

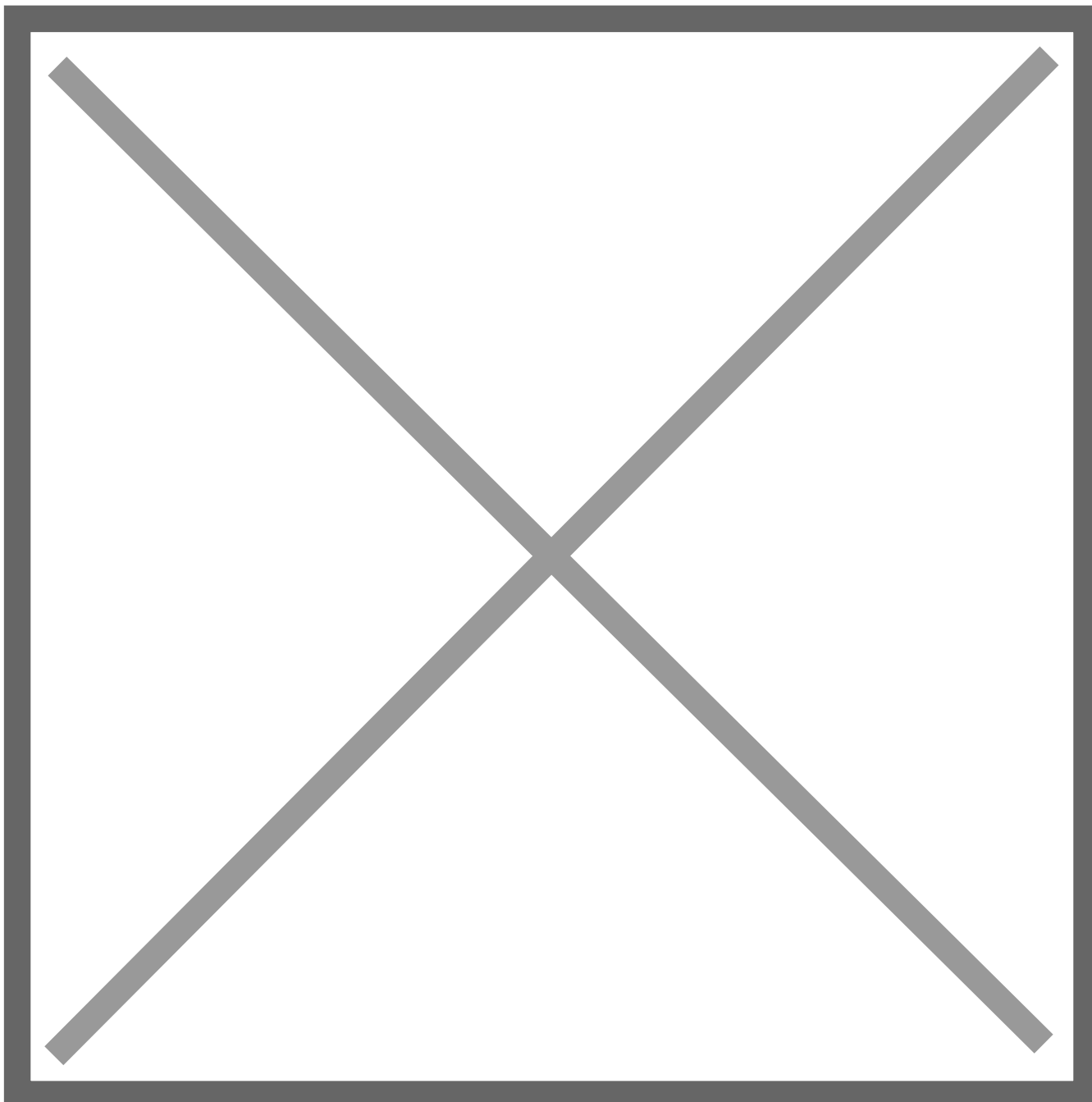


Insights, Tacit Thought | Weekly Investment Insights

The Role of Stabilisers

Published on: 15 August, 2019 | Author: Investment Team

The venture capitalist Paul Graham said that investors should treat optimism similarly to how one would treat the core of a nuclear reactor – as a source of power that is also very dangerous. “You have to build a shield around it or it will fry you”. This is similar to how we view the growth and stabiliser assets in our strategies. The growth component, mainly composed of equities, is like the core of the nuclear reactor. It is responsible for the growth of a portfolio above inflation. The control rods in a nuclear reactor are similar to the stabilisers in our strategies.



The low yields available on government bonds have led many of our peers to shun these assets. We believe this is wrong, not because we have superior insight into how they will perform in absolute terms, but because we know how they perform when the Growth component of our strategies is falling. The chart above shows that even with the low yields available from government bonds in the UK, they continue to be negatively correlated to equities and rise when equities fall.

Now, we would like to rehash a theory that most investors do not give enough credence to as it does not play to their positive outlook for equities.

Government bond yields around the world have continued to fall even whilst economic growth has rebounded over the past decade. This puzzles most investors as the standard cyclical economic narrative is that increasing demand leads to rising prices and this in turn leads to rising interest rates to dampen this demand and control inflation/prices.

Over the past 30, years investors have become accustomed to central banks 'managing' inflation and this leading to ever decreasing interest rates in the world. But what if this dynamic has not been driven by the genius of central bankers but more by wider global themes that are still at play? What if the real problem remains an oversupply of goods and services

or a lack of demand?

At Tacit, we do not know which of the economic outlooks will play out over the coming years and therefore do not take a view on whether government bond yields are too low or too high. We focus on their inherent diversification benefits and would urge others to do the same.

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