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A season for gold



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Or when Mr Market ignores academic theory

A rebel since birth, I tend to **do many things backwards**. For example, I **built a very large portfolio of stock and bonds** before I ever considered **buying a property to I've in**. Of course conventional financial wisdom **suggests you buy your primary residence first, and then begin investing**. So yup, backwards. And as a country boy I was

DRIVING CARS BEFORE I LEARNED TO RIDE A BIKE

Yup. At the time I grew up, mid 1960s, **kids driving mortorised vehicles was a country thing** (*and the guns you ask? Had one from the age of eight*). After all, **if you can drive a tractor you can help in the fields**. All hands are needed during harvest and planting. And **after driving a tractor in fields it's pretty easy to hop into a car and drive on roads**. Note I didn't say "drive well", but **where I grew up there were only about 40 people and perhaps 200 times as many cows**. So a little **veering from lane to lane on a motorway would go unnoticed** except by a bunch of dairy cows grazing in the fields. Yup. Backwards yet again. As a country boy surrounded by farms and fields,

I BECOME FASCINATED WITH COMMODITIES

In our small community there were **many stories about farmers who made**

fortunes, both large and small, by observing conditions in the fields and buying or selling agricultural commodities accordingly. In finance speak we would say they were using local knowledge of expected harvest yields, good or bad, and positioning capital accordingly. They would just say they was making money. Some of these stories mentioned very small amounts of capital that had been parlayed into these fortunes. As an someone who grew up relatively poor (*actually, very very poor*), these anecdotes were both encouraging and fascinating. I wanted to learn as much as I could about how these fortunes had been made in the markets. This was the genesis of my interest in finance. A passion bordering on a (*I say healthy, but some would disagree*) obsession that

SAW ME HEADHUNTED FOR A JOB ON WALL STREET

in the late 1980s. After the adoption of the IBM PC by the financial services industry, Wall Street was beginning to computerise in earnest. Servers were a particular interest to banks, and at that time fault tolerant servers were based on Unix (*mostly SunOS from Sun Microsystem but also some running AIX, IBM's server offering*), as Windows Servers hadn't yet been developed (*those were an early 1990s innovation*). Before Wall Street I was working at AT&T Bell Labs building Expert Systems, a form of AI predominant at the time. Between my Undergrad in Math and Computer Science, and the detailed knowledge of and experience with Unix I gained at Bell Labs, I was an attractive candidate. But

IT WAS MY DEMONSTRATED INTEREST IN

and knowledge of finance sealed the deal, so after spending a few years with Dow Jones I landed a superb position on The US Government Securities trading floor of Deutsche Bank in Manhattan. I was in heaven working for Deutsche Bank, an employer who encouraged me to learn as much as I could about the markets by working with traders and quant and sales staff and immersing myself in both the art and science of finance. Given my strong interest — **cough** — obsession with finance, I was having the time of my life. In the

LATE 1990s DEUTSCHE RELOCATED ME TO EUROPE

working in the financial district, aka The City of London. In this rather different environment than Wall Street — different markets, different instruments, different regulations and different cultures / attitudes towards risk — I learned more about

my obsession every single day. After all that time working in finance through two different employers (*Dow Jones and Deutsche Bank*) and being promoted to the position of Vice President, Global Risk Management, I

TOOK AN MSC IN QUANTITATIVE FINANCE

and yes, once again I was doing things backwards. Deutsche Bank **paid for the qualification**, so I was still **working 60 plus hour weeks at the firm**, some six days a week, seven at times when I was traveling. And **attending business school two evenings a night**. Danced that dance for two years, but graduated and the **Masters degree really opened my eyes**. Although I had a **strong knowledge of finance** from working on trading desks and in Risk Management for years, it was applied. My Masters allowed me to see the academic side, finance from a theoretical nature. It was then

I REALISED I'M A HERETIC NOT A REAL ACADEMIC

because **sometimes academic theory works**, or it describes what we see or expect to see in the markets. **But sometimes it doesn't**. And I feel **compelled to point out when these theories don't apply**. Doing so might (*actually does*) annoy or anger my academic colleagues, but **it strengthens the student experience** and I believe (*having hired lots of people in Investment Banking*) increases a student's marketability and, ultimately, employability. A theory called

THE EFFICIENT MARKETS HYPOTHESIS (EMH)

often comes to mind when I think of examples of how academic theories fail in markets. EMH (*the original academic paper by Eugene Fama, 1970, is linked to at the very very end of this article*) **suggests asset prices reflect all available information**. Thus assets are **fairly priced at all times, and it's impossible to profit**. But the **markets often disagree with academic theory**. A phenomenon we call *seasonality* is an excellent example. **Seasonality is the tendency of some assets to rise and fall in price according to the time of the year**. Now I'm most assuredly **NOT a goldbug** (*rather a money freak who will invest in pretty much anything where I see value*), but in March of 2019, as described here

What's next for Gold? A public signal of secret information

“While we favour long term investments in gold, it is undeniable there are times when we can benefit from an...

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I began building a large position in gold and silver, eventually moving 71% of my retirement capital into this asset class. I’ve taken large positions in bullion in the past, so, of course, I do pay attention to prices. I have known for years that gold is an asset with strong seasonality. The chart below shows the seasonality of gold over a twenty year horizon



Seasonality of gold, 2003 to 2022, source Stockcharts, Author

The vertical bars represent specific months of the calendar. The number at the top communicates, in percentage terms, how many months, over the twenty year period in question, the price of gold closed higher at the end of the month than when it opened. The number at the bottom represents the average percentage change in price. Looking at this chart we can easily make two fascinating observations:

1. **gold rises in price 65% of the time during the month of January.** This amounts to 156 months of the 240 month sample. **An average gain of 3.1% is observed in the price of gold.**
2. **gold falls in price 40% of the time during the month of June.** This amounts to 96 months of the 240 month sample. **An average drop of 0.5% is observed in the price of gold.**

And there are many other examples in this chart. According to **proponents of EMH, this is impossible.** In the simplest of trades, EMH suggests **because the pattern is well known, market participants would buy gold at the end of December, then sell at the end of January.** By doing so they would eliminate gold's seasonality. EMH further would suggest market participants would sell gold at the end of May, and cover the short position at the end of June. Again, these actions would eliminate gold's seasonality. And even though this relationship

IS WELL DEFINED AND PUBLIC KNOWLEDGE

(at least in my circle of market freaks, we are always looking for an edge) the seasonality of gold remains. Finally, **the chart below shows spot gold from January 1st, with the price reflected in the top panel, and performance in the bottom panel.**



Spot gold, January, 2023, source Stockcharts, Author

Clearly the price of gold has been rising during the month of January. Someone call Dr Fama, his theory isn't working!

Or maybe he's doing something backwards?

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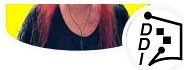
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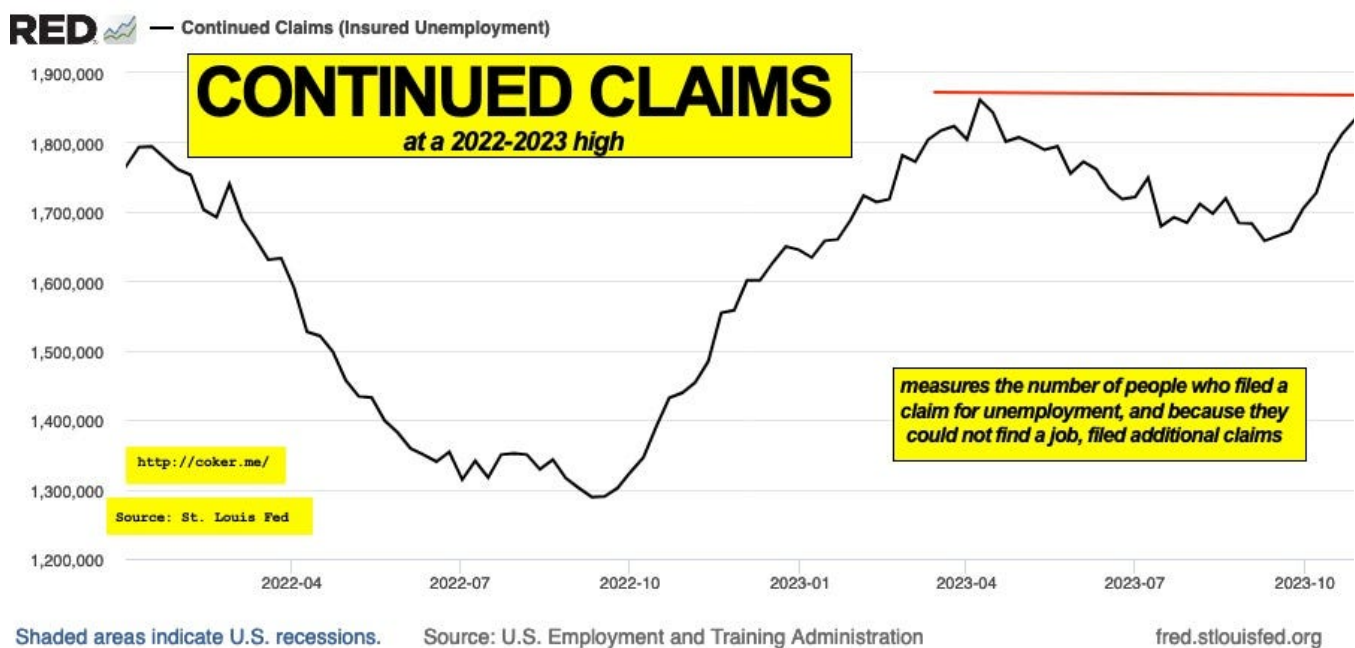
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