WEALTH STORAGE AND ASSOCIATED RISKS

Wealth Storage and Associated Risks

Negative interest rates on excess reserves have made their way into major economies around the world pressuring the traditional banking business model and shifting the overall investment strategy to elevated risk positions in search of more favourable yields (see CoinShares Series Part 1). Most notably, however, is a clear dichotomy in the direction that the US financial system is moving and other major economies such as the EU. Concerns are already coming to pass on a recession cycle and the contagion that can quickly spread across even the healthiest of markets.

Although negative interest rates have not directly impacted most depositors and investors – at least as of yet – the potential trickle-down effects have already become apparent.

Swiss and Danish banks, in deep red interest rate territory for some time now, have already started charging their wealthy clientele.

The options left on the table for depositors, with deep pockets or otherwise, now involve elevated risks on every level. This second part of the CoinShares Macro Perspectives series on the Search for Yields will look at some of these risks within their own individual contexts.

While US banks remain strong on the back of business-focused economic policy, cross-border effects from Europe and Japan, along with the oscillating positions of the US/China trade war may very well end up being a catalyst for the next global recession as fears rise and economic growth confidence falls.

The safety and health of these banks, while still in the green, face challenges as their traditional business models come under increasing pressure. And with lower yields on the table, bottom lines are beginning to hurt.

Outside of conventional policy, more monetary tools are in play. Expansion of cash limit politics and payment ceilings are becoming adopted worldwide. Such measures will be key for regulators trying to secure ever more control over macroeconomic policies.

Hard asset prices are now above pre-crisis levels on the back of 'cheap money'. But median income trails far behind median house prices in most OECD countries [1] which could explain the slow demand for negative interest mortgages in Denmark as explored in the first part of this series.

Such concerns have marked the return of investors to gold markets which is on a steady rise. New funds have also moved into Bitcoin which has now established itself as an institutional store-of-value asset class given the increased availability of institutional-grade trading and custody.

Deposits: Bank Crisis Contagion Risks

Depositor Risks:
Capital Controls and/or Currency Controls
Bank Failure/Bail-in/Bank Run
Negative Interest Rates Charges
Inflation Impact on Cash Value/No-Investment Risk
Increased KYC/AML Compliance

Though the phenomenon of negative rates has yet to find its way into the US financial system, creditors have year-on-year continued to see diminished return on savings [2]. When accounting for inflation, the low rates of a guaranteed return amplifies creditors loss and the risk of no-investment as their purchasing power continues to tumble.

'Just in Case' Laws Go Into Play

While retail banking services have come under pressure from central bank policies, regulation and FinTech bank challengers, watchdogs have placed stop-gap banking procedures and fitness tests to avoid bank failures akin to that of IndyMac and Washington Mutual (WaMu) in the wake of the 2008 global financial crisis with the goal of protecting depositors.

Potential concern is by the very fact that the effectiveness of these new measures has yet to be tested in times of economic duress. And even more evident now is the risks of contagion within a global market.

> *"The main risk is a downturn in the economy, whether it is global or in the Euro Zone [3]"*
>
> *- Mario Draghi, Former ECB President*

Bail-in laws, or 'Bank Recovery' in the case of a lenders failure have been adopted in major economies (EU [4], Switzerland [5], etc). The new norm shifts bank failure to the shoulders of depositors.

But Healthier Banks?

On the US side this doesn't seem to really be of concern. In fact, 2018 closed off with US banks hitting the lowest number of 'problem institutions' since 2007 [6]. Even more notable is that no banks failed in 2018 (Table 1).

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Tab. 1 The Number of Problem- and Failed Institutions in the US has Fallen Dramatically Since 2012

Year	2018	2017	2016	2015	2014	2013	2012
Number of Problem Institutions	60	95	123	183	291	467	651
Number of Failed Institutions	0	8	5	8	18	24	51

Source: Federal Deposit Insurance Corporation (October 2019)

Tunnel Vision?

US banks might find themselves in a better position than their European and Japanese counterparts, but contagion fears abound should a major banking crisis develop in markets where lenders have cross-border exposure. The fear is that a creditor panic setting off a bank-run would not only hurt the underlying health of banks, but risk entire regional economies as borders lose their efficiency in the face of a modern, global financial crisis.

> *“In this day and age, a bank run spreads around the world, not around the block [7] ”*
>
> *- Thomas Mayer, Chief European Economist, Deutsche Bank*

Or, as stated by the International Monetary Fund (IMF) in their October 2019 Global Financial Stability Report: “While post-crisis financial regulation has improved the resilience of banking sectors in many dimensions, US dollar funding fragilities amplify adverse shocks and create spillovers to countries that borrow in US dollars from foreign non-US banks, thus becoming a source of vulnerability for the global financial system [8].”

Banks Employing New Tactics

While bank failure and bail-in would mark the worst for creditors, it’s certainly not the only tool in the shed. One practice that has seen growing traction over the past decade has been the implementation of capital and foreign currency controls by potentially failing banks and bankrupt nation states (Table 2).

Quick restriction of funds imposed by Central Banks could have multiple aims, from preventing bank-runs to protecting the country’s own foreign reserves. Ultimately, however, this imposition falls on the shoulders of depositors who no longer have access to their very own funds.

Tab. 2 Inflow & Outflow Capital Controls, Foreign Exchange Controls, and Capital Restrictions

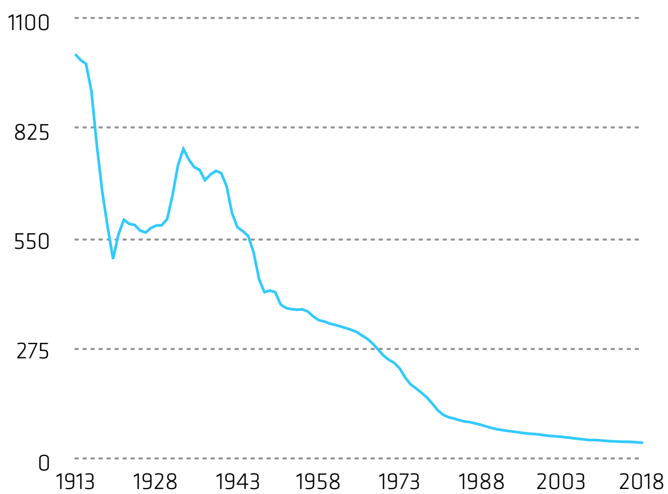
Country	Started	Restriction
Philippines	2009	Inflows
South Korea	2009	Inflows
Indonesia	2010	Inflows
Russia	2010	Inflows
South Africa	2010	Inflows
Thailand	2010	Inflows
Turkey	2010	Inflows
India	2013	Inflows
Malaysia	1997	Outflows (Asian Crisis)
Thailand	1997	Outflows (Asian Crisis)
Brazil	1999	Outflows
Iceland	2008	Outflows
Venezuela	2010	Outflows
Argentina	2011	Outflows
Cyprus	2013	Outflows
Ukraine	2014	Outflows
Russia	2015	Outflows
Nigeria	2015	Outflows
Greece	2015	Outflows

Source: Magud et al, (2018) Annals of Economics and Finance

Cash: Inflation Risks and Transactional Limits

As liquid as it might be, cash inherently returns no yield and is by default, due to central bank economic target policies, subject to inflation diminishing its purchasing power over time (Figure 1).

Fig. 1 Purchasing Power of the Consumer Dollar in US Between 1913 and 2018 (Index 1982-84 = 100)



Source: Federal Reserve Bank of St. Louis (October 2019)

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Demand for cash is on the rise despite the plethora of digital payment options. The Euro's total cash value outstanding in banknotes now exceeds €1.25tn (Figure 2). The US is no exception and is indeed following the very same trend [9].

But the upward trend is being met with regulators placing ceilings on potential cash use that would hamper its demand in their effort to maintain economic stimulus policies.

Policy Makers: We'll Make Them an Offer they Can't Refuse

The IMF posits that "without cash, depositors would have to pay the negative interest rate to keep their money with the bank, making consumption and investment more attractive. This would jolt lending, boost demand, and stimulate the economy [10]."

Various forms of cash restrictions are being attempted. First and foremost, the abolishment of high-denomination banknotes. The majority of EU national central banks for example no longer issue the €500 banknote [11].

Cash also faces upper limits, with some countries passing legislation that criminalises cash payments above a certain level (Table 3). And cross-border cash movements are also limited to $10,000 and €10,000 in the US and Europe respectively.

Tab. 3 Currently Active Criminal Cash Payment Ceilings by Country

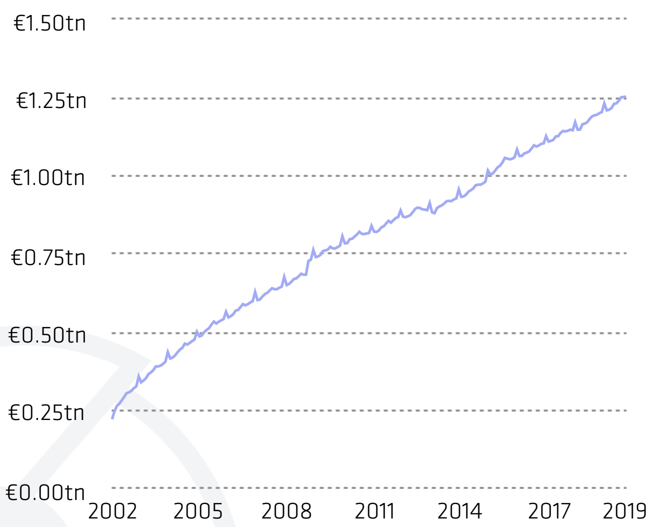
Country	Limits
France	€3,000 (€15,000 for non-residents)
Hungary	€5,000 for business/legal persons
Cyprus	€10,000
Portugal	€10,000
Slovakia	€5,000
Spain	€2,500 (€15,000 for non-residents)
Bulgaria	€10,000
Belgium	€3,000
Greece	€1,500
Denmark	€1,340
Netherlands	€3,000
Australia	$10,000 (proposed)
Uruguay	$5,000

Source: European Consumer Centre France (October 2019)

Hard Assets: Liquidity Risks

Central bank policies from quantitative easing to negative interest rates may have spurred on institutional capital inflows into hard assets such as real estate, due to narrowed bond returns.

Fig. 2 Total Euro Banknotes and Coins in Circulation

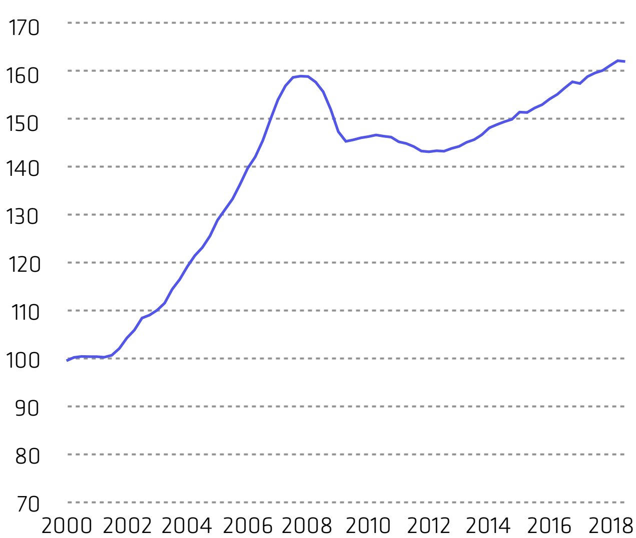


Source: European Central Bank (October 2019)

Indeed, according to the IMF, "lower-for-longer yields may prompt institutional investors to seek riskier and more illiquid investments to earn their targeted return [8]."

Also evident are asset prices, which according to data collected by the IMF, now show real house prices back above 2008 levels (Figure 3). The rise might not be sharp as the run up to the last global meltdown, but it has nevertheless been steady.

Fig. 3 IMF Global Real Housing Price Index (2000 = 100)



Source: International Monetary Fund (October 2019)

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Gold, Bitcoin & Metals: Volatility Risks

Climbing back up to its previous 2011 peak, gold hit a six-year high in 2019 marking the return of demand into the traditional asset class that has seen interest from investors and central banks alike.

Citigroup analyst Aakash Doshi has made a bold estimate in a recent note [12] by the major bank that the precious metal can very well make a resurgence to new highs surpassing $2,000 per ounce (Figure 4).

Potential reasons are plentiful for seeking safe-haven assets that have global status and recognition (see topics on right-hand side of page). From upcoming US elections to the continuous flip-flop efforts of Brexit, gold demand is once again making headlines and interest is once again on a steady rise (Figure 5).

Fig. 4 Historical Gold Price in US$ per Troy Ounce

Source: World Gold Council (October 2019)

Current & Upcoming Global Topics:

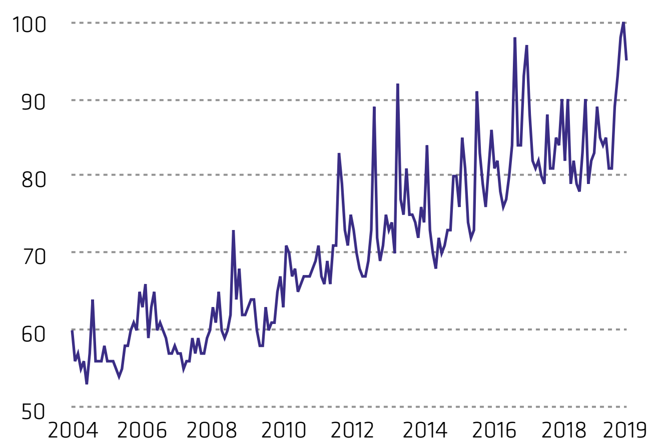
- 2020 US Elections
- US/China 'Trade War'
- Negative Rates (EU, Japan, Switzerland etc.)
- Global Economic Growth Slowing
- Total Global Debt Surpassing $75tn
- Iran & North Korea Nuclear Sanctions
- Brexit
- Civil Unrest in Emerging Markets

More Highs

Central banks that find themselves in potential geopolitical cross-hairs have been quietly and consistently diversifying their assets from large positions of foreign reserves (see boxed story on BRICS on page 5).

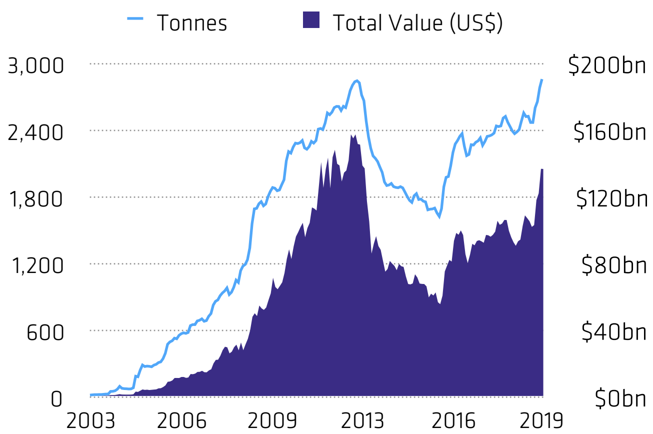
And investors haven't shied away either from the longest perceived asset for store-of-value. Gold ETF Assets under Management hit an All-Time-High in September 2019 to the tune of 2855 Tonnes according to the World Gold Council – a 12% increase from the start of the year (Figure 6).

Fig. 5 Worldwide Google Search Interest for 'Gold'



Source: Google Trends (October 2019)

Fig. 6 Total Global ETF Gold Holdings



Source: World Gold Council (October 2019)

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BRICS (Brazil, Russia, India, China & South Africa) began a cooperative organisation informally in 2006, and started full-scale diplomatic meetings since 2009. The five member nations have collectively increased their gold reserves by 214% since the start of the global financial crisis (Figure 7).

The largest drivers of this growth have been Russia followed by China with 383% and 221% respective increases in their gold reserves. Geopolitical and trade war risks could potentially add more weight in the vaults as has been the trend over the past decade.

BRICS nations are now collectively the second largest holders of gold after the USA, according to official data by the World Gold Council as these countries seek to diversify their asset holdings away from the US Dollar.

They have also proposed an intra-gold trading system, though this has yet come to fruition [13].

Gold 2.0?

Since the start of futures on the CBOE, and shortly after the CME in 2017, Bitcoin has firmly established itself as an institutional asset class having checked off the requirements by regulators and shedding a near decade of concerns on the viability of the largest cryptocurrency.

While institutional products make for increased liquidity, physical markets for Bitcoin have established on and off ramps on a global scale that have advantages over gold in regards to easier self-custody, albeit require private-key management to mitigate total loss risk. This risk, however, might be seen worth the trouble in light of potential banking regulations.

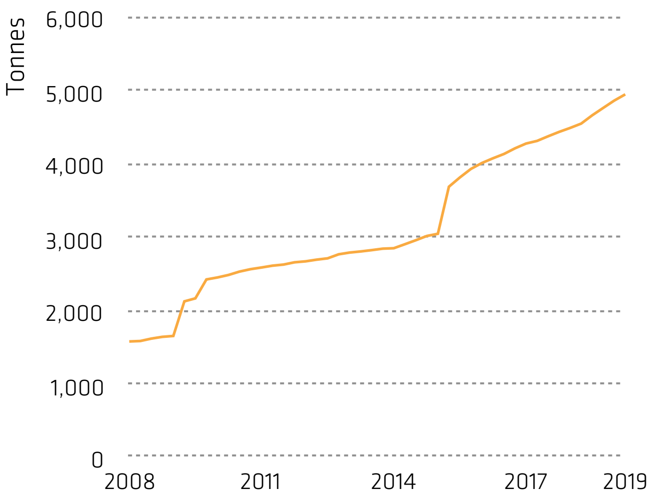
Narrative Adjustment, For Now

Although Bitcoin was designed to address the payments industry, an online cash equivalent, it has veered into the Store-of-Value asset class with the added benefit of total ownership and the ability to transfer value faster and easier than other SoV assets. Furthermore, global trade is easier to facilitate with Bitcoin than with physical gold markets, especially when it comes to settlement finality – as is being able to move in and out of fiat currencies faster.

Volatility Ease

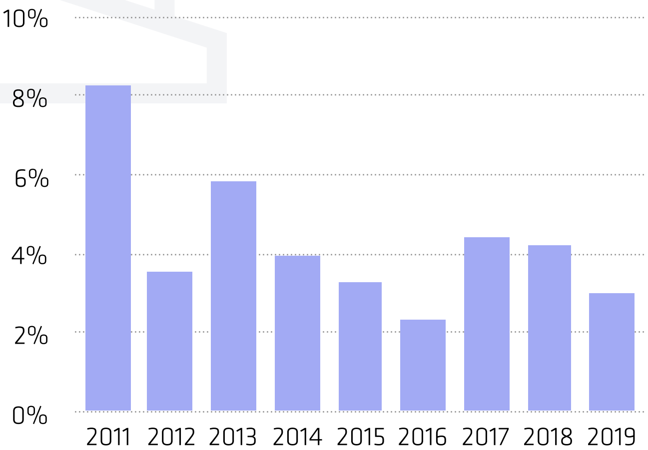
What has been and remains a major concern surrounding the asset is volatility. But 30-day rolling volatility has trended downwards since the genesis of Bitcoin. This year volatility has stayed below 4%, half of that seen in 2011, and on track for a 3-year low going into the new year (Figure 8).

Fig. 7 Cumulative Gold Holdings among the five BRICS Nations (tonnes)



Source: World Gold Council (October 2019)

Fig. 8 Bitcoin Yearly Average 30-day Volatility



Source: CoinMetrics.io (October 2019)

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