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Gold in the Spotlight, Once Again

It has been about a decade since we lent some space to the subject of gold. That was December of 2009, and the yellow stuff had cleared $1,300 per ounce, better than a triple from its 2001 lows. That ride would carry it to just over $2,000 by August of 2011 before heading south. By December of 2015, gold had fallen back to just over $1,000 as both inflation and economic growth failed to impress.

About two years ago, gold began its latest climb that recently saw the price top $2,000 once again. As with any widely followed asset at any price level, there are arguments for owning it or avoiding it. It is often said that gold has a very long history as a store of value and a medium of exchange; that it offers a hedge against inflation and currency devaluation as central banks flood the world with fiat money; that it sometimes rallies in the face of international conflict or high economic stress; and that it can help diversify a portfolio holding primarily stocks and bonds.

On the *other* hand, actually realizing the opportunity suggested by those arguments can be a matter of timing. As the table below suggests, gold may provide a measure of long-term inflation protection. But its multi-year price cycles and shorter-term volatility tend to reflect shifts in *perceptions* of future inflation prospects. Sometimes those perceptions prompt gold to run counter to financial assets, but not always. Gold's latest surge has coincided with a *rise* of major stock and bond averages to record highs.

The table also reflects the potency of *stocks* for beating long-term inflation. And those Dow numbers represent only the price level of the Average without the added return from dividends. For the period 1971 through 2019, reinvested dividends would have boosted the annualized return from the 7.5% indicated here to just over 11%. It bears repeating that gold pays investors neither interest nor dividends.

Stocks & Gold: by the Numbers

End of Year	Gold: London PM Fix	Dow Jones Industrial Average	Inflation: 5-yr Trailing Average
1970	$ 37	839	4.6%
1975	140	852	6.9%
1980	590	964	9.3%
1985	327	1,547	4.8%
1990	393	2,634	4.1%
1995	387	5,117	2.8%
2000	274	10,787	2.5%
2005	513	10,718	2.5%
2010	1,406	11,578	2.2%
2015	1,060	17,425	1.5%
2020*	2,040	27,739	2.1%

*as of 8/20/20 / Sources: Kitco, S&P Dow Jones Indices, MacroTrends

All that said, the real problem with gold isn't gold itself. Eleven years ago, we laid out the case for maintaining a small portfolio position, but cautioned against "the historic tendency for investors to pile into gold near the top of major price swings and bail out closer to the lows."

With the rise of gold-based exchange traded funds, investors have an easier way to build and adjust gold positions. Ease of entry and exit can be a two-edged sword, but wielding that sword wisely and well might help your portfolio merit… a gold star. ■

China: What Now?

Over its 31-year life, this publication has traced the long arc of China's economic rise and implications for global investors. Building on diplomatic and strategic outreach by the Nixon administration in the early 1970s, and then through Deng Xiaoping's Four Modernizations program and normalization of relations with the U.S., the sheer scope of China's economic potential seemed boundless.

With the fall of the Soviet regime in the early 1990s, China's apparent liberalization fit neatly into an optimistic post-Cold-War narrative that saw global integration and cooperation replacing confrontation. That scenario now appears to have been a bit too rosy. But the part about China becoming a great economic powerhouse was certainly on point.

Home to a fifth of the world's population, China is a continental and maritime power. It holds dominant positions in such key sectors as semiconductors and rare earth metals. Its economy has contributed 27% of global growth over the past 15 years, compared to a 10% contribution from the U.S. Its economic growth continues to outpace other major industrialized nations.

Over the past 30 years, U.S. economic growth was impressive by most standards, as gross domestic product (GDP) more than tripled. However, most estimates are that China's GDP is perhaps *30 times* as large as it was in 1991.

Despite current U.S.-China tensions and the antagonisms that dominated its first two decades of communist rule, the two nations have a longer history of mutually beneficial relations. Dating back well over a century, the U.S. opposed occupation by colonial powers seeking to

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A Broad Market Benchmark Has Gotten Pretty Top-Heavy

Some articles risk going out of date before the "ink" dries. We'll hope this isn't one of them. The Standard & Poor's 500 Index had been hitting all-time highs, up about 10% year-to-date through August and nearly 60% above its March 23rd low. Some investors were nervous about the level of stocks generally; others focused more on the concentration in the index's largest companies.

Those concerns helped prompt a sell-off September 3rd and 4th that quickly trimmed 4.3% off the S&P's latest high. Perhaps a little history is in order. Twenty-two years ago, this publication offered a similar cautionary. On that occasion, the 10 largest, hottest names in the S&P 500 had come to represent 20% of its total market capitalization. These were global corporate champions representing key sectors of the U.S. economy.

That concern was a bit early, as most of the market's marquee names continued to rally into 2000. The S&P's top-ten concentration briefly topped 25% ahead of the 2001-02 decline. Stocks did recover from that "Tech Wreck," but the 1999-2008 decade turned out to be among history's worst, often called a "lost decade" in the wake of the Global Financial Crisis.

Today's top 10 concentration recently reached 27% of the S&P's market cap, with just the top five stocks represented well over 20% of the Index at the end of August. Perhaps more notable is the concentration of those names in the technology and communications sectors. That has been a key pandemic investment theme given the acceleration of several trends that benefit these high-profile names. As always, the question is whether their prices have run too far ahead of those compelling prospects.

Standard & Poor's 500 Index

Ten Largest Companies by Market Capitalization

September 1998	September 2020
General Electric Co.	Apple Inc.
Coca Cola Co.	Microsoft Corp.
Exxon Corp.	Amazon.com
Microsoft Corp.	Facebook A
Merck & Co.	Alphabet A (GOOGL)
Royal Dutch Petroleum (ADR)	Alphabet C (GOOG)
Intel Corp.	Johnson & Johnson
Philip Morris Cos., Inc.	Berkshire Hathaway B
Procter & Gamble	Procter & Gamble
IBM Corp.	Visa Inc. A

Source: S&P Dow Jones Indices

As noted in 1998, the popularity of passive indexed investing may help propel a self-feeding phenomenon. Investors drive certain stocks higher, prompting a universe of indexed portfolios to buy more of those stocks, driving investors toward those portfolios, and so on. That process can also work in reverse.

This publication is *not* in the habit of making stock recommendations or market calls. It *is* in the habit of encouraging realistic expectations and maintaining prudent diversification. ■

Investment Performance Review	**TOTAL RETURN *** (Dividends and capital gains reinvested.)			
Selected Mutual Fund Categories *	**--- Annualized through Sept. 4, 2020 ---**			
	1 yr.	***3 yr.***	***5 yr.***	***10 yr.***
Large-Cap Stocks (Blend)	13.9 %	10.9 %	12.0 %	12.5%
Mid-Cap Stocks (Blend)	3.3	4.9	7.2	10.2
Small-Cap Stocks (Blend) †	- 0.8	1.8	5.8	9.5
Foreign Stocks (Large Blend) †	4.8	1.4	5.3	5.0
Diversified Emerging Markets †	11.4	1.9	8.6	3.2
Specialty Natural Resources †	5.9	- 0.8	4.8	1.6
Specialty Real Estate †	- 3.7	2.0	5.9	8.1
Cons. Allocation (30-50% Equity)	5.6	4.8	5.7	6.0
Long-Term Bond	9.2	8.8	8.2	7.2
World Bond †	4.8	2.6	3.6	2.2
High Yield Taxable Bond †	2.5	3.4	4.9	5.7
Long-Term Municipal Bond	2.1	3.9	4.0	4.2

* Source: Morningstar. **Past performance is NOT indicative of future results.**

† Small-cap stocks, high-yield (lower rated) bonds, and sector-specific funds may exhibit greater price volatility than the stocks of larger, established companies and/or more broadly diversified funds. Securities of companies based outside the U.S. may be affected by currency fluctuation and/or greater political or social instability.

Young Investors Go Bull Riding

Who says that youth is wasted on the young? A recent quarterly tracking by E*TRADE's StreetWise found that 51% of Gen Z and Millennial investors have raised their risk tolerance since the coronavirus outbreak by an average of 23 percentage points above the broad population. More than half of those younger investors (under age 34) say they are trading stocks, and 46% are trading derivatives such as options more frequently at levels notably higher than the total population.

However, only 9% of these respondents had seen their portfolios recover from the March sell-off. A majority expect that recovery to occur within the next six months. By

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Aligning with Your Best Interest: An Update

Three years ago, the financial services industry was in the throes of implementing the U.S. Department of Labor's Fiduciary Rule, a highly prescriptive set of guidelines, principles, and regulations addressing potential conflicts of interest in the investment recommendations offered by financial professionals.

That rule was soon sidelined by court challenges and the perspectives of a new administration in Washington, D.C. It then fell to the Securities and Exchange Commission (SEC) to address these issues through its broader oversight of securities brokerage and investment advisory services.

On June 30, 2020, the SEC's Regulation Best Interest (Reg BI) went into effect for broker-dealers and registered investment advisers to enhance the transparency and quality of investor relationships. The objectives of Reg BI are reflected in KMS' new Form CRS, the Customer Relationship Summary.

KMS Form CRS outlines the services provided by the firm and its registered professionals, the types of fees and compensation involved, conflicts of interest inherent in that compensation, and other obligations in offering investment recommendations. It also lists additional sources of related information.

For each of those areas, Form CRS offers "Conversation Starters," questions you might wish to ask your investment professional. That is the essence of Reg BI and of KMS' long and persistent efforts to promote full disclosure and effective exchange of information with all clients. If you have not yet received KMS Form CRS, you can review it at *https//www.kms.com*. Just click on the "Disclosures" tab.

By the way, those Conversation Starters *are* really just a start. You should never hesitate to ask *any* question or raise any issue bearing on our firm's services and your financial well-being. ■

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China: What Now?

exploit China's resources, and the U.S. supported Chinese territorial integrity, including in the resolution of World War II in the Pacific.

A lynchpin for normalizing relations was the concept of "strategic ambiguity." It focused on the development of mutually beneficial trade and cross-investment while agreeing to disagree on certain key issues, including the status of Taiwan, China's maritime claims in the South China Sea, and deep philosophical differences regarding political systems and citizens' rights.

More recent flashpoints have revolved around the status of Hong Kong, the race to 5G, data security, intellectual property theft, and China's courting of nations deemed hostile to the U.S. Nevertheless, the U.S. and Chinese economies are extensively intertwined.

In two decades, Chinese portfolio and direct investment in U.S. assets has grown from less than $200 billion to more than $1.6 trillion. U.S. investment in China, which was negligible in 2002, now tops $300 billion. Those numbers almost certainly understate the immense value of shared participation in producing, promoting, and distributing a universe of goods and services across both nations' consumer markets.

Some still view China as primarily a manufacturing and exporting dynamo relying on cheap labor and a managed currency. But China has steadily climbed the value chain and now generates more of its economic growth internally. Services have grown from 39% of its economy in 2000 to 54% today, compared to the current U.S. level of 70%.

China's economy may not have gained parity with the U.S., but it has taken over the top spot in total global trade flows. It is now the largest trading partner of a number of major advanced nations, and it appears to be increasingly intent on gaining influence by spreading its newfound wealth across key relationships.

President Trump vocally campaigned on, and has promoted, a mostly critical view of the U.S.-China economic relationship. This nation may be deeply divided along political lines, but *both* sides of that divide appear to have gravitated toward the administration view.

A recent Pew Research Center poll found that 60% of Americans had a generally unfavorable opinion of China, including majorities of both Republicans and Democrats. That is the highest such reading in the poll's history, up from 47% just two years ago. More than 80% also see China's growing military strength as a negative for the U.S., although only 41% view its economic growth that way.

With that as a backdrop, it is not surprising that *both* presidential campaigns claim their guy will be "tougher on China." Given the economic realities and potential benefits of a *healthy* U.S.-China relationship, one wonders if the tough talk might just soften a bit once the election is in the rear view mirror. ■

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Young Investors ...

now, it may have dawned on a few that they already would have seen that recovery by simply sticking with the major stock averages. But how boring would that be?

Many investment professionals have long suggested relatively aggressive strategies for younger investors. In theory, their extended time horizon can stand more volatility in the interest of reaping the long-term growth potential of stocks.

Cautious optimism has been a long-term winning bet for U.S. investors, and we all have a stake in that continuing to be the case. In this challenging year, we are inclined to salute optimism wherever we find it, while remembering the important role of caution and education. ■

Has the Pandemic Altered *Your* Financial Expectations?

One might question how much can be gleaned from a survey of just 1,000 Americans. But maybe these results ring true. When the Charles Schwab organization conducted its Modern Wealth Survey last January, respondents set an average of just under a million dollars – $934,000 to be exact – as their standard for feeling financially comfortable. Respondents surveyed in June had dropped that figure to $655,000.

As for a view of what represents real wealth, the June survey indicated an average of $2.0 million, down from $2.6 million in January's survey. There may be some theory of relativity at work here, plus a dose of realism. More than half of June's respondents said that they or a close family member had already been financially affected by the pandemic.

To varying degrees, respondents indicated a greater focus on boosting their savings and, to a lesser extent, their investment in stocks. Respondents also indicated higher levels of financial stress, to an average of 52.5 on a scale of 100, up from 49.5 in 2019. Given the events of the past six months, that bump might be considered pretty modest.

In any event, money isn't everything. Only 17% of respondents ranked it as the primary contributor to overall happiness. In fact, it ran a weak third behind relationships and health. That ranking was *not* changed by the pandemic. ■

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Innovation *Everywhere*

Amidst this year's investing challenges, managers at Franklin Templeton see five major themes driving economic value across multiple sectors for the next five to ten years.

Global e-commerce: No surprise here. Pre-COVID global sales were only about 14% penetrated by e-commerce. Even in the U.S. that figure was just 41% for sectors considered to be *highly* penetrated. Lots of room to run.

Genetics: The cost of human gene sequencing has fallen dramatically, with profound implications for enhanced diagnostics, gene therapeutics, and other advances.

Smart Machines: Artificial intelligence in all kinds of products and product development can feed a "virtuous cycle" of rising efficiency, faster feedback and refinement, and better use of that growing mountain of data.

New Finance: Access to capital and a reliable currency are hallmarks of advanced economies. The use of data to price risk, coupled with the spread of e-commerce, mobile payments, and digital wallets can help boost *developing* countries.

Big Data: The raw stuff must be cleaned, stored, and retrievable in useful ways, requiring infrastructure and new applications to support *all* the dynamic themes noted above. ■

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