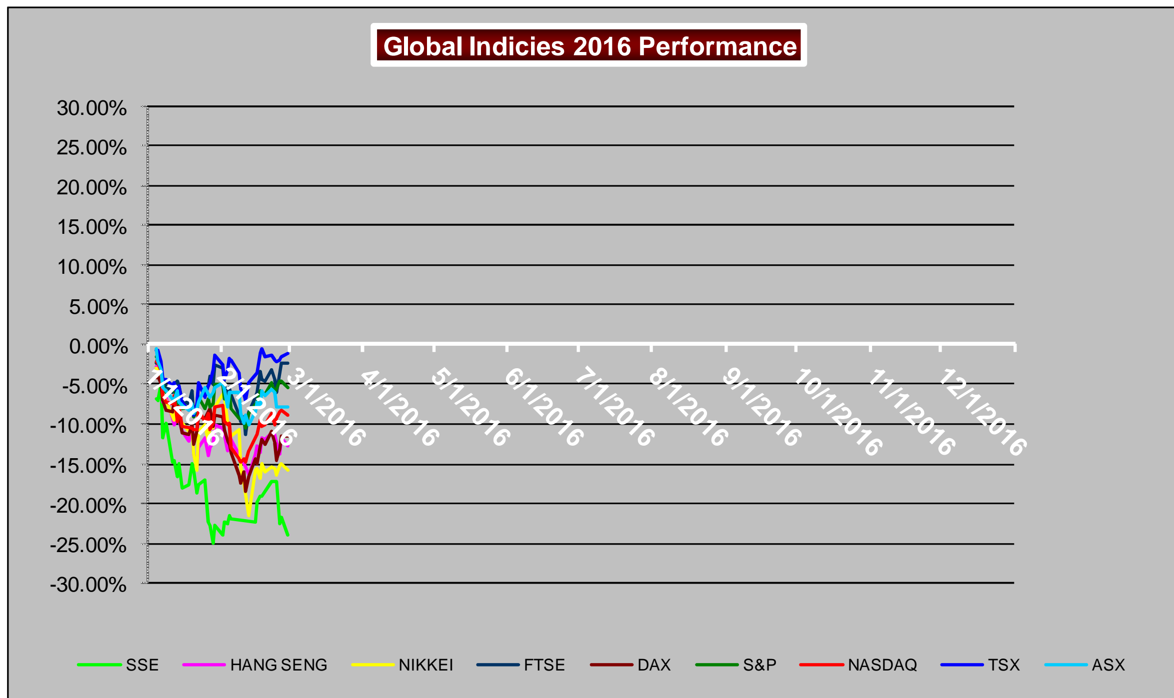
GDB Capital Inc.

GDB March 2016 Newsletter

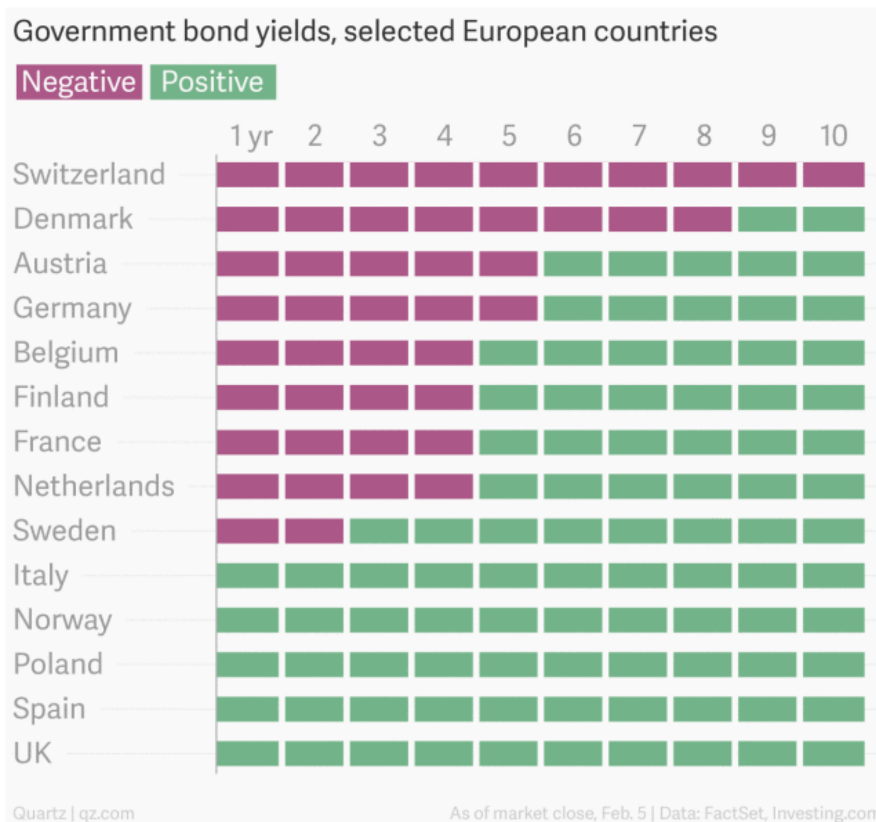
Monthly Market Summary:

2016 February Market Activity		
SSE COMPOSITE	*2,687.98*	-49.62 (-1.81%)
HANG SENG	*19,111.93*	-571.18 (-2.90%)
NIKKEI 225	*16,026.76*	-1,491.54 (-8.51%)
FTSE 100	*6,097.10*	+13.30 (0.22 %)
DAX	*9,495.40*	-302.71 (-3.09%)
DOW	*16,510.40*	+44.10 (0.27 %)
S&P 500	*1,932.23*	-8.01 (-0.41%)
NASDAQ COMPOSITE	*4,557.95*	-56.00 (-1.21%)
ASX 200	*4,880.90*	-124.60 (-2.49%)
TSX COMPOSITE	*12,860.40*	+38.30 (0.30 %)



Investment Themes:

The ECB rolled out another round of rate cuts and increased its quantitative easing package in the beginning of March. As a result, it pushed yields even lower on Eurozone government securities. Below is a clear visual chart showing selected European countries' bond yields by maturity. At the extreme, safe haven country such as Switzerland is exhibiting a yield curve that is completely in the negative territory.



So why on earth would investors lend money to lose money? Basically there are three main groups of bond buyers. The first group consists of central banks, banks, pension funds, and insurance companies that have to buy bonds no matter what the return is for their reserves, to meet liquidity requirements, per investment mandates, and to use it as collaterals to borrow money. The second group of bond buyer are speculators who think there are further downside on yields, therefore, buying them now to profit from gain from the rise in the price of the bonds when rates go down further. The last group buyers are investors who are seeking safe haven for their money and are willing to accept a small loss on government bonds to much bigger loss elsewhere. After

all, sovereign bonds are backed by the governments that issue them and in theory are "risk-free". Global equities had skit to their worst start in 2016 since the Great Depression; commodities have plunged in prices; default rates on corporate bonds are concerning. The risks in all other asset classes make investors gravitate towards the perceived safe harbor of government securities.

For the first group of investors, the demand for government bonds is inelastic, so they will continue to be a pillar of support for government bonds, regardless of investment returns. The second group is made up of traders and hedge funds. As soon as rates are tipped to go higher, they will vanish in a heartbeat. They are well aware of the issues such as liquidity and magnified losses due to the convexity nature of these bonds, therefore, we don't expect this group to be large buyers given the profit and loss tradeoff.

We will focus on the third group of investors who seek safety in the current market environment. For these investors, an alternative to holding government bonds to preserve their capital during times of financial instability could be investment in gold. However, an age old argument against investment in gold is that as an asset class, it is not a yield producing asset, but serves solely for the purpose of storing value. This is true when quality government papers are generating positive yields. However, as the yields across the globe are dipping more and more into negative territory, a non-yield producing asset suddenly appears not so bad after all. Furthermore, currencies, even safe harbor currencies such as the US dollar or the Swiss Franc can be artificial managed by their central bankers, making currency risk part of holding government bonds. As the currency devaluation game generates momentum around the world, there is less and less confidence that during time of turmoil, currencies will serve as a means to preserve wealth. During the market gyration in the first quarter, spot gold price has risen 18.72% against the USD, 14.96% against the EUR, and 16.00% against the CHF.

As the threat of another shock to the financial system looms with the possible burst of the bond bubble, the slowdown in China, and commodity price collapse, more and more wealthy investors will view gold as a sound option to store their wealth versus holding negative yielding "risk-free" government securities.