30 March 2020

Safe havens & gold

Multi-Asset
Global

Losing a little of its shine

- Risk on-risk off behaviour has returned to the market and cross-asset correlations have risen
- Despite the recent sell off in developed market government bonds, fundamentally they remain strong safe-haven assets
- But gold has come under pressure given recent extreme volatility, similar to its move in the Global Financial Crisis

The return of Risk On-Risk Off

The Risk On-Risk Off (RORO) phenomenon is back with a vengeance. In this environment, assets tend to lose their idiosyncratic identity and function as either "risk-on" or "risk-off" assets. "Risk-on" or "risky" assets tend to gain in value during times of positive market sentiment and include the likes of equities, high yield credit and the AUD. However, "risk-off" or "safe-haven" assets tend to outperform in times of market stress and provide downside protection in multi-asset portfolios. Typical safe havens include developed market (DM) government bonds, the JPY and gold.

Risk on-risk off behaviour is back and cross-asset correlations have risen

For much of 2019 and in early 2020, markets were relatively benign with almost all asset classes gaining significantly – be it risky or safe-haven assets. This backdrop was accompanied by **low volatility and created relatively muted cross-asset correlations**. This has all changed during the past two months or so, however.

Since concerns over COVID-19 first prompted a dip in risk assets in late-January, **RORO behaviour has returned and safe-haven assets have snapped into action**, rising in value during the recent market turmoil. Safe havens are the assets that are most negatively correlated with risky assets across the board, and while on aggregate they have performed well once again, even they can be sold off in an environment where investors are longing for liquidity.

Safe-haven assets have snapped back into action

Safe havens not immune

In recent times, some safe-haven assets have come under pressure along with risk assets. This has been most notable in DM government bonds, where the 10-year US Treasury and German Bund yields saw unusually large one-day moves higher in mid-March (see Charts 1 & 2). Indeed, some of these outsized moves have actually weakened the negative correlations between safe havens and risk assets, **which raises the question as to whether DM government bonds may be losing some of their safe-haven characteristics. We believe this not the case.**

Despite the recent jump in US Treasury yields, we believe DM government bonds remain strong safe havens

First, on a statistical level one or two data points would not normally be expected to change the correlation pattern across asset classes. This is something that is only possible during such turbulent times. However, **given the severity of these recent moves in DM government bond yields, correlations patterns between risky and safe-haven assets have indeed been skewed.**

Correlations have been skewed by large moves in DM government bond yields

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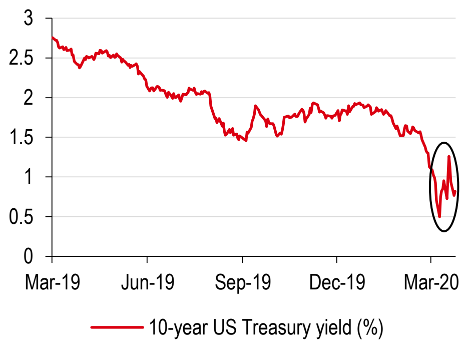
Large fiscal stimulus contributed to rising bond yields

Another reason is the **vast and expansive fiscal stimulus across major emerging and developed market economies**. Expectations of fiscal stimulus and therefore higher bond supply might matter on the day it is announced but beyond any initial reaction, **this doesn't change the longer-run bond yield forecasts**.

US Treasuries have also sold off to raise cash

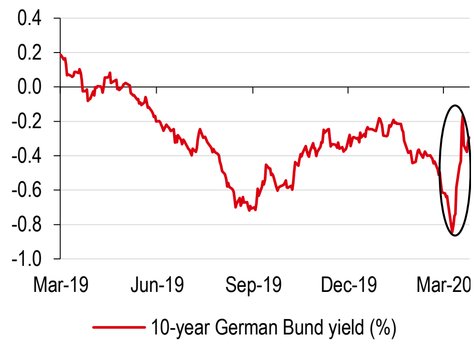
Moreover, yields on (longer-dated) US Treasuries have also risen due to liquidity needs of investors. Put simply, **the incredible rush to cash in the past few weeks has not stopped at US Treasuries**. Whilst that illustrates how cash is king currently, it is also important to note that these positions were liquidated much later than other safe havens, such as gold. We have found US Treasuries to be the strongest safe-haven to a USD-based investor, followed by the JPY and then gold.

Chart 1: 10-year US Treasury yields spiked in mid-March 2020…



Source: Refinitiv Eikon, HSBC

Chart 2: …as did 10-year German Bund yields



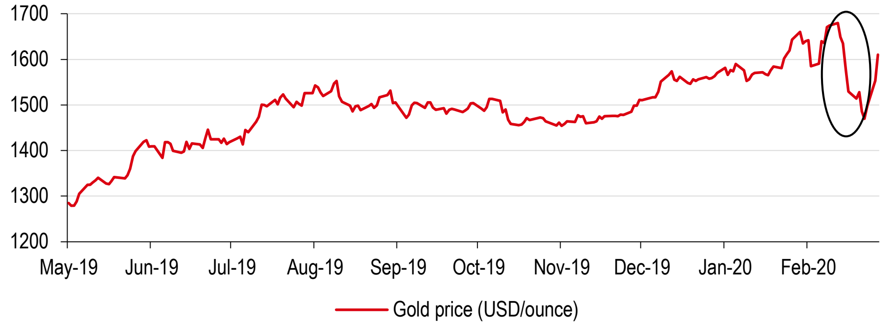
Source: Refinitiv Eikon, HSBC

Gold under pressure

Gold has sold off, with investors looking to raise cash to meet margin-calls

Given that gold was the first safe-haven to come under pressure during this period of severe market stress, it is worth considering why this was the first to wobble (see Chart 2). We believe **this is also likely due to the severity of stock market declines and the need for investors to liquidate positions and meet margin calls on risky assets** (such as equities, high yield and emerging market assets). It seems that when markets are seeing a once in a decade, or even a once in a multi-decade levels of stress, gold does not provide quite the same protection as a portfolio hedge as other traditional safe havens. Indeed, the performance of gold is reminiscent of its behaviour during the Global Financial Crisis when markets were severely stressed also.

Chart 3: The price of gold fell sharply in early March 2020



Source: Refinitiv Eikon, HSBC

Conclusion

We believe that classic safe havens such as DM government bonds, JPY and gold will remain a reliable place for investors to hide during risk-off moves. However given the severity of the market turmoil and the sharp decline in equities, the likes of which we haven't seen in decades, it seems that **gold has temporarily lost a little of its shine**.

Disclosure appendix

Additional disclosures

1. This report is dated as at 30 March 2020.
2. All market data included in this report are dated as at close 24 March 2020, unless a different date and/or a specific time of day is indicated in the report.
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