Antifragile Assets: Select Bonds or Gold?

By Didier Darcet
didier.darcet@
gavekal-intelligence-software.com

'Antifragility' is a concept invented by Professor Nicolas Nassim Taleb in 2012. It's a new way to analyze people, groups of humans, ecological objects and any kind of objects, including financial assets. The viewpoint is the one of stress and reaction to stress.
In a nutshell, fragile objects suffer from stressors while robust ones are resilient; antifragile objects, meanwhile, actively benefit from high volatility, stress, disruptions. Gavekal Intelligence Software has further developed the Theory of Antifragility from the standpoint of physics. The research has led to a formal way of precisely measuring the fragility or antifragility of any asset, a necessary step in building global portfolios with heightened robustness.

Balanced investment portfolios intuitively combine fragile assets, such as most equities, and antifragile assets, such as government bonds from developed economies or precious metals, gold or silver.

However, how does one choose the right antifragile asset? The answer depends on monetary policy.

Monetary Policies: Wicksell vs. Keynes

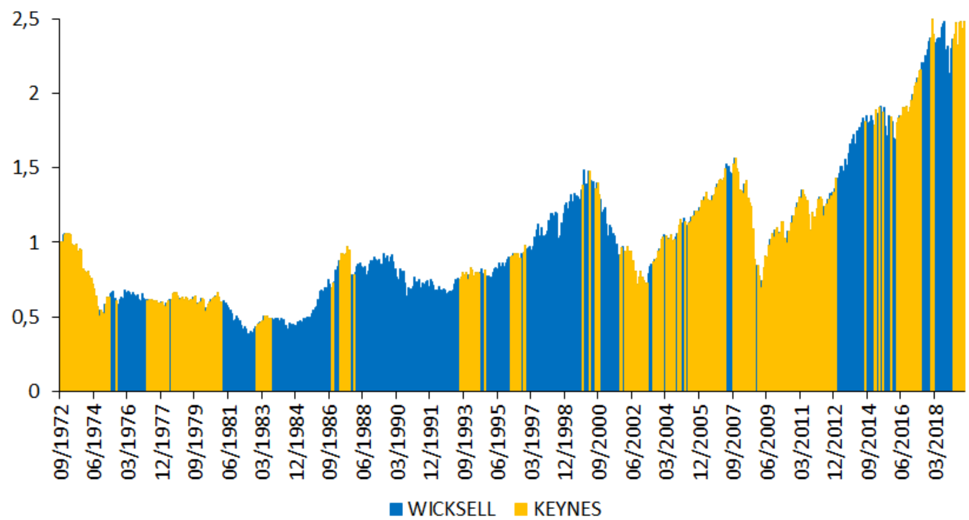
In *Gold Is Money. Everything Else Is Credit*, published in September, we distinguished 'Wicksellian' monetary policies from 'Keynesian' monetary policies.

A simple way to cluster monetary policies is to listen to the market. If the ancient form of money–Gold–paid more than the new form of money–fiat currencies- from the major monetary centers, in the previous 12 months, the world enters into the 'Keynesian' territory. In other words, fiat currencies abandoned their role as stores of value, and started debasing. This, eventually, leads to the 'euthanasia of the rentier'.

Conversely, if fiat currencies pay more than gold, the world becomes 'Wisckellian', insofar as cash rates are driven by the natural growth rate of the economy, and not cut to artificially low levels by Central Bankers.

Curiously, 'Keynesian' and 'Wicksellian' policies have been equally split in their dominance since the end of the Gold standard in 1971. This makes comparison over the past 50 years easier.

Fig 1. MSCI World excess return above cash in 'Keynesian' and 'Wicksellian' times



Source: TrackRisk, Bloomberg data

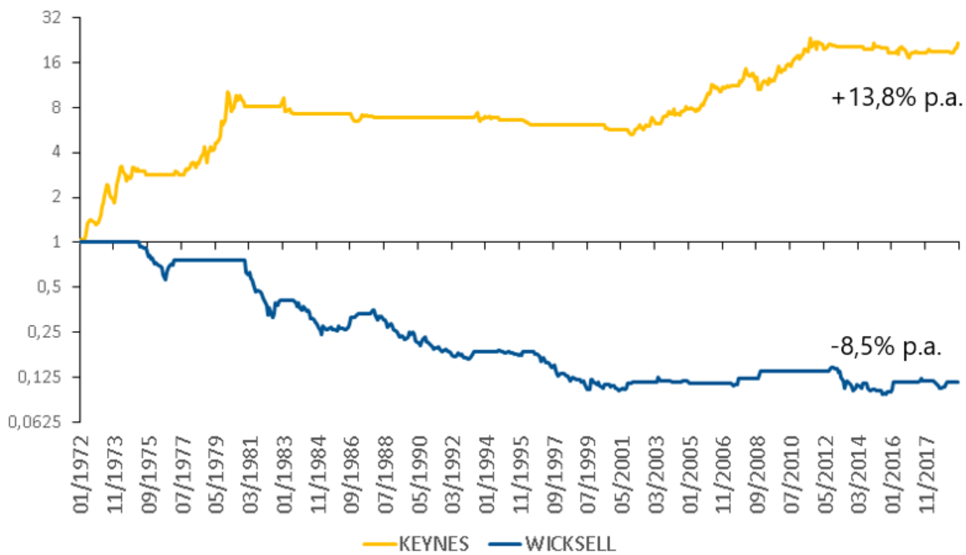
<u>Bonds Love 'Wicksell', Gold Loves 'Keynes'</u>

Figure 2 and Figure 3 on the next page show that monetary policies deeply affect the behaviors of our antifragile assets–government bonds and Gold.

Since the end of the Gold Standard in 1971, Gold has thrived in 'Keynesian' times at a pace of +13.8% per annum above USD cash rate and lost -8.5% per annum in 'Wicksellian' times.

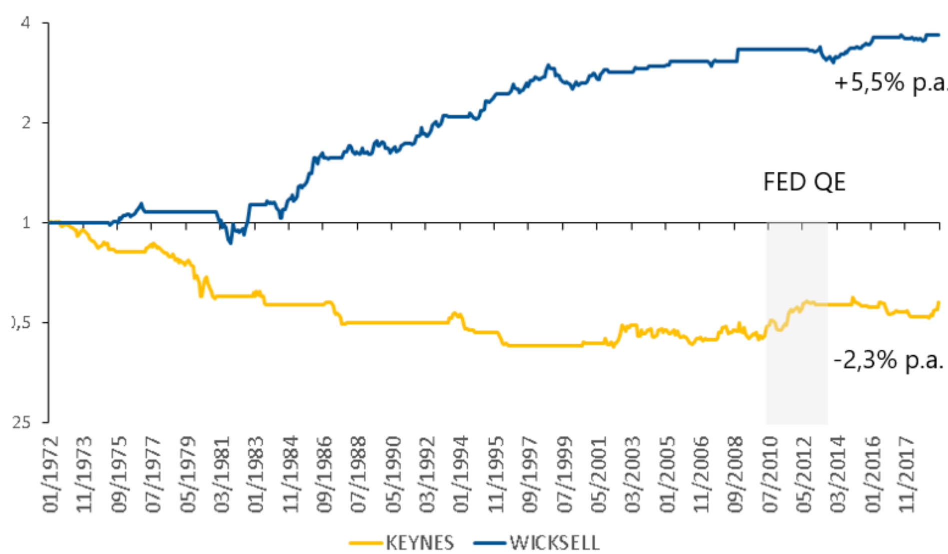
10Y US Government Bonds, on the contrary, generate +5.5% alpha above cash rate in Wicksellian times, and lose 2.2% per annum in 'Keynesian' times. The only 'Keynesian' period when bonds outperformed cash was between 2010 and 2014, when the Federal Reserve purchased huge amounts of US Treasury bonds, multiplying its balance sheet by a factor of five.

Fig 2. Gold's excess return above cash in 'Wicksellian' and 'Keynesian' times



Source: TrackRisk, Bloomberg data

Fig 3. 10Y UST excess return above cash in 'Wicksellian' and 'Keynesian' times



Source: TrackRisk, Bloomberg data

Antifragile Asset Protection During Equity Crashes

The available data sample of equity crashes is limited to a few events, making any statistical analysis doubtful. Figure 4 below, however, shows consistency with the previous analysis. In 'Wicksellian' times, Gold does not provide any protection from equity crashes. In 'Keynesian' times, the situation reverses.

Fig 4. US Bonds and Gold returns in equity crash times

S&P Crash Period	S&P Drawdown	Monetary Policy	10Y UST Return	GOLD Return (Silver before 1971)
1917	-27%	KEYNES	2%	20%
1920-1921	-23%	WICKSELL	12%	-48%
1929-1938	-86%	WICKSELL	9%	-47%
1969-1970	-29%	WICKSELL	-5%	-17%
1972-1974	-43%	KEYNES	0%	137%
1987	-30%	WICKSELL	2%	-5%
2000-2001	-30%	WICKSELL	16%	6%
2001-2002	-22%	KEYNES	11%	16%
2007-2009	-51%	KEYNES	20%	18%

Source: TrackRisk, Bloomberg, Macrobond, Shiller

Conclusion

Investors who believe that 'Keynesian' monetary policies are likely to continue in the foreseeable future, given the amount of cumulated public debt by developed economies and the lack of political willingness to address the issue, should consider Gold as a relevant antifragile asset to balance equity portfolio risks.