of these flows has varied: Asia last year, the US this year. It is important to stress, however, that this shift in demand has been the result of less selling rather than a clear shift to positive demand from this source. Private sector investment demand has been significantly higher in the past, and given generally very low allocations to gold, there is scope for additional demand from this source.

CHART 9

Gold Demand through ETFs (metric tonnes)



Source: World Gold Council

IV. Rising 'financial' demand for gold does not imply rampant speculation

Seasoned investors may regard this increase in financial demand for gold relative to physical demand as inherently speculative, but we would regard it as legitimate. Of course, gold does not deliver a dividend or a coupon, so the entire return is associated with the change in the price.

However, gold does have a reasonable track record in delivering returns in particular situations, such as a weaker dollar, heightened political and market uncertainty, and rising inflation expectations. Since these may all be features of the investment environment ahead of us, a gold allocation still has an important portfolio role to play. Of course there are risks, and an environment of declining global political instability, rising real interest rates, a strong dollar and weaker final demand for gold could drive the price lower – but these are risks which are not our primary concern at this point in time. We also acknowledge that in short-term crisis periods (e.g. September 2008) when pressure on liquidity is intense, the gold price can be dragged down with other assets temporarily, but its diversifying properties have not remained in abeyance for long in these circumstances.

The Long Read

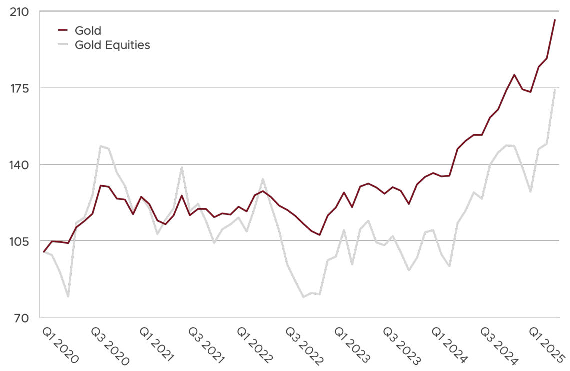
Bitcoin and gold equities are inferior diversifiers

It is also worth considering two alternative exposures which in principle could play a similar portfolio role to gold – bitcoin and gold equities. There is a 'theological' element to the arguments for bitcoin, but we avoid these here to make two simpler points. First, bitcoin is a dollar-denominated asset but demonstrates only a weak relationship with the US currency. It is not, therefore, a good hedge against dollar weakness. Second, bitcoin's long-term correlation with equities is, like gold's, relatively low (around 0.3), but it is much more 'risk-on' in periods of equity market weakness. In these circumstances, bitcoin can behave very much like equities, but as noted above gold has been a genuine diversifier. Finally, bitcoin is around four times as volatile as gold, and there is a strong idiosyncratic element to its performance which limits confidence in how it might behave in more general stressed market conditions.

If gold is a good portfolio hedge, might gold equities be better, delivering diversification but at the same time enhancing returns? The short answer is that this option is inferior. Gold equities have not matched the performance of the underlying asset (chart 10), as the sector has not displayed consistent capital discipline in periods of strong revenue growth; the volatility of gold equities has been materially higher; and unsurprisingly, the correlation of gold equities with equity markets is higher than the gold/equities correlation, materially constraining the effectiveness of gold equities as a hedge when equity markets in general are under pressure.

CHART 10

Gold has outperformed Gold Equities



Source: Bloomberg, MSCI. Saranac

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ABOUT SARANAC PARTNERS

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a community of individuals and families across the UK, Europe and Middle East with specialisations in strategy, investments and financing.

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