

Value in a Sea of Risk

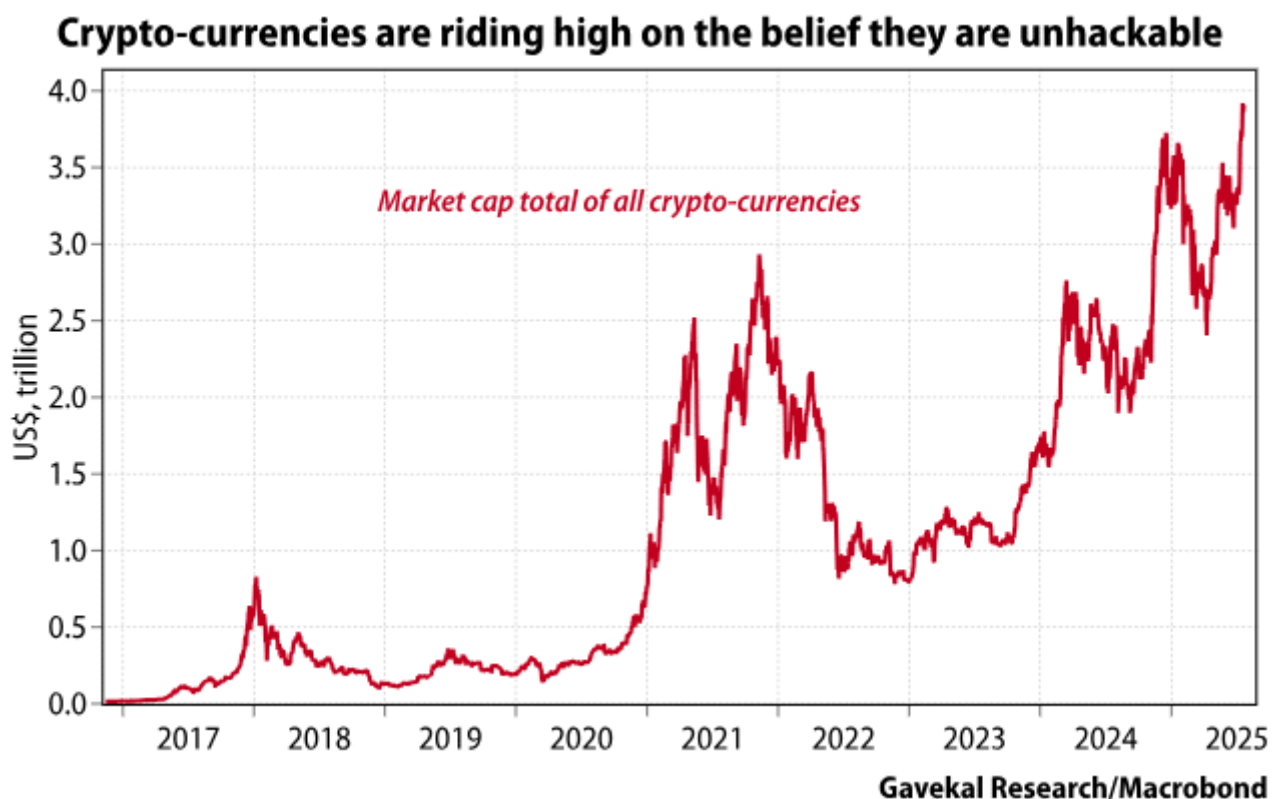
[Take Our Compatibility Survey](#)

A cynic, wrote Oscar Wilde in *Lady Windermere's Fan*, is someone who "knows the price of everything but the value of nothing." A great quip, but in fairness, figuring out value is far harder than figuring out price. In Wilde's own era, Karl Marx famously (and wrongly) argued that value stemmed from the labor required to produce a good. Alfred Marshall later corrected him, showing that value depends on marginal utility- something that can shift over time, and sometimes rapidly (an umbrella's worth, for instance, spikes on a rainy day). The gap between price and value has been central to investing since markets began. Like cynics, technical analysts focus solely on prices (and volumes), while value investors-those few who still wear the label-spend real effort trying to uncover an asset's underlying worth. With this in mind, it seems worth reviewing what gives the main asset classes their value- and what could threaten it.

- **Government bonds:** Their value rests on a government's ability to extract a pound of flesh from consumers and businesses. In recent years, globalization has chipped away at that power especially when it comes to taxing businesses. As a result, governments are scrambling for new ways to fund ever-growing expenses. In the US, President Donald Trump has turned to tariffs - a kind of consumption tax with the benefit of sounding patriotic. In the UK, a wealth tax is being floated, despite a poor global track record for such measures. Across much of the OECD, governments' ability to raise revenue appears constrained. And that is the real risk for government bonds: when states cannot tax, they print-ultimately debasing their currency and eroding bond value over time.
- **Equities:** In theory, their value is determined by the stream of future earnings, discounted by an interest rate. The threats are straightforward: either a collapse in earnings (think recession-or worse, depression), or a spike in interest rates (driven by a debt crisis or surging inflation). Absent those factors, equities tend to be a sound long-term bet.
- **Energy:** A tricky one. As we often note, economic activity is energy transformed-and energy's value lies in its ability to boost productivity. A machine powered by the equivalent of one barrel of oil can typically outperform what dozens of men could produce over hundreds of hours. That makes energy immensely valuable-yet also hard to value. On one hand, we can measure its productivity today. On the other, investing in energy is, in some sense, a bet that human inventiveness stalls-that energy productivity won't improve, and that no cheaper or more efficient sources will be found tomorrow. Over the past 200 years, that's been a losing bet: we've moved from wood, to whale oil, to coal, kerosene, oil, gas, and now nuclear power. And yet, in recent years, policymakers have embraced less efficient sources-solar and wind-while sidelining nuclear.
- **Gold and precious metals:** Another tough asset class to value. On one hand, metals like silver, platinum and palladium have clear industrial uses. On this score, both palladium and platinum were, until recently, treated sniffily by investors for being too tied to traditional autos, just as electric vehicles were gaining traction. But as platinum's recent rally shows, precious metals can also trade on beauty and scarcity, bringing us back to the Gavekal distinction of scarcity assets and cash-flow generators. The catch with scarcity assets is that they rely on a steady stream of new buyers to keep prices rising-much like a Ponzi scheme. That makes them vulnerable to interest rates, or liquidity drying up. Just look at

Chinese art or fine Bordeaux wines, once prized by Chinese collectors, now sharply down as China's excess liquidity evaporated.

- **Crypto-currencies:** like gold, their value-at least in bitcoin's case-derives from scarcity. But unlike gold, bitcoin is easy to transfer, cross borders with and conceal. In an era of creeping financial repression, capital controls and outright asset seizures, that is no small thing. Still, the entire crypto pyramid rests on the belief that multi-user ledgers cannot be hacked. If that faith were ever broken-by quantum computing, state actors, or rogue hackers intent on sowing havoc - we would likely witness the fastest evaporation of US\$3.5trn ever recorded. Then again, anyone capable of such a breach would have every incentive to keep the crypto show on the road. After all, what is the point of hacking wallets only to destroy their value?



Which leaves us with the following risks: currency debasement (bonds), recession (equities), higher inflation (bonds and equities), productivity gains in energy production and use (energy), rising interest rates and tightening liquidity (gold and bitcoin), and hacking (bitcoin). Readers will weigh these risks differently. In fact, even within Gavekal, opinions diverge. But one thing we can all agree on is Warren Buffett's timeless reminder: "Price is what you pay, value is what you get."

DISCLOSURE: Securities highlighted or discussed in this communication are mentioned for illustrative purposes only and are not a recommendation for these securities.

Evergreen actively manages client portfolios and securities discussed in this communication may or may not be held in such portfolios at any given time.

This material has been prepared or is distributed solely for informational purposes only and is not a solicitation or an offer to buy any security or instrument or to participate in any trading strategy. Any opinions, recommendations, and assumptions included in this presentation are based upon current market conditions, reflect our judgment as of the date of this presentation, and are subject to change. Past performance is no guarantee of future results. All investments involve risk including the loss of principal. All material presented is compiled from sources

believed to be reliable, but accuracy cannot be guaranteed and Evergreen makes no representation as to its accuracy or completeness.