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Gold and Precious Metals Trading

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What am I going to talk about?

(1) A brief history of the gold trade
(2) The physical gold trade – Switzerland's peculiar role
(3) Major players and market forces in the Gold trade
(4) Invest in gold – glitter or paper?

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(1) A brief history of the gold trade

(a) What are precious metals?
(b) What are they used for?
(c) Concentration on gold
(d) Development of the gold trade

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(a) What are precious metals?

- Def.: a **rare**, naturally occurring metallic chemical element of high economic value; historically: used a currency; today: commodity
- Best known: Gold (Au) and Silver (Ag)
- Other major PM: Platinum (Pt), Palladium (Pd), Rhodium (Rh)
- Specialist PM: Ruthenium, Osmium, Iridium

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(b) What are they used for?

- **Pd**: catalytic converters; dentistry; jewelry; electrical contacts;
- **Pt**: catalytic converters; jewelry; investment; industrial appliances;
- **Ag**: currency since 700 BC (pound *sterling* = 1 pound of sterling silver); jewelry & silverware; dentistry; photography; electronics; mirrors & solar reflectors; musical instruments; medicine (due to antibiotic features); investments; clothing;

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Au:

- ‘Money’ → efficient indirect exchange & wealth storage; ease of exchange due to standardized minted gold coins since 600 BC
- Investment → hedge against inflation & economic downturns (approx. 40% of global use)
- Jewelry → mature economies: 18 Karat; emerging markets usually 24 karats (approx. 50% of global use)
- Medicine → dentistry & use in various microscopes;
- Industrial uses include protective coatings for satellites & in electronics due to high conductivity of electricity
- Food & drinks

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(c) Concentration on gold – why?

- since its discovery gold has acted as a "currency" because of its scarcity, difficulty in mining, people's attraction to it, easy handling, non corrosiveness / stability / non – reactiveness
- Gold traditionally is a symbol of wealth & power and is considered as a unique storage medium for value
- Gold is by far the most important PM traded globally

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(d) Development of the gold trade

- Old days:
- 1500 BC: Nubia makes Egypt the wealthiest nation in the world as gold becomes the recognized standard medium of exchange for international trade
- 1091 BC: little squares of gold become legal tender in China
- 560 BC: first gold coins are minted in Asia Minor / Lydia
- 50 BC: Rome starts minting the Aureus
- 1284: Venice starts minting the Ducat which is the “USD” for over 500 years
- 1377: Great Britain introduces a monetary system based on gold & silver
- 1792: USA adopts a monetary system based on gold and silver

→ Gold coins essentially used as ‘money’

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- More recent history:
- 1816: Great Britain officially ties the pound to a specific quantity of gold
- 1900: USA officially adopts the gold standard (= fixed exchange rate USD/AU)
- 1913: USA reduced the gold backing to 40% of Federal Reserve Notes
- 1925: Great Britain returns to gold bullion standard in the form of currency being redeemable for 400 ounce gold bullion bars
- 1931: Great Britain abandons the gold bullion standard
- 1945: Bretton Woods Agreement: gold ounce fixed at USD 35 and fixed exchange rates for major currencies established → USD becomes reserve currency of the world
- 1968: two tier system emerges → official transactions between central banks continue at USD 35 per ounce; other transactions are subject to 'market"
- 1971: Bretton Woods system abandoned in steps

→ In this period currencies backed by gold existed; such currencies cannot be created arbitrarily by a government or central bank but is limited by gold holding.

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- Post Bretton Woods
- ➢ USD becomes a fiat currency = not backed by gold but by the health of the US economy and the value of the promise of the US government to pay; there is no intrinsic value in the currency based on extrinsic backing by gold / silver
- ➢ 1972: Chicago Mercantile Exchange launches futures trading for 7 currencies
- ➢ 1974: COMEX in New York starts trading first gold futures contracts

→ Modern day trading classifies gold as a hybrid: commodity as well as currency

→ Practically speaking trading takes places at the FX desk of banks for most transactions, as the vast majority of transactions are conducted in paper form only;

→ Although gold is classified as a currency in that sense, it fixes in USD like most other commodities

→ Physical gold trade has seen a great liberalization since the late 1970s and remains largely unregulated

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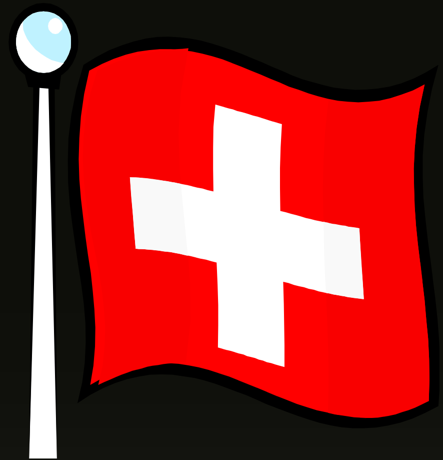
(2) The physical gold trade – Switzerland’s peculiar role



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- Switzerland has no natural gold worth speaking of; despite this, Switzerland plays a major part in the world's gold trade
- Until 1968 London was the most important and largest trading hub for Gold
- Since then Switzerland has taken up a central role in the world's gold trade
- 6 refineries on the LMBA good delivery standard list deliver 90% of the world's gold; 4 of the world's leading gold refineries are located in Switzerland: ARGOR-HERAEUS, Metalor, PAMP, Valcambi; together they refine approximately 70% of the world output of refined gold products
- Example figures for 2011:
  - total gold mining production: 2,700 tonnes of raw gold (excl. recycling and "illegal" mining)
  - total amount imported and refined in Switzerland: 2,600 tonnes of raw gold
- 4 reasons for Switzerland's dominance:
  - very safe country
  - very efficient logistics
  - global banks UBS and CS
  - most importantly: consistently the highest quality of refining products is achieved → Refined in Switzerland stands for a quality assurance no other geographical area can achieve
- The consequence: 3 of 5 refineries worldwide with the title REFEREE of the LBMA to ensure quality standards are based in Switzerland: ARGOR-HERAEUS, Pamp and Metalor

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How did Switzerland become so important in the gold trade?

- South Africa has mined approximately 40% of worldwide available gold
- 1967 saw the introduction of the Kruegerrand – the world's most popular gold coin
- During the collapsing years of the Bretton Woods systems Swiss banks saw a chance to grab the global gold market
- At the time two factors helped Switzerland emerge as hotspot for the gold trade:
  - ➢ Cold War → Soviet Union was second largest gold producer and exchanged gold for oil
  - ➢ Anti- Apartheid sanction against South Africa → S.A. as largest producer of gold was subject to restrictions to sell its gold to the US, EU, Japan and Australia; Switzerland never implemented any restrictions on S.A.
- Established refineries in Switzerland now dominate the market globally due to their technological advantage and integration into the Swiss financial system
- Trend: post global credit crisis saw an increase in demand for alternative investments that are considered solid and preserve capital and can be outside of the financial system → private gold storage systems in Swiss freeports and private storage facilities

(3) Major players and market forces in the gold trade

(a) Gold Exchanges

- **London Gold Market**: largest marketplace; mainly spot trading; bullion is traded amongst LBMA members, regulated by the Bank of England, priced in USD, using ounces as base unit; price is fixed twice daily by 5 banks: HSBC, Deutsche Bank, Societe Generale, Barclays, Scotia Mocatta;
- **New York Mercantile Exchange / COMEX**: usually futures trading and some derivatives, first exchange to offer gold options;
- **Zurich**: second largest exchange, no price fixing, no price limit restrictions;
- **Hong Kong**: fills the empty trading times of London & New York, mainly through the CGSE

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(b) Gold Miners by tonnes (2013)

- Barrick Gold (Canada) – 203 tonnes
- Newmont Mining (USA) – 143 tonnes
- AngloGold Ashanti (Souh Africa) – 116 tonnes
- Goldcorp (Canada) – 76 tonnes
- Kinross Gold (Canada) – 75 tonnes

(c) Gold Refiners (2013)

- Valcambi (CH) – 1,400 tonnes
- Metalor (CH) – 650 tonnes
- Rand Refineries (South Africa) – 600 tonnes
- Tanaka (Japan) – 540 tonnes
- PAMP (CH) – 450 tonnes
- Heraeus (Germany) – 450 tonnes
- Argor Heraeus (CH) – 400 tonnes

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(d) Banks

- The five biggest bullion banks on the London market are: HSBC, Deutsche Bank, Societe Generale, Scotia-Mocatta and Barclays

(e) What influences the gold price

- No one central bank or institution controls the gold market
- In general relatively free market forces influence the gold price
- Traditionally gold is viewed a inflation hedge, conservative investment for insurance purposes and conservation of capital / value
- Economic downturns and upsetting (regional or global) political events as well as a weakening in the USD usually let the gold price increase; economic growth usually has seen gold prices moving sideways or declining;
- Since the Global Credit Crisis there is increased demand by private investors globally for gold and private storage facilities

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(4) Invest in gold – glitter or paper?

Deal Ticket - LM181967374587 https://fxtraderplus.ibb.ubs.com/onetoolplus/app/site/assemble/full

UBS

Account:	0235-00143088
Entry Time:	02-Jun-2014 13:06 GMT
Entry User:	ch188361
Trade ID:	LM181967374587
Product:	PM Forward
Currency Pair:	XAUHKD
Amount:	I Bought XAU 160.754 oz
Counter:	I Sold HKD 1,554,248.86
Trade Date:	02-Jun-2014
Value Date:	11-Jun-2014
Spot Date:	04-Jun-2014
Spot Rate:	9668.08
Forward Points:	41.2600
Forward Rate:	9668.4926
Quote Basis:	HKD per XAU
Location:	Zurich
Delivery Method:	ACCOUNT
Source System:	FX TRADER PLUS
Status:	ACTIVE
USI Issuer Id:	1030338960
USI Trade Id:	MOR0000000000000000000002787850807

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(a) How can you invest in gold?

- Bars and Coins → physical gold that is transportable and globally acceptable, which requires storage
- Exchange traded funds → financial product physically backed by allocated bullion, traded on an exchange
- Gold accounts / paper-gold → like a FX currency account
- Alternative investments:

➢ funds investing either in precious metals and/or precious metals related stock (e.g. refiners, mining companies)

➢ Futures and options

➢ Gold accumulation / savings plans

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(b) Consideration when investing in gold – what do you want?

- Personal preference: ease of transaction versus “the real McCoy”?
- Doomsday scenario versus rational asset allocation?
- Personal mobility and its disadvantages → transport costs, storage costs, import and export restrictions, customs and other “red tape”
- “Golden Bridge” back into legality

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Thanks for listening – Q&A