MAM Insights

Throughout the history of mankind, gold has been a universal symbol of wealth. Beautiful and scarce, it was extremely coveted among ancient civilizations as the symbol of status and power. Jewellery, ornament, and early forms of money were all crafted out from gold. Over the millenniums, the world's fascination for the commodity hardly diminished. Although the majority of monetary systems today are no longer tied to the gold standard, the precious metal is still perceived and considered as some form of insurance against fiat currencies, which rely on faith and trust to support and sustain their relative values. To this day, gold has been able to maintain its intrinsic value because, unlike fiat currencies, there is only a limited supply that cannot be artificially increased. In modern economics and portfolio management, gold has become a desirable alternative for investors seeking diversification or hedge against economic stress, inflation, geopolitical uncertainty, war, and more. Today, the world offers a wealth of ways to buy and sell gold. In this note, in response to a series of inquiries from clients, we will cover some of the ways investors can gain exposure to the commodity and discuss the pro and cons to using each investment vehicle.

Table 1. Executive Summary - Five ways to invest in gold

Investment Type	Investment Vechicle	Financial Mkt Tradable	Cost of Transaction	Custody	Liquidity	Transaction Speed	Security
XAU	XAU Curncy	Yes	★★★★★	★☆☆☆☆	★★★★★	★★★★★	★☆☆☆☆
ETF Replication with Derivatives	UGL US Equity	Yes	★★☆☆☆	★☆☆☆☆	★★★★☆	★★★★☆	★☆☆☆☆
ETF Physically Backed, Non-Deliverable	GLD US Equity	Yes	★★★☆☆	★☆☆☆☆	★★★★☆	★★★★☆	★★☆☆☆
ETF Physically Backed, Deliverable	PHYS US Equity	Yes	★★☆☆☆	★★★★☆	★★★☆☆	★★★☆☆	★★★★☆
Physical Gold	Bullion, Coins, etc.	No	★☆☆☆☆	★★★★★	★☆☆☆☆	★☆☆☆☆	★★★★★

Rating. 5-Stars = Best in Class / 1-Star = Worst in Class

Chart 1. Gold Spot Prices (Weekly)

XAU Currency

Investment Vechicle	XAU Curncy		
Financial Mkt Tradable	Yes	Liquidity	★★★★★
Cost of Transaction	★★★★★	Transaction Speed	★★★★★
Custody	★☆☆☆☆	Security	★☆☆☆☆

The gold spot (XAU) is the most liquid and efficient way to gain exposure to the precious metal commodity through the foreign exchange market and trades in troy ounces (Oz). There is no physical gold behind the transaction. Indeed, if there were, trading costs would be significantly higher and liquidity just as dampened because moving gold from point A to point B can be a rather expensive task. However, for most trading purposes, that is no problem since investors are mostly speculating on the price movement of the underlying asset or using the "currency" as a way to efficiently hedge their portfolio against tail risk or inflation. Similarly to other fiat currencies, the gold spot has no intrinsic value and is therefore dependent on the trust and support of investors to support and sustain its relative value.

ETN Replication with Derivatives

Investment Vechicle	UGL US Equity		
Financial Mkt Tradable	Yes	Liquidity	★★★★☆
Cost of Transaction	★★☆☆☆	Transaction Speed	★★★★☆
Custody	★☆☆☆☆	Security	★☆☆☆☆

Unlike traditional ETFs for which portfolio are built to track the price of a commodity on a one-to-one basis, ETN using derivatives can either track the returns of the underlying asset or magnify the returns of the portfolio with leverage by a factor 2x or 3x. Through the use of derivatives those type of investment vehicles carry a significantly higher level of counterparty risk. Options and futures used to structure the products will appear and be recorded on the balance sheet of the depository bank. As a result, the counterparty risk exposure inherently cancels out the purpose of holding gold assets in the first place (beside price movement speculation) since the intrinsic value of the investment would become null should the depository institution become insolvent.

ETF Physically Backed, Non-Deliverable

Investment Vechicle	GLD US Equity		
Financial Mkt Tradable	Yes	Liquidity	★★★★☆
Cost of Transaction	★★★☆☆	Transaction Speed	★★★★☆
Custody	★☆☆☆☆	Security	★★☆☆☆

Launched back in 2004, the first physically backed gold ETF was seen by many as a revolution. The fund has since then been widely, perhaps blindly, adopted by investors seeking to gain exposure to gold with enough liquidity for institutions and large investors. However, this product should only be seen as a "tracking vehicle" with no claim on the underlying asset and therefore no tangible value. The reason for that is an investor can only request physical delivery of metal if they own a minimum of 100,000 GLD shares or $18.1 million, at current spot price as of this writing. Additionally, even if an investor does own enough shares, the GLD ETF reserves itself the right to settle the delivery request in cash rather than physically. So why do investors buy it? Well there are a few reasons. First, it is cheap (40bps per annum.) and convenient. Then, investors can employ leverage through options. Yet, counterparty risks are everywhere and defies the reason why an investor would seek to own gold in the first place. In time of financial stress, the risks inherent to holding the product would only rise. With the custodian being one of the largest bank in the world (HSBC), a systemic disruption event would more than likely negatively impact the value of the investor's shares in the product.

ETF Physically Backed, Deliverable

Investment Vechicle	PHYS US Equity		
Financial Mkt Tradable	Yes	Liquidity	★★★☆☆
Cost of Transaction	★★☆☆☆	Transaction Speed	★★★☆☆
Custody	★★★★☆	Security	★★★★☆

Investors willing to remain invested in the banking system can gain exposure to gold through a physically backed and deliverable ETF. PHYS offers such solutions, at a marginally higher cost (60bps), yet remains very liquid. The assets are fully allocated and provide the trusts with direct beneficial ownership. These are allocated trusts where the investment is allocated to a specific bar with a serial number. While it is subject to minimum redemption requirements, unit-holders have the ability to redeem their units for physical bullions on a monthly basis. The Royal Canadian Mint can ship the bars virtually anywhere in the world. Additionally, the physical redemption will never dilute remaining unit-holders. All physical redemptions are equal to 100% of the NAV per unit of redeemed units, less redemption and delivery expenses, including the handling of the notice of redemption and the applicable bullion storage in-and-out fees. Because the trusts store their commodity in custody with the Royal Canadian Mint, there are no financial institutions in between unit-holders and the trusts' physical bullion. Hence, no risk of financial losses in the event of bankruptcy or nationalization of the financial institutions. Thus, protecting some of the reason as to why an investors could seek to own gold.

Physical Gold

Investment Vechicle	Gold Bullion, Bars, Jewellery, Coins		
Financial Mkt Tradable	No	Liquidity	★☆☆☆☆
Cost of Transaction	★☆☆☆☆	Transaction Speed	★☆☆☆☆
Custody	★★★★★	Security	★★★★★

For investors who prefer to keep their metals outside of the banking system, as governments have banned ownership in the past, there are several ways to achieve this by owning physical gold. The most common way is to own bullions, which refers to the stamped weight and fineness of gold. It can take a bar form, be round like a coin, or be in any shape or form representing both a tradable and practical size and form. Typically, the price of a bullions will include the cost of the metal plus the cost associated with refining, shipping, and the dealer's premium.

Gold bars are available to investors at various weight, starting as low as 1 gram. Heavy bars are usually best suited for larger investors as they can be stored in insured facilities specialized in precious metals. One thing to remember is that investors can buy and store gold in Switzerland VAT free. However, there are some shortfalls to owning large bars. They are more difficult and cost to sell. As a result, investors considering such option should be ready to hold and store gold over longer periods of time in light of the limited level of liquidity inferred by such asset. In general, gold bars are produced by government mints as and some private companies such as Johnson Matthey, Wall Street Mint, Sunshine Minting, Credit-Suisse, Engelhard, and PAMP.

Buying metals in smaller denominations (i.e. coins or rounds) can be very useful too as it is both easier to store and split into smaller amounts. These can be stored at home or in vaults. However, because of the smaller sizes, the premiums associated with these can be high. Yet, buying from local coin dealers can be economical if they have too much inventory. Newly minted coins can be easy to buy, and their purity is guaranteed by the government mints that produce them.

We have been looking into EFG and UBS as service providers to gain physical gold exposure. Please reach out directly to us should you want to know more about the process to buy physical precious metals.

The Bottom-Line

Based on our analysis, we would recommend three of the five vehicles. First, physically backed and deliverable ETFs seem like a good compromise to us. They have the benefit of being liquid, relatively cheap, and offer more security than some other products. Then, investors more concerned in the financial system's stability who are willing to hold on to the commodity for longer periods of time should turn towards physical gold. While more expensive, it comes with a wide range of benefits ranging from security to asset ownership. Lastly, investors seeking to speculate on the price movement of gold, we would recommend the gold spot for both its cheapness and liquidity.

We continue to be very bullish gold and believe we are at the dawn of a secular bull market. We are happy to provide you with further advice upon request.

As always, please feel free to reach out to us should you have any questions or comments regarding this research.

Kind regards,

MAM Investment Team

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