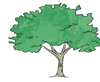

TIM
UNDERWOOD

Newsletter – December 2024

As we start a new year it is helpful to look back to the last year and see what strategies worked and what was missed. We can use this insight to plan a strategy for the year ahead.

1. Gold

Asset allocation to gold in 2024 was a success with the price rising by 26% to $ 2,624. That is quoting the price in US dollar terms. If the US dollar is not your spending currency or base currency then the price movement in your base currency is important. In GB Pounds terms it was +28% and in Euro terms the price movement was +34%. In Japanese Yen it was +40%. These differences show the impact of the stronger US dollar in 2024 compared to other currencies.

There is a view that after a strong performance an investment is likely to temper its future growth and that may well be the case. However gold in Yen terms in 2024 was preceded by two strong years such that the 3 year gain for the Yen investor was 90%. A trend can continue for some time.

2. Gold mining companies

A mining company has a very simple business model. Get the gold out of the ground, refine it and get it to the market. If the price is higher than the costs to do this then a profit is made. If the price goes up and the company can control its costs then the profit will increase. For example if a company has an all in cost of production of $1,800 per ounce and the price sold was $ 2,000 the profit is $ 200 per oz. When the gold price rises to $2,600 and the costs are controlled at $1,800 then profits should soar and the share price of the company. In 2024 gold mining companies saw their share price rise by on average 25% which, while good, is less than what might be expected.

Gold mining company shares have not been in great demand in the year and bid higher and higher. This is because the US stock market has been dominated by a handful of big technology companies and gold miners have been largely ignored. A US bank noted that the mean holding of US assets in gold investments was historically 2%, but it is currently 0.5% so a mean reversion would see a huge uplift in this sector. Mining companies were expecting a good 2024 with a gold price of $ 2,000. As it turned out the price of gold for the latter half of the year was $ 2,600 so, if costs were controlled, profits should be much higher than expected. As we move into 2025 and companies report for the full 2024 we might see some very positive profit surprises.

3. Emerging countries

Sometimes it is not just what is included in a portfolio that results in success, but also what is excluded. The emerging country stock markets BRICs (Brazil, Russia, India, China) were often promoted as being the future and having great potential. In 2024 the BICs (Russia has been dropped due to sanctions) made some gains but over the last 3 years are well down and problems loom with weaker currencies against the US dollar. Not an attractive asset class at the moment.

4. US stock market: SP500 index

This index has had a successful 2024 rising 25% but 50% of that was from just 7 companies. The other 493 companies made up the rest of the return and valuations are very high. According to John Hussman a US fund manager: *On 6 December 2024, the S&P 500 set the most extreme level of valuations on record, exceeding both the 1929 and 2000 market peaks on measures that we find best-correlated with actual, subsequent 10-12 year S&P 500 total returns.*

Take a company like Tesla the manufacturer of electric cars and the 7th most valuable company in the USA. As I write this the shares trade at $400 and a price/earning ratio of 100. That means if you buy shares for $100,000 over a year the expected return on the shares from earnings is $1,000. Not paid in cash, the company does not pay dividends but is retained in the company for your future benefit. The company at this share price is valued at $ 1,300 billion but in 2024 Tesla sold just 1.8 million cars. It also has a product line of basically only two cars, the Model Y and the Model 3 and they have 70% of the same parts. With strong competition from other manufacturers and the whole industry struggling, it does seem a very high valuation for the company, but this is where index tracker funds place their investor's savings.

5. Bonds

The classic portfolio model is 60% equities and 40% bonds, the latter reducing volatility and providing some income. The attraction of bonds depends on who issues them, what the duration is and of course the price. The benchmark is the 10 year bond and usually the longer the bond duration the higher the interest rates received, as it entails a higher risk over a longer period. The global bond market is larger than the equity market as huge sums are raised by governments and corporations.

Germany can sell 10 year bonds at the moment with a yield of 2.6%pa. The USA at 4.8% and the UK at 4.9%. These might be attractive to pension funds which can match their income to expected payouts, but for many these yields do not look attractive for the next 10 years. If interest rates fall due to a recession bonds might make a capital gain on the other hand they do not like rising rates. Reduced volatility in a portfolio and some income makes sense at the moment.

6. UK stock market.

The major companies in the UK have trailed their counterparts in the USA in terms of capital growth over the last year, however they have offered good cash dividends. But the UK is now going through a period of economic confusion. The new Labour government recently introduced a finance budget that was not well received and in the longer term its policy of "Net Zero" seems to me, to be the biggest policy of self harm the UK has seen in generations. Therefore UK assets have become less attractive for now.

On 20 January Mr Trump becomes the President of the USA for the second time. We are living in interesting times.

Best wishes

Tim Underwood 14 January 2025

Disclaimer - Newsletters are not financial advice. See www.timunderwood.com for details and other Newsletters