Rodrigo Gordillo:	00:00:06	Welcome to Gestalt University, hosted by the team of ReSolve Asset Management, where evidence inspires confidence. This podcast will dig deep to uncover investment truths and life hacks you won't find in the mainstream media. Covering topics that appeal to left-brain robots, right-brain poets and everyone in between, all with the goal of helping you reach excellence. Welcome to the journey.
Speaker 2:	00:00:28	Mike Philbrick, Adam Butler, Rodrigo Gordillo and Jason Russell are principals at ReSolve Asset Management. Due to industry regulations, they will not discuss any of ReSolve's funds on this podcast. All opinions expressed by the principals are solely their own opinion and do not express the opinion of ReSolve Asset Management. This podcast is for information purposes only, and should not be relied upon as a basis for investment decisions. For more information, visit investresolve.com.
Mike Philbrick:	00:00:54	Well, good afternoon all for joining us again for ReSolve Riffs. Having a little fun today, and I just want to remind everybody before we get started, that the information contained in these ReSolve Riffs happy hour type Friday discussions is not intended for being advice, and we're going to talk about topics. We're going to share potentially sites that, whether they be ours or other people's sites, or downloads and things like that, we believe them to be accurate. If they're not accurate, again, you're going to have to do your own sleuthing to check everything that we might talk about, anything that might be construed as a recommendation is not. This is entirely for entertainment purposes and hopefully some education around-
Rodrigo Gordillor:	00:01:47	Everything here is made up. Nothing is real. It's all-
Mike Philbrick:	00:01:50	Nothing is true. The only thing that's true and real are the cocktails. So I just want to make sure that we all keep it real and today we've got even little kids joining us for happy hour. This is the reality of doing these things from our homes and enjoying some good intellectual conversation on various topics of current events and whatnot. So with that aside, let's roll the Riffs. I know for me, I just went with an absolute, just a nice premium beer with natural ingredients, the Caybrew, right out of the Cayman Islands, and that's what I'm sipping on today. It's hot out there. It's summertime now, and a cold beer seemed appropriate.
Adam Butler:	00:02:39	It's always sunny-
Adam Butler:	00:02:39	My beer fridge was empty, so I'm relying on a nice cognac, which is good.
Mike Philbrick:	00:02:46	Wow! Nice.
Adam Butler:	00:02:48	Apparently too. I don't know when, we should probably share some of this insight. It's a little off topic, but we have it on very good authority that the nitric oxide that comes off of cognac can help battle SARS-COVID.

Mike Philbrick:	00:03:04	That's right.
Adam Butler:	00:03:04	It can prevent onset, reduce symptoms, reduce the length of symptoms, so maybe we'll share some research or something but ... Well, it's the nitric oxide ... and brandy.
Rodrigo Gordillo:	00:03:18	What about scotch?
Mike Philbrick:	00:03:24	Nope.
Rodrigo Gordillo:	00:03:24	I do a lot of that. I'm basically immune from it. Did you hear that ... German medical doctor that was interviewed two months ago? I shared with you guys, where he was asked, what can you do? He's like, "Drink lots of whiskey, it can help you disinfect." It's almost ...
Richard Laterman:	00:03:45	Not the COVID, but it just makes you feel a lot less stressed about the whole situation. …. I went into the Far East and got some Sapporo – solid beer.
Mike Philbrick:	00:03:59	That's some Zen coming in from that.
Rodrigo Gordillo:	00:04:02	I'm doing the 12 year ... I don't know. Cardhu Single Malt.
Rodrigo Gordillo:	00:04:09	I think I have the COVID. I decided not to go to the clinic today. I'm going to give it one more day before I give up.
Richard Laterman:	00:04:16	That's the second time you've told us you think you have it.
Adam Butler:	00:04:18	Are you kidding? It's the sixth time he's told me today.
Richard Laterman:	00:04:23	No, I mean, throughout the pandemic. ….
Mike Philbrick:	00:04:25	It is quite good. You're right. The cognac has a certain flavor to it.
Rodrigo Gordillo:	00:04:33	it's the fact that the daily scotch every hour on the hour.
Adam Butler:	00:04:38	Okay. What's the topic on guys?
Mike Philbrick:	00:04:39	So gentlemen, how about a little gold?
Adam Butler:	00:04:42	You're breaking up today. I didn't see the close.
Mike Philbrick:	00:04:45	How about a little disaster recovery? I don't know, let's have a peak here, what we did coming into the-
Rodrigo Gordillo.:	00:04:50	It was slightly higher, much to my chagrin. Given what I've been putting out there recently. I think it beat treasuries today.

Mike Philbrick: 00:04:57 Yeah.

Rodrigo Gordillo: 00:04:58 At your own risk Rod. I have 20 basis points. I've been warning you. We always have this gold debate internally. What we're going to talk about, I think is the difference between the valuable place that gold has in a portfolio from a diversification standpoint, and the almost religious zealotry around this yellow metal that people seem to think is the one thing that solves all of our problems. I love these people, they're friends of mine. You guys are somewhat that, i.e Richard sometimes-

Richard Latermanr: 00:05:44 You have friends? No, I don't think that's the case.

Rodrigo Gordillo: 00:05:49 That 20 year chart, that gold beats everything else-

Adam Butler: 00:05:53 It does.

Rodrigo Gordillo: 00:05:53 Yeah. No, I know. I remember from yesterday.

Mike Philbrick: 00:05:57 It does. I'm always amazed, everyone's so enamored with U S stocks and they are enamored with being long term investors. Gold has outperformed U S stocks over the last 20 years. Funnily enough, over the last 10, not the case. So it's interesting. We have a recency bias there-

Adam Butler: 00:06:14 And not the case for the last 30 or 40 either. So it's-

Mike Philbrick: 00:06:17 Fair comment, you're right. So picking the start point and picking the end point is very important in winning this argument. Let's be very clear. Framing is a very important thing here.

Gold

Adam Butler: 00:06:29 Well, I think you guys should get your whole macro story off your chest. I mean, you've got strong, passionate views on this. We should share the macro story. And I don't want to spoil the ending by framing this too much, right? So come on, out with it. How do we feel about gold and why?

Mike Philbrick: 00:06:49 Well, okay, so gold has a fixed production function and it's about 1.6 to 2%. So all the gold that's existed in the world-

Rodrigo Gordillo: 00:06:56 Per year you mean?

Mike Philbrick: 00:06:59 The compounding. So all the gold that's been mined by the pharaohs and stolen from the Aztecs still exists today by and large, and it was considered this sort of pillar of monetary policy because it had this fixed rate of growth. That fixed rate of growth sort of matches the economic rate of growth that you might have, and thus, it allowed for there to be some control over the supply of money. And then you come into Ray Dalio's 1971 story is it? Where they come off the gold reserve and you have fiat currency, and now you have the ability to manufacturer currency without any sort of constraint. So gold has, there's no debt tied to gold. You can't make it appear out of thin air. So it provides sort of a governor on the way in which you can manufacture gold or produce currency and withdraw currency from-

Adam Butler:	00:07:57	Oh God. Now I'm trying to listen to our podcast, like I was told to do once-
Rodrigo Gordillo:	00:08:02	That is narcissism at it's best.
Mike Philbrick:	00:08:04	You've got to mute that.
Rodrigo Gordillo:	00:08:05	It's just, I want to watch myself while I talk, in many screens.
Mike Philbrick:	00:08:11	I've already seen some of the comments, digital gold, digital gold, Mike get on the faster horse, we'll get there...
Rodrigo Gordillo:	00:08:16	That's a different story. I can get behind having a conversation about Bitcoin.
Mike Philbrick:	00:08:26	We'll get there. So, I mean, this sets up the macro opportunity for gold. It has a place as currency for a long period of time in the human psyche. So there's the monetary policy, and then there's the ability to bear debt and how that has sort of effects on different asset classes and the ability for central banks to create money in this fiat currency, that world that we live in. How does gold behave in this new sort of monetary, what do we call it? Modern monetary theory period, or postmodern, modern monetary theory? There's a lot of pretty smart people. Ray Dalio, says, if you don't own gold, you either don't understand history or you don't understand economics. It's a broad sweeping statement. It's a nice soundbite. But it does have a unique position. It has unique characteristics.

When we look at our market target and we look at those two dynamics of inflation and growth, and we look at the regimes and we look at what asset classes have sort of structural relationships in those regimes, you do see that gold has some unique performance characteristics in different economic regimes. I think we'll always come back to agreeing that there is something unique about gold, and there is a particular position in the portfolio for it. The fun conversation is the one of, when does it come in? We certainly have a systematic way to approach that problem when we're going to allocate to it, the characteristics it has to have to be allocated to, when we would reduce positions, when we would increase positions, all that's systematic, and we love that part.

The narrative part is probably a bit more fun, a little bit more ... Just to have a bit of a fun chat about that. Then let's talk about the opportunity to transition to a digital gold. We'll talk, I think, more next week too about Bitcoin. The production rate of Bitcoin, I think is 1.8% of the halfing in another four years that halfing is

0.9%. So again, you have this modern gold created of the ashes of the 2008 crisis. And so that's a really interesting story as well, but I'll stop talking and I hope that sets the table for some fun discussion now.

Rodrigo Gordillo: 00:10:42 Well, all that makes sense to me. The reason we have these discussions internally and the reason that I have ... I'm just, the whole gold bug thing, because we're surrounded by them in Canada. I am a strong believer in gold for the reasons that you explained, and specifically the fact that I left Peru because of the inflation going for 20% of 7000, 200% in six months, it is a real thing. I see the pain, I see the value in owning gold in a period of high inflation, hyperinflation.

I remember when I first got into the business, I was in constant conversations with this one guy, that I wanted him to be a mentor so badly, right? I wanted him to teach me about investing and how to think about the world of investing. I kept asking him like, "What should I read?" And he gave me a book on gold and the history of gold. I'm like, "That is wonderful, I now understand gold better than ever, thank you so much, what else should I read?" And then he gave me another book on gold. And then another one. He gave me seven books on gold and he said, this is all you need to know about managing money, right? This is all you need to know about ... It's the only thing that solves all of your problems. And-

Richard Laterman: 00:11:53 Why isn't he here with us today?

Rodrigo Gordillo: 00:11:57 I brought it up, but I think it was last minute. We came up with this maybe last week, but I may bring him in. The problem I have is that I feel gold has a very unique place in asset allocation, especially for periods of high inflation. But this idea that it's also the best thing to own at all times, including deflation, including when there's economic growth and when it's not doing well, it's okay, it's only momentary because the world's going to blow up anyway, is the other thing that bothers me about the gold bug conversation is that, they are Bane from Batman, right? They talk about how the world is going to blow up, it's going to be terrible, but they're secretly, they just can't wait to be right and see the world fall to ash, it's the fourth turning and so on, so that they can be finally proven right of this explosive growth in gold. And this mentor of mine-

Richard Laterman: 00:12:51 It sounds a little bit like the straw-man version of it, but keep going.

Rodrigo Gordillo: 00:12:58 Again, I am a fan of gold, so I can defend many aspects of gold. I just literally last week I had this podcast with Things That Make You Go Hmmm. What's his name?

Mike Philbrick.: 00:13:10 Grant.

Rodrigo Gordillo: 00:13:11 Grant, right? And he interviewed four experts and they were all just ready for the apocalypse. It's not a straw-man because it came out of their mouths, right? To the point where even Grant, who's a gold bug was like, "Ah, this is a little much." And then there was guy that called that said, look, it's going to hyperinflationary in the next year or two. And then there was one other guy was like, "Listen, that's not me, he's very passionate about that, the world is going to end and we're not going to have any currencies left at all." It's like, Oh, so that's the level down? Is it, right? Even now in this particular period, the last year or so, where everybody's like gold killing it. See, I told you so. And I'm like, is it so exciting when treasuries are still doing better than you over the last 12 months and through this scenario? I mean, gold is-

Richard Laterman: 00:14:05 But it's close though, right? The problem is you can't print gold ad infinitum as you can with the U S treasury.

Rodrigo Gordillo: 00:14:15 I'm happy with the inflation story. I'm just not so sure it matters that much any other time.

Adam Butler: 00:14:21 Well, where are we headed…?

Mike Philbrick: 00:14:23 The deflation story.

Richard Laterman: 00:14:24 Yeah. In the deflationary periods, ….

Mike Philbrick: 00:14:29 Is it an or is it an end?

Richard Laterman: 00:14:32 Right. I think that's a good point. It's not gold or treasuries, it's both in some kind of equilibrium, but in defending gold, I think when you imagine that central banks, even before COVID struck, were already dealing with secular stagnation to some degree, expanding their balance sheets as much as they could. And now that's been just exacerbated by the pandemic and there's nowhere to run. The Fed is printing money at the fastest rate than any other central bank. And it's going to be a beggar than neighbors sort of situation. Other central banks are going to have to react because there's not enough growth to go around. So they have to devalue their currencies. And gold, in my opinion, has to be thought of as a currency in this environment. And it's the one currency that it doesn't have a central bank behind it, printing its way and flooding the market with it. I mean, that's just the easiest and most obvious way to defend having a position in gold.

Rodrigo Gordillo: 00:15:39 It was the same discussion being had in 2008, right? Eric Sprott, going out and saying that we'll never see gold below whatever the price was at the time, a thousand. There's a lot at stake for the world for that gold being a currency at all in any way whatsoever, right?

Richard Laterman: 00:16:08 Not in any way. If there's growth, I mean, we know in the last decade or so since the depths of the great financial crisis, gold hasn't done, it did a little bit and then it crashed quite a bit, I think around 2012, it was. But I think it's maybe not so much gold being the best asset. I mean, there's also the side of treasuries and the fact that you have now treasuries being held majoritively by foreign governments, as opposed to domestics. This is a unique thing about the U S treasury, that other central bank, other sovereign bonds, like the Swiss, the British, the Chinese, the Japanese and Euro areas, they're mostly held by their domestic investors.

The U S treasury is mostly owned by foreign holders. And so that becomes a little bit of an issue as well, especially since they can either default on the bond, which historically tends to be a problem, right? Especially if your holders are domestic. Argentina is going on their eighth default, I think, and it's easier for them because they have a lot of their bonds being issued abroad. In the case of the U S, you can't really imagine the U S defaulting on their bond because they are the global reserve currency and they benefit from doing so. And it's likely that they're going to try to create some sort of inflation. The Fed has already indicated that they're more comfortable dealing with inflation. The problem is right now, it's all deflation, right? So no one can see this inflationary environment coming around.

Deflation

Rodrigo Gordillo: 00:17:41

Let them go ahead and try. We've been crying wolf about this forever. Isn't that what they've been wanting to do for the last 10 years? Weren't they desperate for …?

Richard Laterman: 00:17:54

They've accelerated the printing press. And the velocity of money has also collapsed with everything that's going on. The problem is when this philosophy comes back up.

Mike Philbrick: 00:18:05

Well, it's one of those problems that it happens all at once, but it doesn't sort of creep up and slowly get in, it becomes a problem, everyone perceives it as a problem. It really is one of those items where you have to question the opportunity. Well, probably in any strategy, preparation versus prediction. If you think about our more risk parity type, prioritizing a preparation where you're having that diversity built into the portfolio at all times, and suffering the languishing returns of whatever asset classes happen to be out of favor, because they're not in the regime. We have allocations to gold all the time and they drag sometimes and they shine sometimes.

So that's your first step, is if you want some inoculation, you have it there all the time. And then the question is, as you say, well, Rod, can you predict it? How might you predict it? What strategies might you use? It's interesting as interest rates come to zero as an asset class. We have the macro picture where there's a lot of money being added to the system, and there's a finite amount of gold. It logically at some point, the gold should be worth more because there's the same amount of gold and there's more money sloshing around the system. But moving that forward and saying, okay, so you have this ... Now I forgot what I was going to say. This fixed amount of gold without any debt or claim against it ... Now I lost my train of thought. I'm sorry.

Richaed Laterman: 00:19:40

I think it's the argument for scarcity, right?

Mike Philbrick: 00:19:42 I think you're on mute, Adam.

Adam Butler: 00:19:47 I think what you're trying to ... The argument is pretty simple, right? There's units of currency and there's units of gold. If you expand the number of units of currency relative to the units of gold, then obviously gold is going to be worth more units of currency, right? So that really is the entire argument for gold. Really, the whole idea of deflation versus inflation needs to be divided between this idea of economic inflation or a rise in CPI that can happen because of scarce inputs, whether ... Inputs could be commodities, it could be labor, rising labor costs, or it could be a decline or sorry, a rapid increase in the supply of the units of currency, right? So governments are trying to create inflation by creating units of currency that then supposedly increases the price of goods and creates demand for those goods as investors want to buy them today, rather than risk the potential for having to pay up more for those goods and services tomorrow, right?

Gold is a funny thing with inflation, because it's not really tied to inflation so much as ... In a deflationary scare, for example, the 1930s, governments are printing money in order to reduce the risk of deflation, because there's all this debt outstanding, They want to reduce the unit value of this debt. They do that by trying to reduce the value of the currency. They print more currency, therefore we got more units of currency per unit gold.

The price of gold goes higher, but it's not that you've got inflation, you've got deflation, but the governments of the world are trying to offset this deflation by creating more units of currency, right? In the 1970s, you've got this massive inflationary scare, it's not, I actually am not quite sure what the dynamics were that drove ... I mean, gold outperformed inflation, it outperformed other commodities, it was by far the best performing asset in 1970s. Correct me if I'm wrong, but I think it compounded, at sort of 18% a year for the decade, from 1970 to 1980.

Richard Laterman: 00:22:04 But I think it was a function of leaving the gold standard as well, right?

Adam Butler: 00:22:09 Yeah, that's fine to say that, but what happened after the gold standard was abandoned that precipitated this large rise in gold? It must have been a reduction of, sorry, a massive increase in the units of currency that precipitated this. At the same time, when all these other inflation … gold, sorry, with oil, et cetera. But-

Rodrigo Gordillo: 00:22:35 It was that. France was eyeballing the amount of money printing. I think it was around Nixon, around the war, and they were like, all right, cool. I can still exchange X amount of dollars per unit of gold? I'll start doing that right away. That's when it all went to hell, right? All that has happened, right? This is kind of like the ... thing, right? A lot of these gold bugs were saying how ... One question was, when are people going to realize how important gold is? And one of the guys said, "Listen, I actually have given up, I don't think investors in the world will ever recognize what the value of gold really is, and they'll continue to use this fractional reserve system until it falls apart." Well, I'm like, well, it's all a construct. We just made up that this gold thing is the thing to care about and inflation, it could be many other things. It used to be salt.

Mike Philbrick.:	00:23:33	Well, we didn't quite make it up. We observed it over 5,000 years. As a human race we've made it up-
Richard Laterman:	00:23:40	It's existed longer than any currency or any debt.
Rodrigo Gordillo:	00:23:44	We've used many different types-
Mike Philbrick:	00:23:45	Yeah, we've evolved from shells. Monkeys trading shells on the beach.
Rodrigo Gordillo:	00:23:51	It's all made up, right? If the reality is that the world has decided that the fractional reserve system is a way to go and ... There's also dynamics. Clearly we can print a lot of money while there's deflation and credit to the point where ... We need to understand those dynamics before gold even becomes a factor. What if the world has decided that gold is no longer important? There's only a few people that really care about it that much, that they need to talk about a day in and day out for their livelihoods-
Richard Laterman:	00:24:21	Well, central banks are still…
Rodrigo Gordillo:	00:24:23	My point is I feel that the world has decided that they don't care that much about gold. Their narrative is-
Richard Laterman:	00:24:30	Well, the price action would disagree with you, but-
Mike Philbrick:	00:24:32	In the world there's $10 trillion worth of gold approximately in the world? So I wouldn't say that it's irrelevant. … . And there's central banks that own a portion of it. I remember what I was coming back to Adam as well, because I think when you're talking about the different ways in which gold can manifest returns, and it's a Jekyll and Hyde asset class, sometimes it acts like a zero coupon bond. And then sometimes it acts like some sort of growth asset. So you had the inflationary 03' to 08' period and all of a sudden, it's this growth asset in the inflationary growth paradigm. And in the deflationary paradigm, it acts sometimes as a zero coupon bond with no fear of default, until such time as you get some sort of liquidity squeeze and then it acts like an equity asset again. It's really got this very difficult behavior. And I think we saw that too. I only saw pieces of this. I know you guys were working on our clustering algorithm, and I saw the clusters and how gold sort of sat between the treasury personality and the equity personality. And that's probably something to actually dig into a little bit from the standpoint of ... Someone asked, well, okay, you've got gold. What else can you use? Is it TIPS that you can use? And

maybe there's combinations of asset classes and maybe there's some currencies that might act more like gold.

Analyzing Clusters

So I'd be keen to hear any sort of insights that you have from some of the kind of cluster analyses that you guys looked at. And I think there's also one other factor that's kind of different this time, which is that you have a very, very low yield now on treasuries and now gold has a negative carry, right? You have to store gold, you have to dig it up, process it, and then put it in a vault and guard it. So it doesn't have a positive yield like bonds do. Well, some bonds in the world do have negative carry now. But that's an interesting sort of ... The European Union area has some negative carry on bonds. So that's an interesting new playing field that really hasn't been entered into, which will be a very interesting thing to see price action-

Richard Laterman: 00:26:40 Yeah, the opportunity cost.

Mike Philbrick: 00:26:40 Right.

Richard Laterman: 00:26:42 I think becomes the crux of the matter when you're seeing interest rates across the globe come down as much as they are. I mean, the credit worthiness of the U S has started to kind of come into the spotlight, into question. I think we're so far from that becoming kind of front and center stage, but you start to ask, how long can they keep running this debt, this deficit? Especially when you have foreign holders of your debt. I mean, this situation with China, all of a sudden China could decide to give up part of their US treasury holdings in sort of a currency war situation with the U S. What does that do for treasuries? I think there's a stronger argument now that you might want to diversify part of your treasury holdings if you have them into something that can't be defaulted. I would add that-

Mike Philbrick: 00:27:45 Go ahead.

Richard Laterman: 00:27:45 I was just going to add that we've, I think recently talked about the commitment of traders report and the fact that the producers have never had such a large short position in gold because they're probably hedging their exposure to the metal, but that adds another layer of complexity to it. And obviously gold has, as you mentioned, the Jekyll and Hyde thing, it does have equity like volatility. It does have that oscillation that we've talked about, which treasuries typically don't have, but it also becomes this hedge against a phase shift in the economic paradigm.

Mike Philbrick: 00:28:26 It's interesting March though, and I see some conversation going on in the panel on YouTube. So like and subscribe you guys. But yes, we agree that February, March period was a liquidity squeeze, even treasuries actually had some wobble.

Rodrigo Gordill...: 00:28:46 The question was, can you expand on what happened? There was a moment there that gold didn't help, right?

Mike Philbrick: 00:28:46 Right.

Rodrigo Gordill...: 00:28:54 It lost money. And then yesterday in the beginning of the day, not the end of the day, but the beginning of the day was acting as an offset. And why that happened? You were explaining that, right? ….

Mike Philbrick: 00:29:09 It's a liquidity thing. Sometimes it becomes a source of capital, where I need capital because other stuff's going down. So I got to get stuff from wherever I can get it from-

Richard Laterman: 00:29:19 That happened in March.

Mike Philbrick: 00:29:21 That was my point earlier too.

Richard Laterman: 00:29:23 Along with treasuries.

Mike Philbrick: 00:29:25 Exactly that. March was a liquidity crisis. And so this is the Jekyll and Hyde type situation where in the liquidity crisis, and what was so unique about March is even off the run, treasuries had difficulties, but if you were on the run, treasury would be that the note of the bond you were okay, but anything other than that.

Rodrigo Gordillo: 00:29:44 Let me show a chart on it.

Mike Philbrick: 00:29:45 Sure, go ahead.

Rodrigo Gordillo: 00:29:51 You guys see that? That's from my tweet the other day. This just basically shows the 12 month look back, gold in blue, 30 year treasuries in yellow, and then 10 year treasuries levered to the same volatility as gold, okay? My point here was, that's not about inflation, but the idea that the moment the gold starts doing well, the gold bugs are like, it's amazing, this is the only thing you need to own. And my point here was like, no, you're still being beaten by something. And your treasury is levered up. But you can see just back to the original point of what happened in March, that it wasn't just gold that took a beating when it was a fire sale of everything.

The markets were so bad, liquidity was gone, you needed to sell whatever you could in order to cover your margin. So you see that everything just sold off for those periods. And that happens every time. It happened in 08', every time there's a liquidity event, everything gets blasted, right? That's what happened then. The follow-up question was why did it do well yesterday? Well, because yesterday wasn't a liquidity event. It was just a bad day in the markets. And when there's a bad day, the first reaction is to go to safety. The better bet was to go with long bonds. Treasures were up one and a half percent in gold. It started off well and ended up not doing so well at the end of the day. I think it was negative by the end of the day. Anyway, that's the difference between a normally working, not a very liquid market and using these asset classes to have non-correlated return streams. And then those moments where the only thing that works is a little tail protection.

Adam Butler: 00:31:34 But look, right? I mean, we're 30 minutes in, so I think we should sort of reveal the true context for this discussion, right? Which is always, the ReSolve way is why choose, right? The Holy Grail here is to have diverse asset classes that are fundamentally designed to thrive in very different economic environments. There are environments where gold does very, very well and treasuries do very, very poorly. The 1970s obviously are a very good example. There's also periods where gold does well and treasuries do well. A part of 2008 was that, the 1930s were that type of environment. And then there are times when stocks and bonds both do poorly. There's times when stocks and bonds both do well, gold does poorly. In reality, you want to have all of these things in the portfolio. Mike referred to this earlier, in the discussion, he referred to our target plot. Maybe if I can just share my screen-

Mike Philbrick: 00:32:39 Yeah, definitely share that because it's not intuitive if you haven't seen it before.

Adam Butler: 00:32:42 This is what Mike's referring to. When you think about the idea of creating a portfolio, really what you want is to maximize your opportunity for diversification. Mike, you always say preparation over prediction, right? And I think we all agree there are ways that we can make reasonable forecasts using systematic methods, trend, and carry and skewness and seasonality. There's a wide variety of systematic ways that you can probably create an edge in your ability to estimate the direction or estimate of returns over the sort of near term future. But you don't want to start there, right? You want to start with, I want a universe of markets that are designed to flourish in very different market environments.

If you just sort of take a simple framework of dividing economic regimes into periods of rising and falling inflation, rising and falling growth, then you obviously want to start with the idea of having access to different markets that are fundamentally designed to do well in each of these different quadrants. Rising inflation and accelerating growth, slowing inflation, accelerating growth, slowing inflation, slowing growth, rising inflation, slowing growth, and there's different markets of fundamental properties that make them highly and specifically useful in each of these different quadrants. I do find it interesting, just while we're on gold, that gold does end up in three of these different quadrants, right?

Gold does seem to have utility in ... as Mike says, it is a real Jekyll and Hyde type of market. But you don't want to just think about owning gold or when should I own gold in isolation? You want to have access to gold if you want to have access to diversified commodities, emerging market bonds, TIPS, somebody mentioned in the comments TIPS, emerging equities, all the different equity markets of the world, right? Different regions of the world have equity markets who thrive at different times for different reasons. Everybody seems to focus on other domestic equity markets. We've got to free ourselves from that type of thinking. So I want to throw this out there is it's, while we've had a lot of fun sort of debating the relative merits of gold over treasuries or gold as a standalone asset class. That's really not the way that we think about this at ReSolve and it's not the way that we think that investors should think about owning gold or owning treasuries in general.

Rodrigo Gordillo: 00:35:23 I think what I was saying was ... Obviously the last couple of weeks I've been responding to the dogmatic nature of this magic metal that solves all problems, right? It really is a great diversifier. And even in this period, it has been a great diversifier. In fact, you said it does actually act well in three out of the four quadrants, but it does out of the three quadrants, it does the worst in deflationary scenario. You're still better off with sovereign bonds when there's panic on the street. So you just can't, I haven't been able to convince a gold bug that, that's still a good idea. There's one, I think, Raoul Powell has his 12 months, his top two choices are I think, treasuries and gold. So there you go. There's one guy, one global macro guy that sees the benefit of owning both in this type of scenario. And also even if they do ... One question was TIPS, what does better, TIPS versus gold? Actually, it depends. This is a lot of the path dependency that we talk about, right? ….

Mike Philbrick: 00:36:34 TIPS are a calculation, right? Go ahead.

Rodrigo Gordillo: 00:36:36 It depends on a bunch of things, right? If you think about possibilities here, one could be that CPI actually grows to the point where TIPS are a really great option to really hedge the true underlying inflation. And it may also be a period where the government wants to confiscate gold. And so TIPS does a better job than gold does because somehow gold is just not tradable anymore. It's kept to some sort of-

Adam Butler: 00:37:01 Also, I think TIPS hedge a different type of inflation. By the way, Cory threw that at us in the comments. So I just called him out and said, if you want to have a say here, you might as well join us. So Corey is invited to come on the call here. I think TIPS had CPI inflation. You do get inflation in a scenario that is led by extreme demand growth. You've got a demand for labor and demand for goods and it's a strong growth environment.

Mike Philbrick: 00:37:36 Check your Slack Corey.

Mike Philbrick: 00:37:38 Check your Slack Corey. Hop on.

Adam Butler: 00:37:40 Corey is not into it at the moment. Anyways, I do think that you've got to ... Again, right? It's not either, or. The gold bugs tend to be all over gold and hate treasuries. The treasuries guy tends to be all over 60, 40 portfolios and hate gold, but they play a role in different economic environments. There will come a time when gold will, just like the 70s when gold will deliver double digit returns for 10 years and stocks and bonds will both deliver zero or negative returns together. And there'll be no excuse for not having at least contemplated, what are the rationales for

		owning gold? And then ... I mean, the other thing to think about is a gold is just so pathetically under owned in portfolios, right? At least some people own, either on at least a broad exposure to high grade bonds. There's some treasuries in there buried underneath a mountain of credit risk, that there's some treasuries in there, right? But nobody ... Gold is so chronically under owned, even people with a strategic allocation to commodities, most of the commodities indices are now role efficient commodities. Sort of example of the PDBC, the Deutsche Bank, efficient roll commodities indices, tend to focus on the commodities with the highest roll yield. Gold has a long term negative roll yield. Almost invariably, there are very few times when gold has positive roll. So you're constantly fighting this negative roll yield. A lot of the smart commodity indices will under own gold for that reason. So you've got to be really thoughtful-
Rodrigo Gordillo:	00:39:25	Why not own the physical gold? Because then you avoid ... In fact, this is a big argument, is even if you buy ETFs, you're still screwed at the moment that you need it the most, because you're not going to be able to get ....
Mike Philbrick:	00:39:40	This is the advancement in some of the ETFs, right? So GLD actually holds the physical gold, ... there's products, actually owned with gold, and subject to certain minimum delivery, you can actually have it delivered to your door. Now in the age of confiscation, I think in the great depression, there was a decree by government that a safety deposit box would not be opened without a Marshall present from the IRS or a person from the IRS present, because that was a moment of confiscation. I'm pretty sure that's a real thing. It's possible ....
Rodrigo Gordillo:	00:40:18	I read it in the gold books.
Mike Philbrick:	00:40:18	That could be entertainment. So just keep that in mind-
Richard Laterman:	00:40:21	Going back to TIPS, do TIPS have enough liquidity or anywhere near the liquidity that gold has? I was just curious because-
Adam Butler:	00:40:30	No, that's a really good point actually. I mean, the total aggregate global inflation protected bond supply is a fraction of the size of gold. And so, yeah, I mean ... Look, the government issues inflation protected bonds to the extent that there is relative demand for inflation protected bonds versus nominal bonds. Now we've had 30 years of deflation or disinflation. So what do you think the demand is currently for inflation protected bonds? It's very small. So the government can create inflation protected bonds and whatever bonds they want.
Rodrigo Gordillo:	00:41:06	You mean Bridgewater can create a TIPS. Because I think it was Bridgewater that forced their hand, right?
Adam Butler:	00:41:10	Well, they certainly consulted...

Mike Philbrick:	00:41:13	I think they were the initial order, but I think there's several great points there that were sort of layered on top of one another. One I think is that if you were to look at portfolios today and you were to look at the last 10 years of performance, where that performance has come, you're going to find portfolios that have a strong home country bias in North America. They're going to have significant exposures that what's done very well over the last 10 years, that creates an overconfidence in the current set of circumstances and sort of puts blinders on the potential to include these other asset classes, which by the way, I mean, I've been circling the drain in this field for, getting on to 30, 36, 25 years.
Adam Butler:	00:41:13	Don't say it.
Mike Philbrick:	00:41:59	It's funny, I came into-
Adam Butler:	00:42:01	You lost all the gray hair.
Mike Philbrick:	00:42:05	I came in, in 1990 as very fresh and Japan was all the rage. 10 years later, tech stocks are the rage. And then all of a sudden it's the resource boom. And now we're back at tech stocks again. And it just seems to me that every decade, whatever was the actual shining star, beautiful baby, sexiest lady, there's an often repeat. I mean, it can and it certainly will. We don't inform our systems based on any kind of tenure overlay like that, but it seems to me that portfolios are particularly underexposed to a certain set of assets. They're particularly overexposed to another set of assets. Underneath, if you look and say, okay, well let's just step back. You look at stocks, you look at what happened in December of 2018, and you look at that low in stocks. You look at the low in stocks here, they're kind of the same. If you look at the low in gold in 2018 in December, and you look at the low in gold in this go around, there's a significant difference in those two lows, which reminded me of sort of 2008 when gold bottomed in October. And it was much higher in March and stocks bottomed. And then you had this run and from then until sort of 2012, gold had a really nice run and sort of outperformed a lot of other asset classes. And then had its peak, had its star moment where-
Rodrigo Gordillo:	00:43:30	Including 2011.
Mike Philbrick:	00:43:32	Got the last dollar in, everybody get in the pool. Okay. The pools full. And then the story turns over. All I guess we're saying is you've got to have a methodology of at least if you're not considering these assets at all, that in our opinion would be a mistake. You have to have a way in which you're going to conclude them.
Rodrigo Gordillo:	00:43:52	Given that this, I'm sure we are going to attract a lot of gold bugs, what I want to point out is let's assume that the world doesn't end Bane style, right? It doesn't blow up and the only thing that's going to be left standing is what you can barter with gold. It has a utility from a portfolio construction perspective, using non-actual gold metal instruments like futures, where you can create a better portfolio and actually use the capital efficiency you get from futures contracts on gold in

order to get better returns than you would from just simply owning gold, right? It's so antithetical for us to say, look in a risk parity portfolio, you want to have some gold, you want to have it in equal risk contribution. Then you want to lever this whole thing up because leverage is just, from the gold bug perspective, that's the whole problem with this system. But if you move a step back from that and you just simply use it, you become utilitarian about it and you use it as best you can with what I think is appropriate from a portfolio construction perspective, there's a lot of value in owning gold in the right way, using instruments, such as futures to get that exposure., right? I think this-

Richard Laterman: 00:45:03 By the way, just to make a side note here, if you are thinking of this dystopic future, where you're going to have to rely on barter, you don't want gold. You want a source of water seasoned bullets. Gold is not going to do much for you in that scenario.

Rodrigo Gordillo: 00:45:17 That's right. That’s in my basement, baby.

Mike Philbrick: 00:45:19 No, I don't need any gold because I have guns and I'll just come and take your gold.

Adam Butler: 00:45:22 Exactly.

Rodrigo Gordillo: 00:45:23 You're going to lead in the zombie apocalypse, for sure. Look at your size, best football player.

Mike Philbrick: 00:45:30 I don't know. I'm a juicy piece of meat for them. I can feed a family of zombies for days.

Adam Butler: 00:45:37 Corey is saying that we need to launch a trend following ETF that includes an overlay to gold. I mean, come on, raise your hand people, is that something that you're going to buy?

Mike Philbrick: 00:45:45 What about your permanent portfolio with the trend following overlay? I mean, you've done some work on that already. What we're coming to is that the permanent portfolio, Harry Brown kind of covered a lot of this. I don't think it's a coincidence that Harry Brown was, the permanent portfolio is out there and Bridgewater sort of institutionalized it as well via risk parity. The way that those two ideas could be coincidence discovery too, fine by that. But it's just interesting that-

Gold and Risk Parity

Adam Butler: 00:46:14 The difference, right? They’re subtle. Certainly the framework is the same, right? Conceptually Harry Brown said, you want to own these four different asset classes. You want to own real assets like gold and real estate. You want to own stocks. I think for Harry it was U S stocks. You want to own gold, you want to own cash, right? Sorry, you want to own bonds, you want to own cash. As a framework, that makes a lot of sense, right? That captures the idea. Well, I always say risk parity is about two things. It's about diversity and balance. The permanent portfolio captures the idea of diversity really well. It's not comprehensive, but you get most of the way there, right? You'd want to add TIPS, you'd want to diversify geographically and this and that, whatever, but as a framework, it captures this idea of diversity. What it gets wrong is the idea of balance, right?

Mike Philbrick: [00:46:14] Correct. I agree.

Adam Butler: [00:47:07] So you're going to have treasuries and cash in a portfolio. Cash is a problem, because how do you judge the risk of cash? Obviously if you can own bonds in the portfolio alongside stocks and gold for commodities, stocks and commodities have five times the risk of treasuries. So if you're going to hold the old 50-50 in stocks and treasuries, 90% of your risk is in stocks, right? So the risk parity concept just sort of says, I agree, we need diversity, but also let's have some balance. Because if you don't have balance, then the bonds in the portfolio have no opportunity to express their unique personality. We acknowledge that they're designed to do well in very different economic environments, that's great.

A lot of pieces have sort of shown that for 60-40, the bond sleeve offers no diversification benefits, this is true. What it does is it reduces the volatility of the overall portfolio because it reduces the exposure to stocks. It's not because of the diversity that the bonds offer. In order to actually allow the personality of bonds to emerge, you've got to have bonds with a sufficient capital allocation, so that both bonds and stocks are delivering the same amount of risk. Now bonds can pull this direction, stocks can pull in this direction and they will bounce each other off. You had to look through this prism of how do bonds reduce risk on equities? It's dependent on how much bonds you've got in the portfolio relative to equities, right? And this is the idea of risk parity...

Rodrigo Gordillo: [00:48:52] Because it turns out that what you described is the correct way of describing risk parity. And one thing, I almost love the fact that we're doing a gold conversation because people seem to forget that a key component of a risk parity approach is the commodity and gold section. It's amazing to me over and over and over again, by the gold bugs and other global macro players, how poorly they understand where his parity is. In their minds, is what happens when risk parity busts when correlations of bonds and equities go to one, right? That's a problem. Of course, nobody that executes risk parity doesn't know that. They know that in the 70s, bonds and equities were basically the same bet, just with different volatility. What they fail to mention is that once you include that third leg of the stool, that commodities part, and nobody wants to talk about that for some reason. I don't know if it's because they're being disingenuous or they just simply don't know. Once you include that, a key component actually gets you through those periods of high correlation between bonds and equities quite nicely. ….

Adam Butler: 00:50:10

I think it's a ... problem. I think it's just that there's abundant availability of stock and bond data, right? You can just go to Ibbetson and download their annual data for stocks and bonds and run some real simple analysis. That's the only reason I can think of that-

Rodrigo Gordill...: 00:50:28

But not only misinterpret, there's one guy, I can't remember what company he's in ... In Real Vision, I saw risk parity, defending risk parity, whatever. And he goes on there and runs billions of dollars on this risk parity strategy that is just bonds and equities. And I'm like, you're the reason, you're the guy that just didn't implement it right, right? This is the reason why nobody gets it, or maybe you are one of many. Maybe the truth is that risk parity is mostly run that way rather than that kind of all weather style with the gold component. I just wanted to kind of put a little parentheses and talk about that because for all you gold bugs out there, we're with you, just not all with you.

Mike Philbrick: 00:51:12

It's interesting, Sean ..., out there is suggesting that the potentially all weather has too large a weight on deflationary environments. So in that whole weighting scheme, maybe the deflationary aspect has too large of a weighting-

Richard Laterman: 00:51:29

It's recency bias, right?

Mike Philbrick: 00:51:34

Yeah. I think this probably goes back to Rod, you did 90 years of risk parity, and I think you can probably offer some insights on those different areas. It's interesting, you would think that there was these challenging periods because of the bond exposure. And again, risk parity is of always about having something, killing it and having something killing you. And it is about, and then collecting all the risk premium associated with all those asset classes while you've balanced off what's killing you and what's killing it. So you balance off those risks and you have this constant tailwind of the risk premium. Go ahead.

Adam Butler: 00:52:16

While Rodrigo's finding what he's looking for. I'm in the middle of writing a paper on how to think about risk parity. Because I think so many people judge the value of a risk parity strategy ... Typically risk parity is a quantitative approach, so it's evaluated the way quants evaluate things, which is in terms of the historical performance of simulated back tests. And I think that is one dimension. But for risk parity, and we could have many other episodes on this one topic, I know. Certainly in the context of risk parity, it's not just about long term performance. I mean, imagine you've got a situation where bonds have had 30, 40 years of just ridiculous Sharpe ratio, right? You've got this peak in bond yields in 1982, short term bonds in the high teens, that have come down to the 10 year treasury now, is at 0.5, 0.6% as of whatever, today or yesterday. So there's been a massive tailwind.

Also, you start with high bond yields. Most of the returns to bonds come from the coupons. So you've got a tailwind from declining yields which raised the price of bonds. You start with these very high yields. So bonds themselves have done very, very well with very low risk. If you look at back tests of risk parity strategies, obviously risk parity strategies that emphasize a higher allocation to bonds are going to have better long-term performance over the history that we have for most markets, right? My analysis goes all the way back to 1985, which doesn't include the 1970s. So it's been basically a really good time for bonds. So you've got to look one level deeper. It can't just be about the long-term performance of this risk parity strategy. By the way, I missed the whole point about the fact that there are an enormous number of ways to form risk parity portfolios, right?

There's the way that All Weather does it, which is sort of looking at the economic fundamentals and forming a strategic allocation and then rebalancing. So when stocks outperform bonds for a while, Bridgewater will rebalance, they'll sell some stocks to buy some bonds and vice versa, whereas a lot of risk parity strategies are trying to balance risk dynamically based on the current risk environment. And so when the volatility of stocks rises relative to bonds, they're going to reduce their allocation to stocks and increase their allocation to bonds, right? And then there's a whole other portfolio construction step in terms of, what type of risk are you trying to balance?

You're trying to equalize risk across all the different markets, are you trying to equalize risk across the different asset class clusters, stocks and bonds and commodities, or you're trying to allocate risk equally across the principle components or the emergent directions of risk in the portfolio? There's a variety of different ways to construct risk parity portfolios. So if you know this, there's a variety of ways to construct this, you run all these different simulations, you're going to find the ones that do the best are the ones that have the largest strategic allocation to treasuries.

And to Sean's point, Sean ... point, those are the ones that look the best. They also obviously have a major systemic over-allocation to deflationary environments. They're going to do really well in deflationary environments, but they're going to underperform in inflationary environments. So one of the things, I'm going to share my screen, one of the things that I'm trying to make a point about in this new paper is that, there are ... You want to evaluate the performance of these risk parity strategies in terms of how they perform in the context of each of these regimes, right? For example, this is the Sharpe ratio of risk parity strategies in different economic regimes, different-

Rodrigo Gordillo: 00:56:22 Are you showing your screen?

Adam Butler: 00:56:23 I am. You're not seeing?

Rodrigo Gordillo.: 00:56:24 Okay, Ani, please push that through. There we go.

Adam Butler: 00:56:30 Can you guys see it now?

Mike Philbrick: 00:56:31 Yes.

Adam Butler:	00:56:35	Okay, because I can't see it on the live video. Anyway, I broke it down into inflationary growth, deflationary growth, inflationary stagnation, deflationary stagnation. And so this is just the Sharpe ratio that was observed for each of these different ways of forming risk parity portfolios. And I'm not going to go through all the different things that are going to be in the paper. But I'll just, as a sneak preview, the inverse variance, the ones that are second from the left on the top, was one of the best performing strategies in sample from 1985 to 2020. The minimum variance type strategies, The HRS MINVAR, very strong performing strategy. The HRP variant strategy, also very, very strong performance strategy in sample. By virtue of weighting based on inverse variance, these dramatically overweight bond type assets, which in the sample period have very strong Sharpe ratio. But if you specifically evaluate the performance of each of these strategies broken down by how they perform in each of these regimes, that's where you reveal the fact that the inverse variance strategy, highly sensitive to deflationary periods, right? So what ones are more balanced in how they performed, the … strategies, performed very well. For example, the max bets PCA correlation strategy. I'll go into all of these strategies in the paper, but this needs to be taken into account. You don't want a strategy that purports to be risk parity, performs very well in the back test, but it's heavily reliant on a very specific type of market and a very specific type of regime.
Rodrigo Gordill...:	00:58:22	It's far from the risk parity concept.
Adam Butler: Anyway, I'll-	00:58:25	Correct. It's not expressing risk parity, even though the back test looks strong.
Rodrigo Gordillo:	00:58:30	The intention is to make it risk parity, but inadvertently you are making a bet and you may not even know it, right?
Adam Butler:	00:58:39	In lots of strategies. That's exactly right. What's interesting, in 2020, what strategies did the best? Well, there's strategies that systematically overemphasized deflationary assets. Why? Because treasuries did very, very well during the market meltdown. But in commodities, these did very, very poorly. So if you're looking at a risk parity strategy and it did exceptionally well in Q1, you actually need to ask some questions. Now, I mean, we run a risk parity strategy. It had a drop during the liquidation phase of the market meltdown, right? When both treasuries and gold went down with stocks in the third week of March, it didn't last very long, rebounded very quickly when liquidity returned, and the market was able to reset back to some form of macro efficiency. As a snapshot, if a strategy did really well, that doesn't necessarily mean it's a good risk parity strategy. It just means that it was a strategy that was very well tuned to the type of environment we had this year.
Rodrigo Gordillo:	00:59:47	Another question that's come up that I think I want to address here. Sorry, Mike.

Mike Philbrick: 00:59:52

Well, I was going to say we're coming up to our happy hour, so we're going to go beyond potentially. And there's a couple of questions. One is, I think well tuned for you Rodrigo and one for Jason or for Adam, because Adam, you just had a discussion with Jason Buck. He's got a couple of comments. Do you guys think a permanent portfolio risk parity has forced Kelly betting? I think you could probably read the other question. Then for you Rod, how do you understand an All Weather allocation having some diversity from bonds when we approached the zero bound on interest rates? I know that's one of your favorite topics, so I want you to jump on that one first and then give Adam ….

Rodrigo Gordillo: 01:00:36

I just have it up, so I'll just go.

Mike Philbrick: 01:00:38

Perfect.

Rodrigo Gordillo: 01:00:39

One of the biggest knocks against risk parity, and I remember reading a GMO article years ago, that was knocking risk parity because ... Let me just share my screen here before I continue. It was knocking risk parity saying, equities are the only place to be in a period where bonds are going to clearly do poorly, right? This was just after the credit crisis. And so, I'm going to share my screen now. Okay, what he was referring to was a period between 1940 and 1981, where the 10 year treasury lost 60%, right? The thesis was, what if this happens and you're in an All Weather type portfolio or risk parity type portfolio, where your returns are not even zero as the question is asked, but the returns are actually negative year after year and for a full 40 years, having a total return of negative 60%, right?

And so this seems, in theory, this makes total sense and we stopped there. That piece stopped there. It made that statement, and then it said, look at how well equities did, that's what you needed to do. But the problem with that thesis is that you needed to predict, you needed to predict that equities were going to be the best performing asset class over the next 40 years. And the whole point of risk parity is that it's about preparation rather than prediction. You don't need to predict. And the question really is once with empirical data, what happens when you still include an asset class that lost 60%, as long as you have the other asset classes, right? The myth being risk parity is just a levered bond portfolio, right? Especially if you're levered and you're going to have a bear market, why would you do that? And the way that people see it, is a bond allocation that because of the below volatility has 120% allocation, inflation assets only have 20% allocation because they're more volatile and equity allocation is 60.

This is disastrous not only are you losing 60, you're losing 60 plus 20% more, right? But the thing about risk parity is that first of all, everything is seen through the risk parity lens. So from a risk budgeting perspective, and there's many ways as Adam just alluded to, from a risk parity perspective, this is a perfectly imperfect balance, right? And what's interesting is that in spite of having an allocation to that dragging market, if you actually created a risk parity portfolio that had the same level of risk as U S equities, you still had a lower draw down, similar risk profile and a higher rate of return during that 40 year period. Now, of course, this requires us, we had a drag-on returns from bonds, right? But there was an offset by commodities and equities during that period. When you put that together in a non-levered way, you're not hitting.

In fact, you have a very low volatility portfolio because you're well-diversified. And so you need the leverage to be able to get to that level of risk that can compete with U S equities. And if we're able to do that, we see that without having to make a decision upfront or a guess, as to which asset class is going to do best, you end up with a portfolio that has the highest likelihood of performing well and surviving during that period. And so from a risk parity perspective, we know that one of our three buckets is going to do really, really poorly. The whole point is that we just don't know. And therefore we include them all. Now that's, again, I just want to emphasize that as risk parity, we also do factor tilts and we do make bets, but from a risk parity perspective, I think this should be enlightening to a lot of people. I'll just-

Adam Butler: 01:04:19 Just while you're on the theme though, Rodrigo, someone's asking, well, what about right now? Why would anybody use risk parity when bonds have a zero expected return? And I think you've had some good comments recently about that.

Rodrigo Gordillo: 01:04:32 Yeah, I did a little video on this. This is my new series that I'm going to put out. It ain't what you don't know that gets you into trouble, it's what you know for sure that just ain't so, right? We know for sure that starting yields are 0.75% when I do bets, is a bad idea, right? What is the point of owning bonds in your portfolio when the yield is 0.72? You're not going to give your clients the return that they need, right? Well, it turns out that when yields are that low, something else is better, right? Something is likely to have better valuations. And this is probably at the bottom, equities were at a better valuation than they are now.

So one of the other stools is probably going to perform well. Maybe we're here because of this chaos and we're going to print a bunch of money and gold ends up having an absurd, Sharpe ratio, gold and commodities have an absurd Sharpe ratio for the next 10 years, we don't know, right? But at 0.72, the first thing that comes to mind is there's no point. And I'm having this discussions. Advisors saying, I'm completely getting out of my bonds or reaching for yield, or I'm just going to equities because I need that excess risk premium. I imagine that this conversation was being had by German investors and advisors back in 2015 when their yield was at 0.79. And they said, what's the point of owning it? There's no value in owning this for investors, right?

But fast forward five years, you can see that not only did we get lower yields, but we went to negative territory and continue to be in negative territory, right? So just be careful about what you think the value of bonds are in a portfolio, when had you just owned the 10 year bond, right? Again, this is a low vol investment. So again, we talk about capital efficiency and we talk about future. So you can actually, if you want to match this with risk parity and get better returns, you can, but simply owning the 10 year bond, your client that you decided to take off this bond portfolio, annualized at 4.65% during periods of negative yields, right? Because there's no theoretical reason why we couldn't envision a period where yields are negative and deflation and CPI is even worse. And therefore the real yield is positive, right?

Mike Philbrick:	01:06:42	In fact, the Fed changed its language around there being a zero bound, over the last two years. And so why would they change their language that there's a zero bound? We don't know, but there's the possibility ... So first of all, we have precedent for negative rates. Second of all, if we observe, we have the Fed, changing its language around a zero bound to a lower bound. So-
Rodrigo Gordillo:	01:07:13	If the 60-40 prevailed in Germany during that period, that 60-40 portfolio did just fine and better than equities, right? So again, it ain't what you don't know that gets you in trouble, it's what you know for sure. And what everybody knows for sure is that it's not worth owning bonds right now because of the lower starting yield. What I explained in that 40 year period where bonds lost money and make sure that you have proper portfolio construction can still get you there, and just don't count on bonds not being the best performing asset class over the next five years. We don't know. Anyway-
Mike Philbrick:	01:07:47	Except for gold.
Rodrigo Gordillo:	01:07:48	Except for gold.
Adam Butler:	01:07:50	The flip side to that too, is that maybe bonds represent a discounting mechanism, which has pushed the valuations of all markets higher, that the expected carry for all the major asset classes is much lower than normal. So you can't juice returns on these asset classes, the expected returns are all low. So at least you can minimize the risk you take and exposure to these asset classes. Do you want to have low returns plus extremely high risk, or do you want to have low returns while minimizing your risk, right? If you are in a withdrawal situation for retirees or pensions or endowments, low returns coupled with high vol is mortally toxic. Low returns with very low vol is survivable. So this is a twist on this that I think few investors think about. They only focus on the returns. If all returns are low, then you need to minimize volatility. And so that's another major emphasis.
Rodrigo Gordillo:	01:09:00	There's one last question that I think it's important to cover, is the thoughts on using the diversified risk parity approach versus assets collection and sizing, but adding more tactical asset allocation style approach where you rotate in and out of various asset classes. I'm glad you asked. I mean, this is what Resolve is all about. We've been doing this at the beginning. We didn't think that risk parity was good enough ....

Mike Philbrick: 01:09:20 Thanks mom.

Rodrigo Gordillo: 01:09:23 Risk parity is not good enough. Therefore, we're going to be smarter than it and try to tilt towards things. The way we see it is we do it from a factor based perspective, right? Adam alluded to it in the beginning, it's seasonality, carry, skewness, value, mean reversion, a wide variety of things. So there is merit in that. And in our research, it shows a ton of value, but I will also say that in 2020, having that hubris of tactical asset allocation hurt you. Being prepared, our risk parity, 6% non-levered mandate ... You guys hear my daughter, by the way, yelling at me?

Mike Philbrick: 01:10:03 Mine's waving at me at the door too.

Rodrigo Gordillo: 01:10:05 Apparently I have to go. But if you guys ... Risk parity this year, being humble and being ….

Mike Philbrick: 01:10:15 This is why men over the centuries have had happy hour at an actual place, not their home.

Adam Butler: 01:10:25 I'll share my screen now, because this is a really good point. You can think about risk parity with trend overlay or whatever as TAA, but you can also separate them into risk parity with a risk budget to trend and a risk budget to carry as an example. You can expand it out into other factors. And I show this slide a lot in some of the CFA society presentations that I've done over the years. This is a little bit dated, but if I could share my screen quickly. This is a long-term simple trend strategy in a simple carry strategy. You can see that they are uncorrelated to one another and uncorrelated to risk parity over the long term. And there's obviously some real magic in putting them all together, right?

A trend on its own, a 1 Sharpe, carry on its own, a 1 Sharpe, add them to risk parity, which has a 0.81 Sharpe on its own. And you push the long-term Sharpe ratio up by about 30%, right? This is just super simple implementations of all of these things, but it's just showing, I mean, the best way to think about risk parity is not necessarily as just stocks, bonds and commodities. It is a way to think about how best to, first of all, find diverse sources of return, where the returns are derived from very different fundamental drivers and then maximize your diversification across those different sources of return.

So that's all this is, you've got stocks, bonds, commodities, and then you add trend, you carry, you add skew, you add seasonality, you add value and on and on and on, and you just increase your expected return per unit of risk with the caveat, as Rodrigo says, that it doesn't always outperform good old U S equities, which have obviously been on just an incredible tear over the last 10 years. Somebody asked about forced Kelly betting. We're gonna need to connect on this afterwards, because I don't see how a vol based risk parity strategy represents a forced Kelly betting strategy. I guess we'll have to take this off-

Mike Philbrick:	01:12:55	That's from Jason Buck, who I know you just had a chat from. So you guys can connect after that and-
Adam Butler:	01:13:01	Yup. I will say that, you should listen to the conversation with Jason and I this week. He did make the good point. And we did chat about the fact that thinking about risk in ways, other than volatility, as an example, including divergent regimes versus convergent regimes. Divergent regimes sort of crisis type regimes, convergent regimes, could be considered sort of vol selling versus vol buying. Jason runs up a tail hedge strategy, there is I think, merit and thinking about adding a specific sleeves of strategies, like trend and like tail hedge strategies that are able to balance across convergent and divergent regimes. Again, just preserving this idea of balance, but in a different framework for risk. So-
Rodrigo Gordillo:	01:13:54	There's one big black hole there for risk parity is, when we touched upon it in the beginning, which is when liquidity dries up on everything and everything needs to be sold down, right? So risk parity was holding up beautifully until that two, three day period where bonds, gold, everything that was acting as protection just went south.
Mike Philbrick:	01:14:14	And not only that, there's two areas. Liquidity is certainly a source, '94, the bond massacre, where there is a pervasive change in the discount rate across all assets where the discount mechanism, that's cash is King, where we're going to change the discount rate for the calculation of every asset. That's going to have a negative impact on risk parity. There's no sort of perfect portfolio scenario that you have everything hedged, that just-
Rodrigo Gordillo:	01:14:44	Well, I don't know. There's private equity. It's a straight line off. Madoff. It just keeps going up. Well, it's gone. I haven't seen an abstract in about a month and a half. It's amazing.
Mike Philbrick:	01:15:02	Someone also asked about TIPS instead of regular bonds in risk parity portfolio. It's not quite right because the bonds and TIPS are sort of assets that hedge ….
Rodrigo Gordillo:	01:15:14	It's 50% treasuries and 50% kind of gold. ….
Mike Philbrick:	01:15:19	It's not quite right because the calculation of inflation and TIPS is a very specific calculation versus what happens in gold. The '03 to sort of '08 period where you had this rip in gold and TIPS that's not quite the same result-
Rodrigo Gordillo:	01:15:37	Alex Shahidi has a great section in his book, that you reviewed it Adam, it's called the Balanced Portfolio, something like that, by Alex Shahidi. He has a section on TIPS that really dissects it and talks about its two unique characteristics and why it's a problem and why it can be useful, but there's always a but there.
Adam Butler:	01:15:57	That's a great read, by the way.

Mike Philbrick:	01:15:58	We should have actually had him on, but I guess we should rename this, this happy hour is gold versus treasuries in defense of risk parity. We got more vitriol.
Rodrigo Gordillo:	01:16:08	We just can't get away from it. We're like the gold bugs, we're the risk parity bugs.
Mike Philbrick:	01:16:11	We're the balanced bugs.
Mike Philbrick:	01:16:17	All right. Well, that was another wonderful conversation with you guys.
Adam Butler:	01:16:22	Thanks so much for all the comments, the questions actually, that was really helpful. It helped to guide the conversation and prompted us to go in directions that we probably wouldn't have gone otherwise. So keep up the great work on the questions and engagement, really appreciate that.
Mike Philbrick:	01:16:38	That's the point. And if you like, and subscribe, it helps us get more people on this call, which levers the opportunity if we get more great guests. By the way, Jason, I know that you did the podcast, you might as well hop on one of these happy hours too, at some point in the future.
Adam Butler:	01:16:54	Oh yeah. Jason's going to be on the show for sure.
Rodrigo Gordillo:	01:16:57	For sure. All right, gents. Have a great weekend.
Adam Butler:	01:17:05	Have a great weekend. Cheers.
Speaker 1:	01:17:05	Thank you for listening to the Gestalt University podcast, you will find all the information we highlighted in this episode, in the show notes@investresolve.com/blog. You can also learn more about Resolve's approach to investing, by going to our website and our research blog at investresolve.com, where you will find over 200 articles that cover a wide array of important topics in the area of investing. We also encourage you to engage with the whole team on Twitter, by searching the handle at Invest Resolve and hitting the follow button. If you're enjoying the series, please take the time to share us with your friends through email, social media. And if you really learned something new and believe that our podcasts would be helpful to others, we would be incredibly grateful if you could leave us a review on iTunes. Thanks again and see you next time.