

The Case For Gold

Jordan Eliseo
Chief Economist
ABC Bullion
May 2017



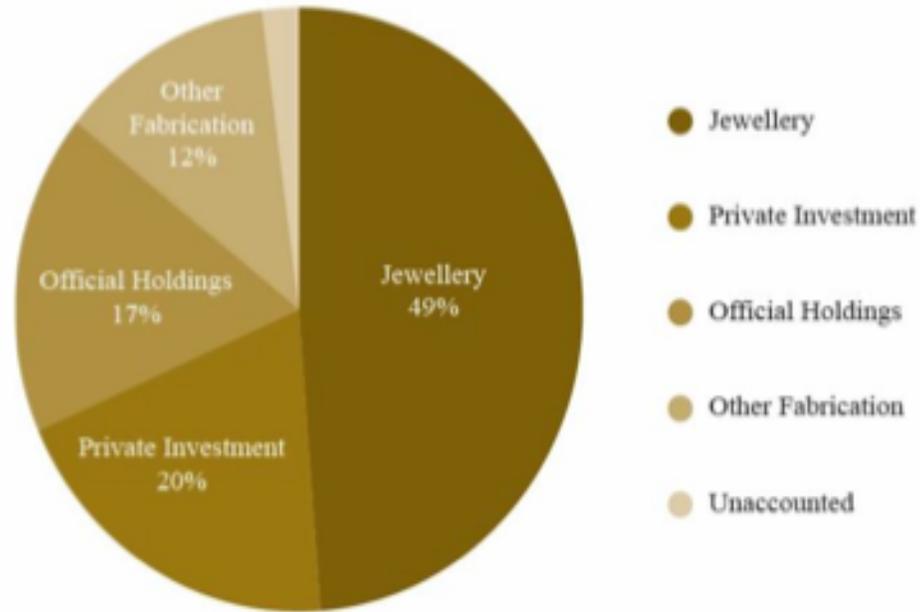
What we are going to cover!

- Understanding the Physical Bullion Market
- Myths of Investing
- Why Gold is “Not” a Commodity
- Benefits of Investing in Gold
- Why gold will outperform financial assets in years ahead

Understanding the Physical Bullion Market



Who Owns and Buys Gold

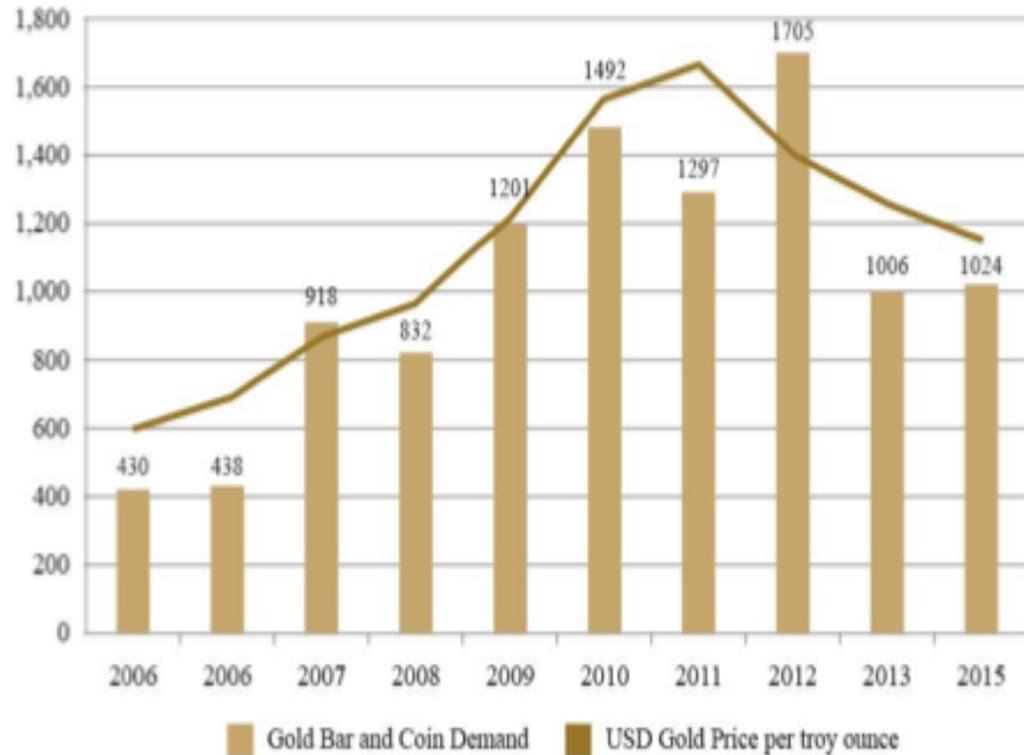


Source: Boston Consulting Group, World Gold Council

Owners	Tonnes
Central Banks	30,500
Jewellery	85,900
Individual	34,400
Industry	21,600
Other	3,600



Gold Bar and Coin Demand



Source: World Gold Council, ABC Bullion, Q1 2016 Gold Demand Trends

- Noticeable increase since 2006
- Peak in 2012
- Figures trending higher again in 2016
- North America, Europe and Japan all seeing increases in demand
- Australian demand (SMSF) trustees at record highs in 2016

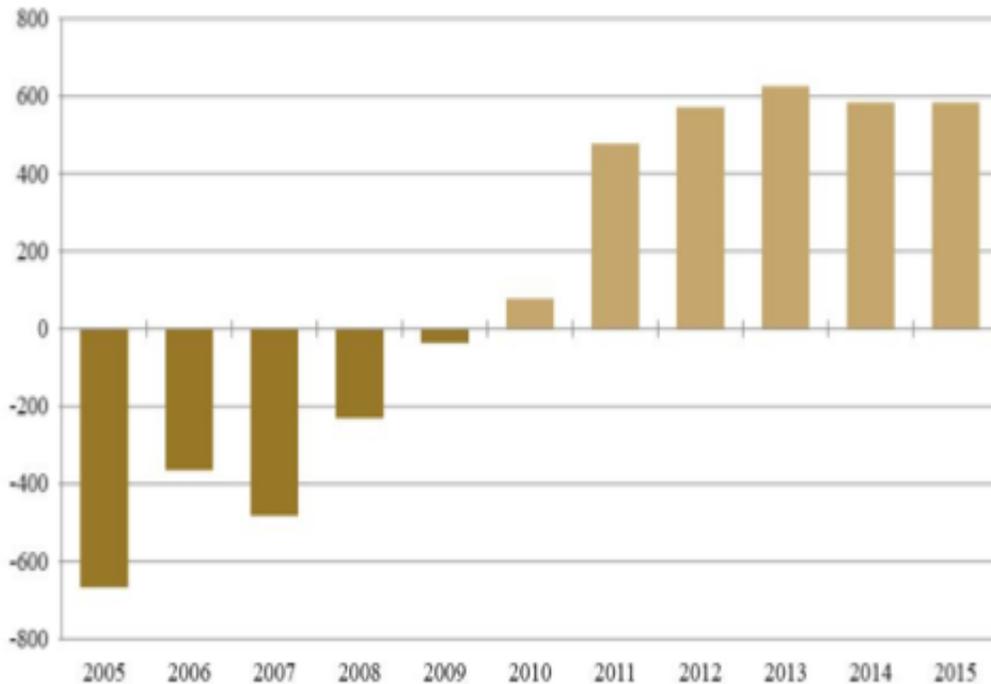
Gold ETF Market since 2004



Source: World Gold Council, GLD website, 25th May 2016

- Gold ETFs relatively new invention
- Launched in early 2000s
- Positive contributor to overall gold demand
- Correlated to gold prices
- Demand picking up in 2016/17

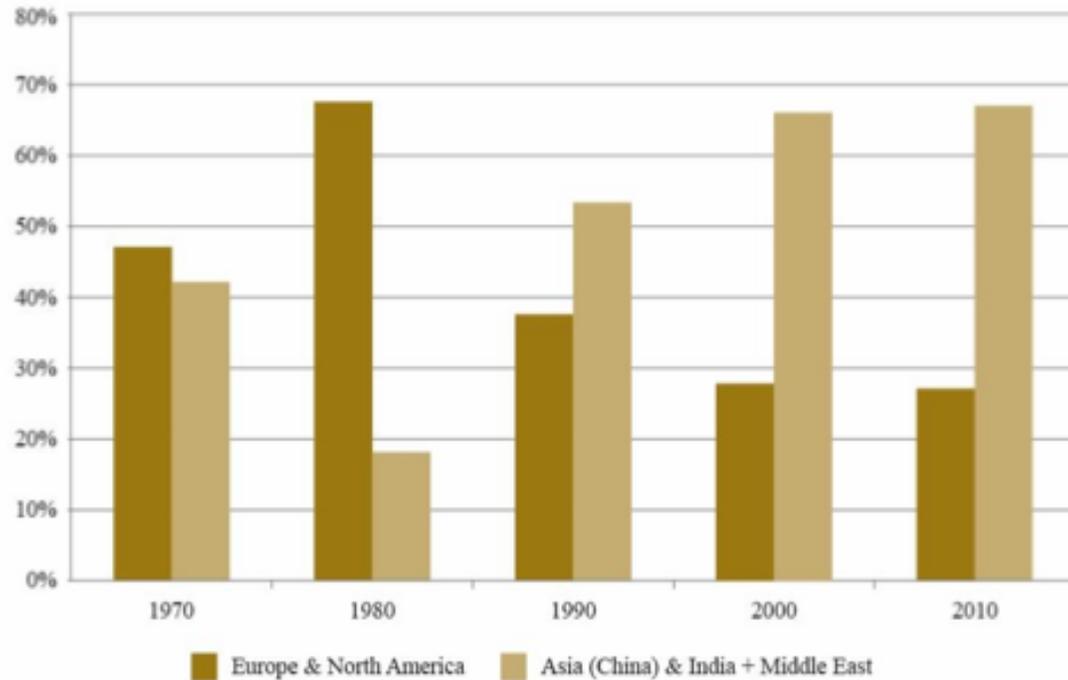
Central Banks Net Buying (Tonnes)



Source: ABC Bullion, World Gold Council, Gold Demand Trends, Q4 2015

- Central Banks were net sellers every year from mid 1980s until the GFC hit
- Buying coming from **Emerging markets** (<4% of FX reserves in gold vs. +20% in advanced economies)
- Western Central Banks: ceased sales, **AND** began repatriating gold from New York, London, Paris

The rise of China and India and the Eastern migration of gold buying!



Source: World Gold Council, GFMS, Thomson Reuters, Bloomberg, 2011

- Circa 70% of gold demand at end of 1970s was from North America & Europe
- Picture has changed in last four decades, as gold demand has migrated East
- Circa 70% demand now from Asia/India/ME
- Driven by high savings and growing wealth of 'middle class', plus central bank buying

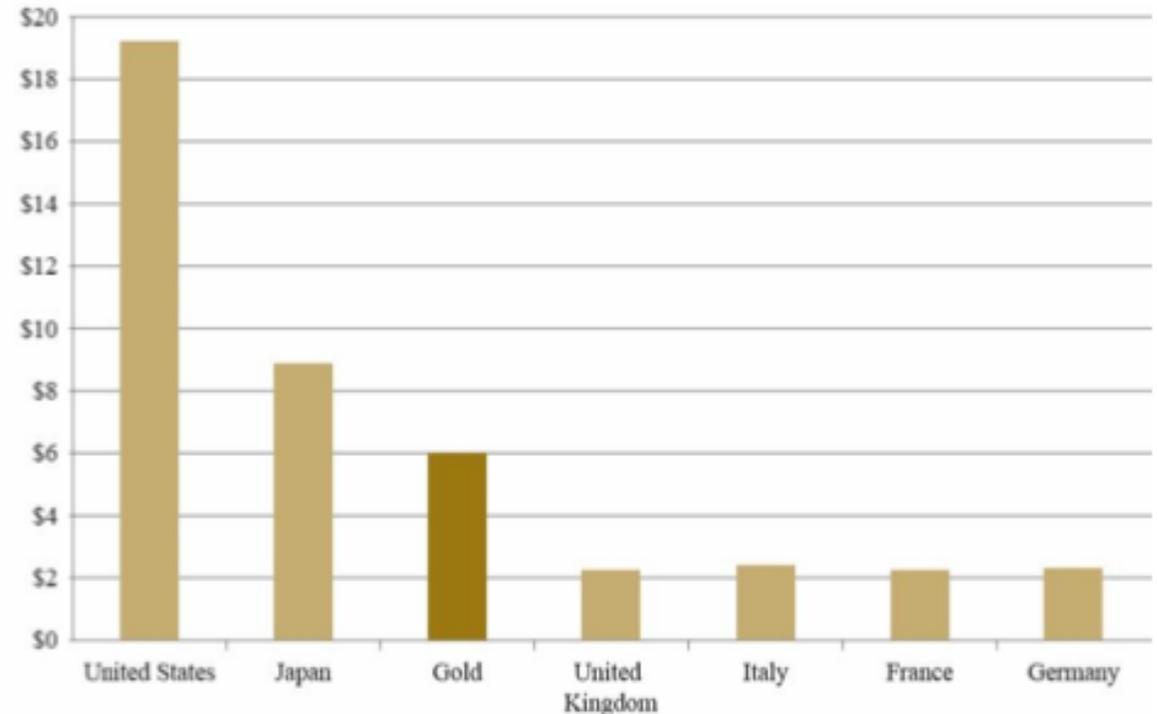
Size and Liquidity in the Gold Market

Liquidity

Where	Oz (mill)	USD Billions
London (OTC)	55.1	67.4
COMEX	16.9	20.8
TOCOM	1.5	1.8
MCX	1.4	1.8

- USD \$100bn turnover per day minimum
- Over-the-Counter (OTC) circa 70% of total
- Turnover substantially larger than listed equity markets, and most sovereign bond markets too

Size (USD \$ Trillion)



Source: ABC Bullion, World Gold Council, www.nationaldebtclocks.org

Myths of Investing in Gold

The background features abstract, overlapping geometric shapes in various shades of blue, ranging from light sky blue to deep navy blue. The shapes are primarily triangles and polygons, creating a dynamic, modern aesthetic. The text is centered in a clean, sans-serif font.

Myths of gold investing

Practicalities of investing in gold

- ▶ Physical gold is inaccessible to everyday investors
- ▶ Physical gold is expensive to trade
- ▶ Physical gold is expensive to store

The role of gold in a portfolio

- ▶ Physical gold only does well in periods of high inflation
- ▶ Physical gold will fall when interest rates rise



Gold: A highly accessible investment



400oz ABC BULLION CAST BAR GOLD

- ▶ Cast Bars from 1oz to 1kg Gold Bar (\$1.8k-\$53k) popular with trustees
- ▶ Can purchase 'pooled' gold from as little as AUD \$50 per installment
- ▶ Metal can be bought 24/7 online, over phone, in-store with bullion dealers



Source: ABC Bullion, RBA, World Gold Council

Gold: Not Expensive to Trade



- Smaller bars do attract larger premiums, as do coins and tablets
- 1kg cast gold bar (circa AUD \$50k value) traded at a margin of just 1%
- Pool allocated metal sub 1% margins
- **For medium-long term investors, physical gold is cheapest method of investment**

Gold: Not Expensive to Store

Asset Class	Average MER
Australian equities – broad based	0.41%
International equities – broad based	0.49%
Foreign Exchange	0.47%
Fixed Income and Cash	0.27%
Commodities	0.49%
Average MER	0.43%

Year	Gold Value	Cost	ETF Basket Value	Cost
Year 1	\$100,000.00	\$250	\$100,000.00	\$430
Year 5	\$141,158.16	\$281	\$138,943.86	\$597
Year 10	\$217,189.33	\$326	\$209,598.68	\$901

Source: ABC Bullion

Gold: Stored in a private vault for \$250 a year

Works out at 0.25% on a \$100,000 investment



Gold: Doesn't need High Inflation

Average annual inflation and gold price movements – USD and AUD

	US Inflation	USD Gold Price	Australian inflation	AUD Gold Price
1970s	<u>7.7</u>	<u>34.5</u>	<u>10.4</u>	<u>37.3</u>
1980s	5.5	0.00	8.1	2.3
1990s	3.0	-3.3	2.2	0.1
2000s	<u>2.3</u>	<u>11.8</u>	<u>2.9</u>	<u>8.8</u>

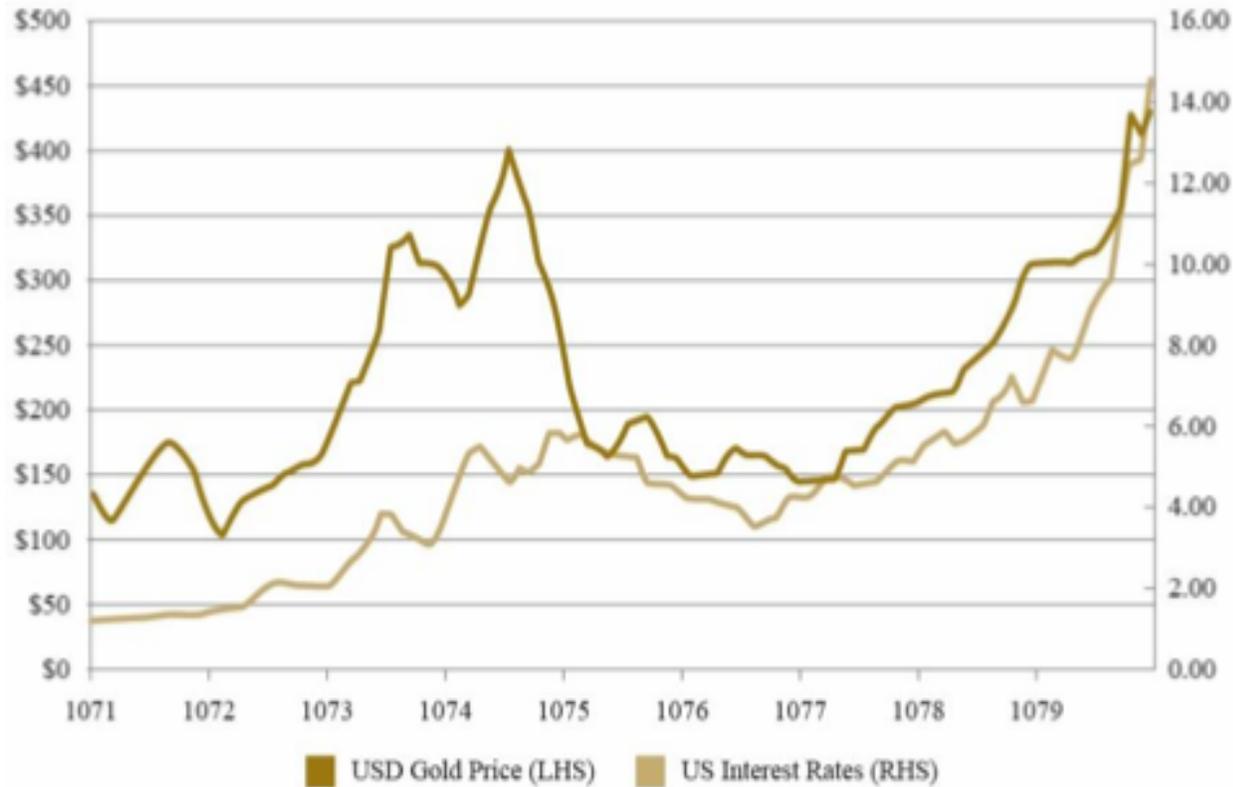
Source: ABC Bullion, Cor Capital, IRESS. RBA, St Louis Federal Reserve

- ▶ Gold does indeed do well in periods of high inflation.
- ▶ But it does not require high inflation to prosper.
- ▶ Deflation, financial market volatility, 'real' interest rates, central bank buying, geopolitical tension etc. also drive prices.



Gold: Often rises with Interest Rates

Interest Rates and Gold Price (1970s)



Source: ABC Bullion, St Louis Federal Reserve, MacroTrends

- ▶ Three of the fastest periods of gold price appreciation occurred whilst the Federal Reserve was ***raising*** interest rates
- ▶ Two, from 1971 to 1974 and 1976 to 1980 can be seen in the chart
- ▶ The other was between December 2001 and 2007. US Fed hiked rates from below 2% to nearly 6%. Gold went from USD \$260oz to USD \$665oz
- ▶ Fed hiked rates Dec 2015: Gold was USD \$1,050oz then

The background features abstract, overlapping geometric shapes in various shades of blue, ranging from light sky blue to deep navy blue. These shapes are primarily located on the right side of the frame, creating a modern, layered effect. The text is centered on a white background.

Why Gold Is not a Commodity

Gold: Unique Supply Profile

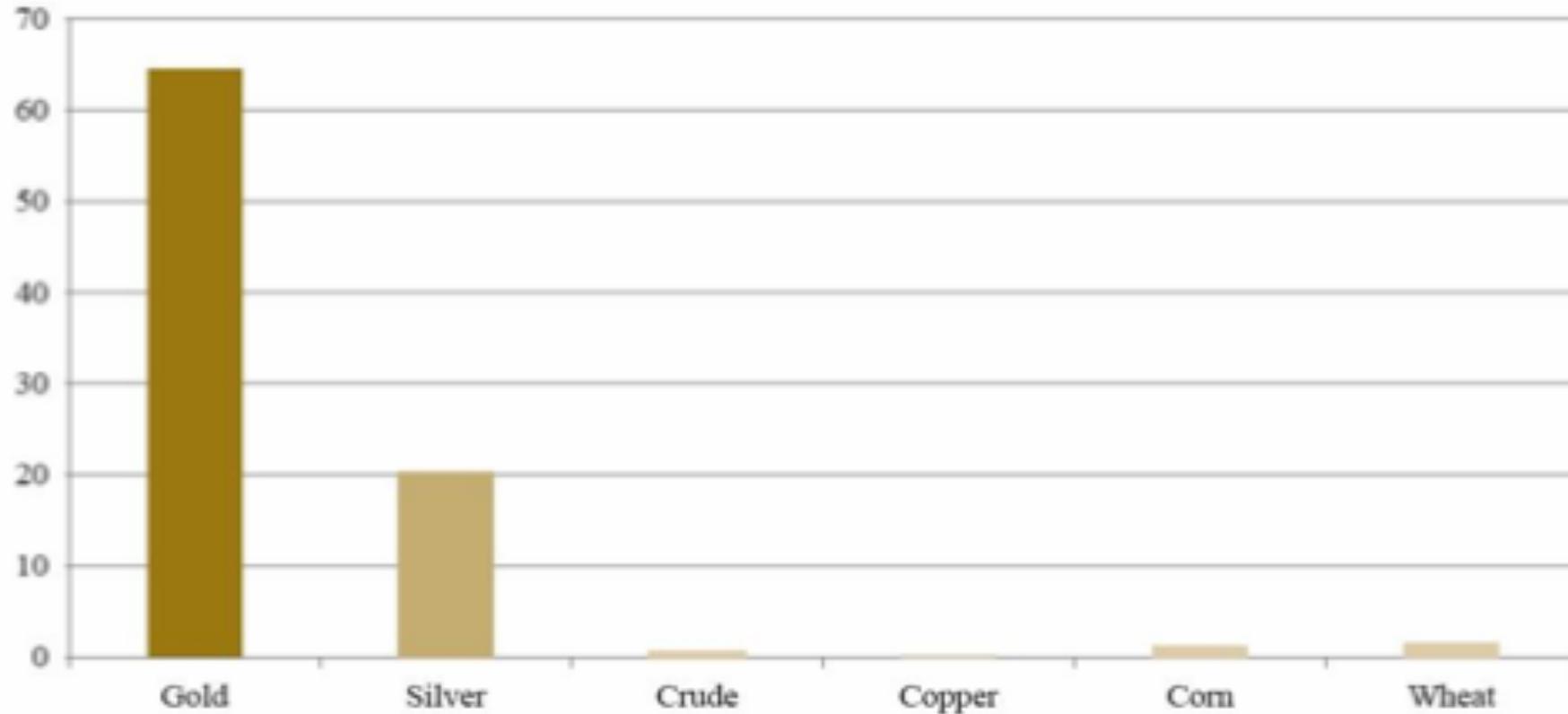
Stock:	Existing supply of a particular item
Flow:	Annual production of a particular item
Stock to Flow Ratio:	Existing stock divided by annual production

Total Known Gold Supply:	176,000 tonnes (end 2013)
Gold Mining Production:	2,700 tonnes (average last 10 years)
Gold Stock to Flow Ratio:	65:1
Increase in Total Gold Stock:	1.5% per annum

**Total gold supply is incredibly stable
Unalterable in any meaningful way**



Gold: Stock to Flow in Perspective

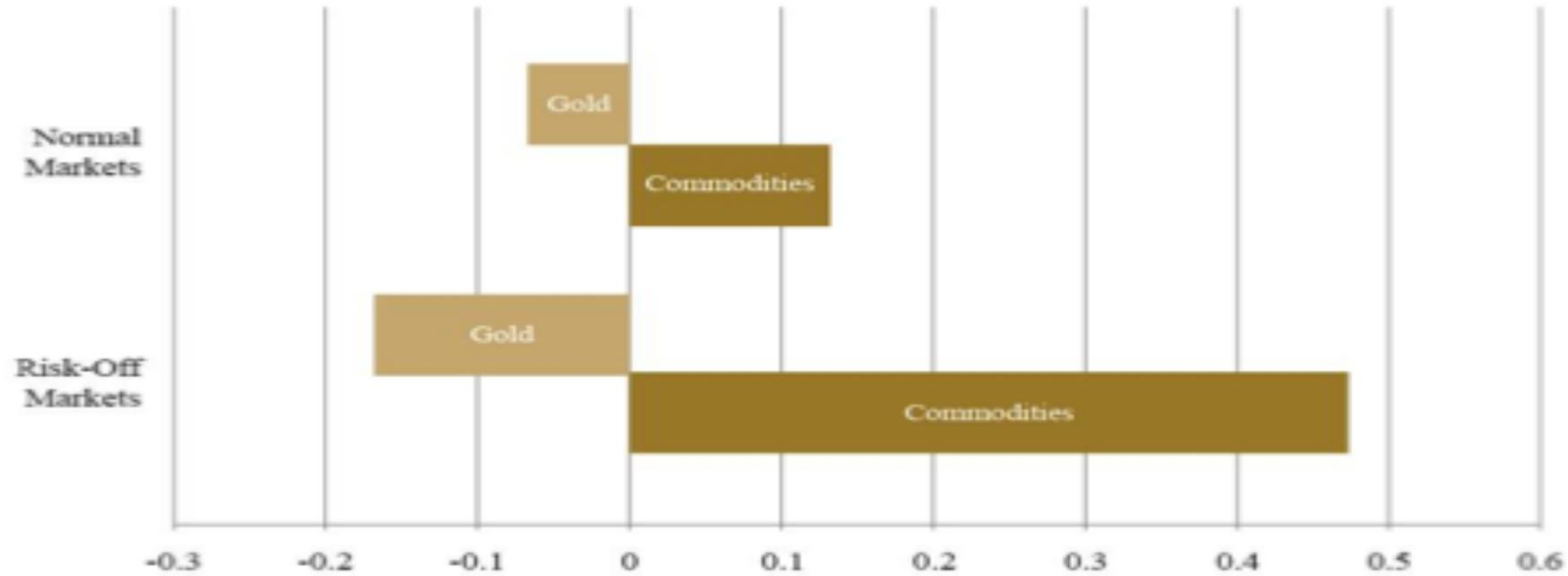


Source: Incrementum Chartbook



Gold doesn't behave like a commodity

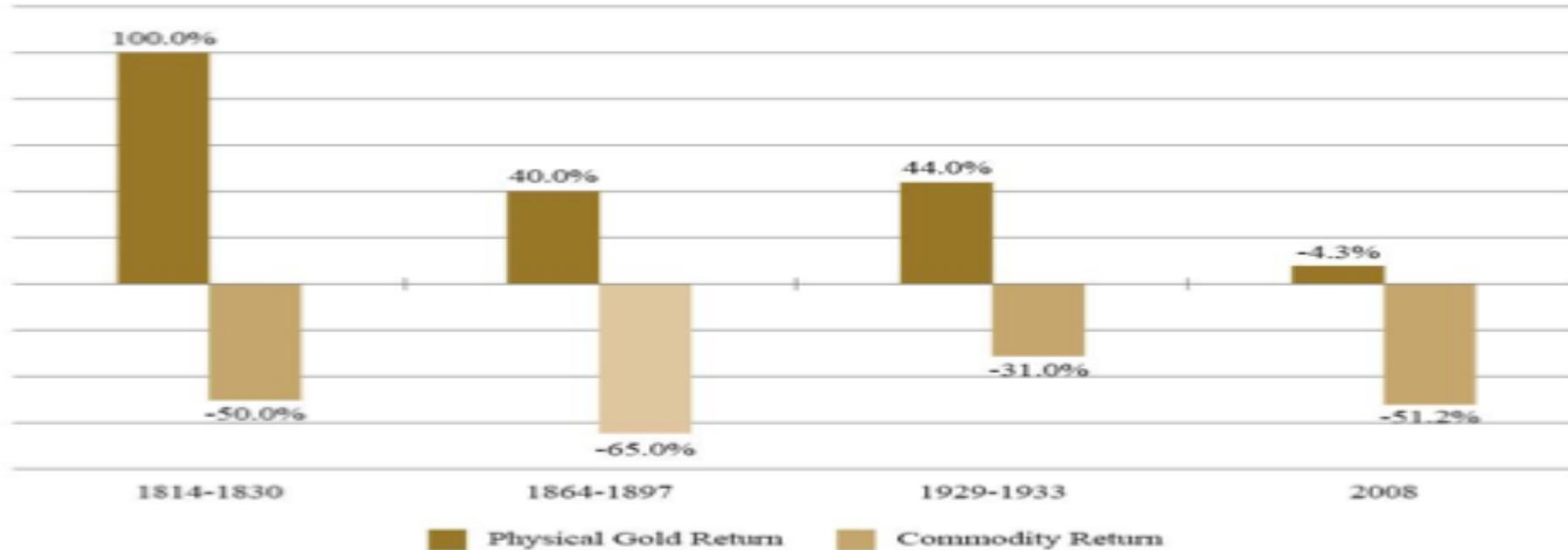
Correlations: Gold and Commodities versus the Stock Market



Source: World Gold Council

Gold doesn't behave like a commodity

Performance Differentials during Deflationary Shocks



Source: Roy Jastram; "The Golden Constant", World Gold Council, Goldman Sachs

Gold is a Currency (still)

- ECB formation (1998): 15% of \$50 billion of reserve assets used to set up the ECB was gold
- ECB (2015): *“Gold remains an important element of monetary reserves”*
- BIS (2013 annual report): *“Gold is to be dealt with as a foreign exchange position rather than a commodity”*
- Ex Fed Chair Alan Greenspan (2014): *“Gold is a currency. It is still, by all evidence, a premier currency.”*

Gold should be treated as a form of money

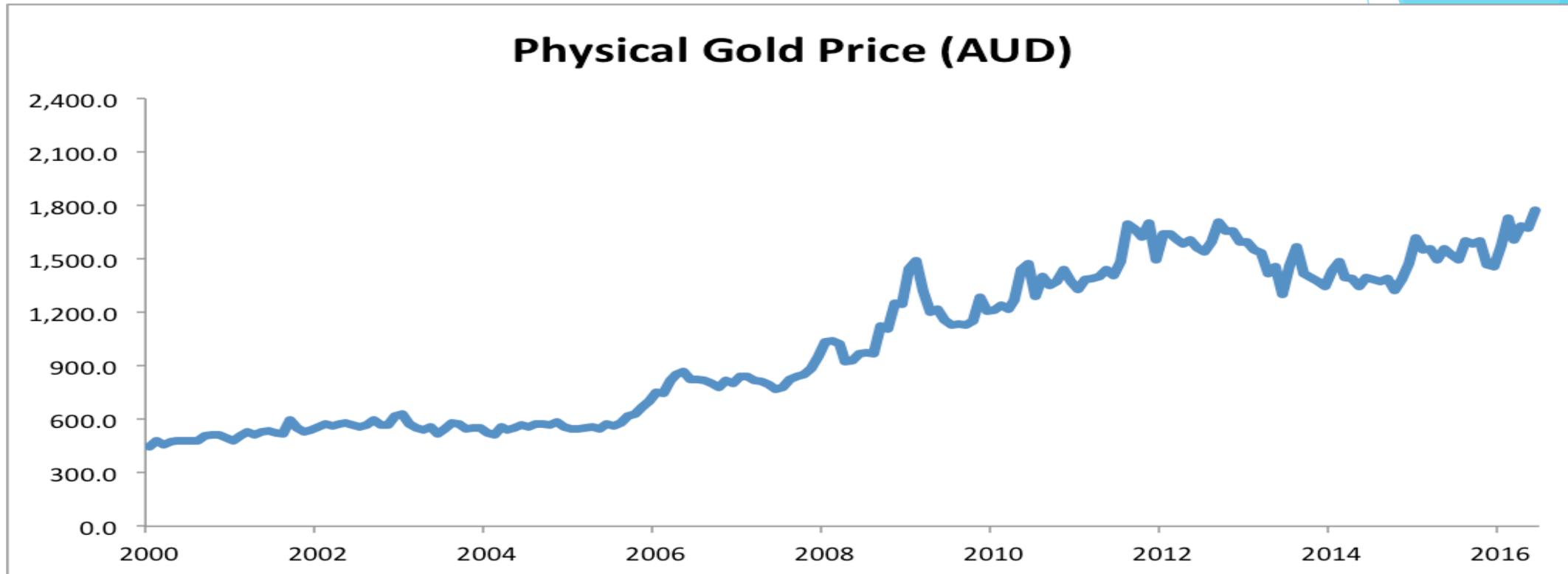
Gold is an alternative to a bank account or term deposit or another foreign currency one might wish to incorporate into their portfolio



The background features abstract, overlapping geometric shapes in various shades of blue, ranging from light sky blue to deep navy blue. These shapes are primarily located on the right side of the frame, creating a modern, dynamic feel. The text is centered on a white background.

Benefits of Investing in Gold

Gold: Strong long term returns



Source: World Gold Council, December 1999 to June 2016 inclusive



Gold: Strong long term returns

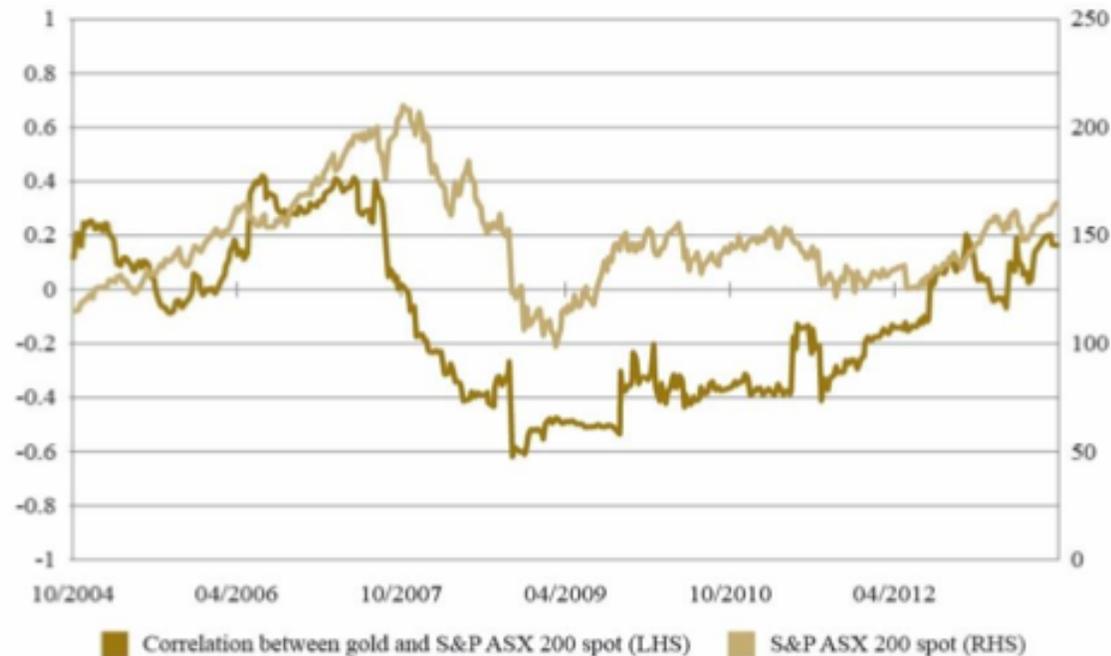
Asset Class	1yr	5yr	10yr	Since Dec99
Gold (AUD)	15.92	4.69	8.13	9.57
Shares	0.56	7.02	4.80	8.14
Bonds	7.02	8.03	7.33	7.14
Cash	2.20	3.06	4.30	4.89

Source: Cor Capital, RBA, IRESS, Chant West, ABC Bullion: asset class returns to end June 2016 inclusive



Gold: Uncorrelated to Equities

1 year rolling correlation: ASX & Gold



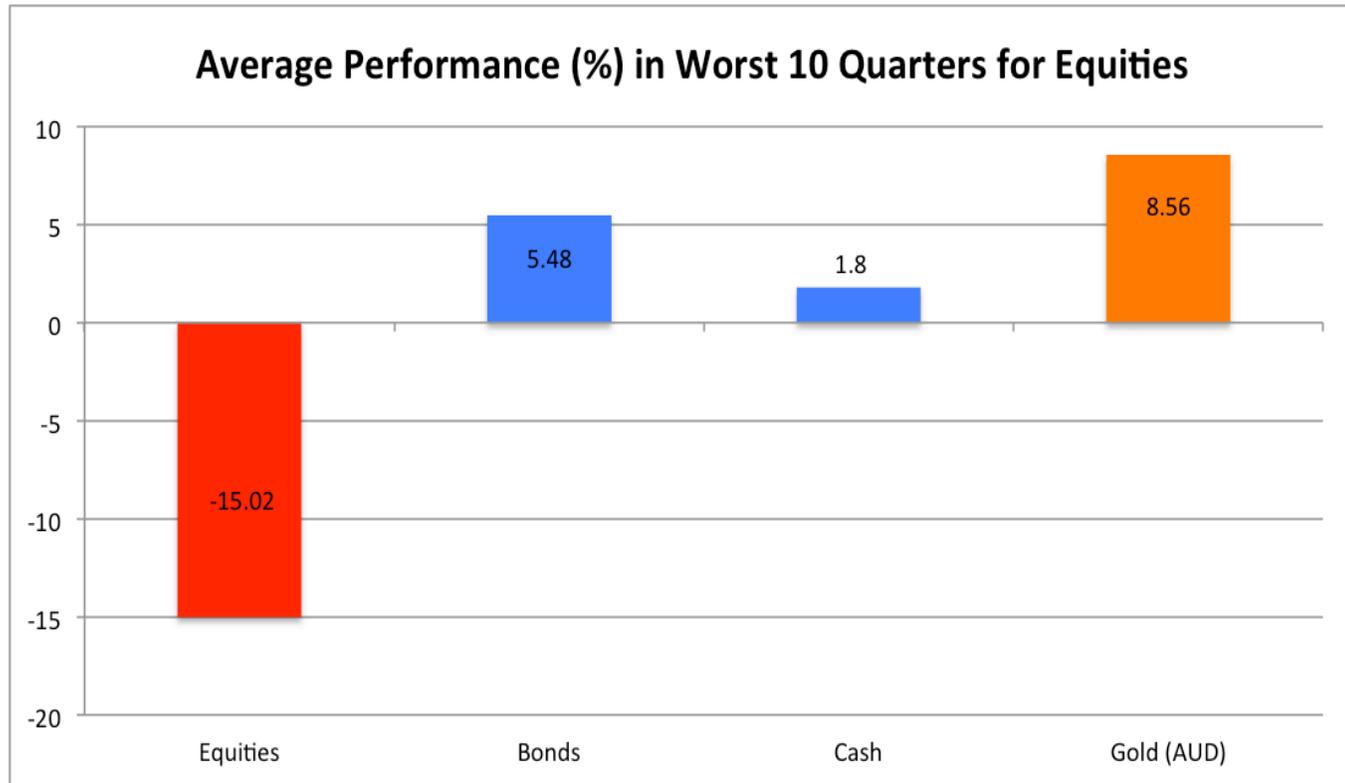
Source: Bloomberg, World Gold Council

- Chart highlights fact that AUD gold tends to rise when the ASX is falling
- Long-term (1971 onward) data confirms this phenomenon
- Correlation when ASX rises: 0.16
- Correlation when ASX falls: -0.59
- Gold is simple way to balance a portfolio and hedge against equity market corrections

Source: Cor Capital, IRESS



Gold: Highest performing 'risk off' asset available to all investors



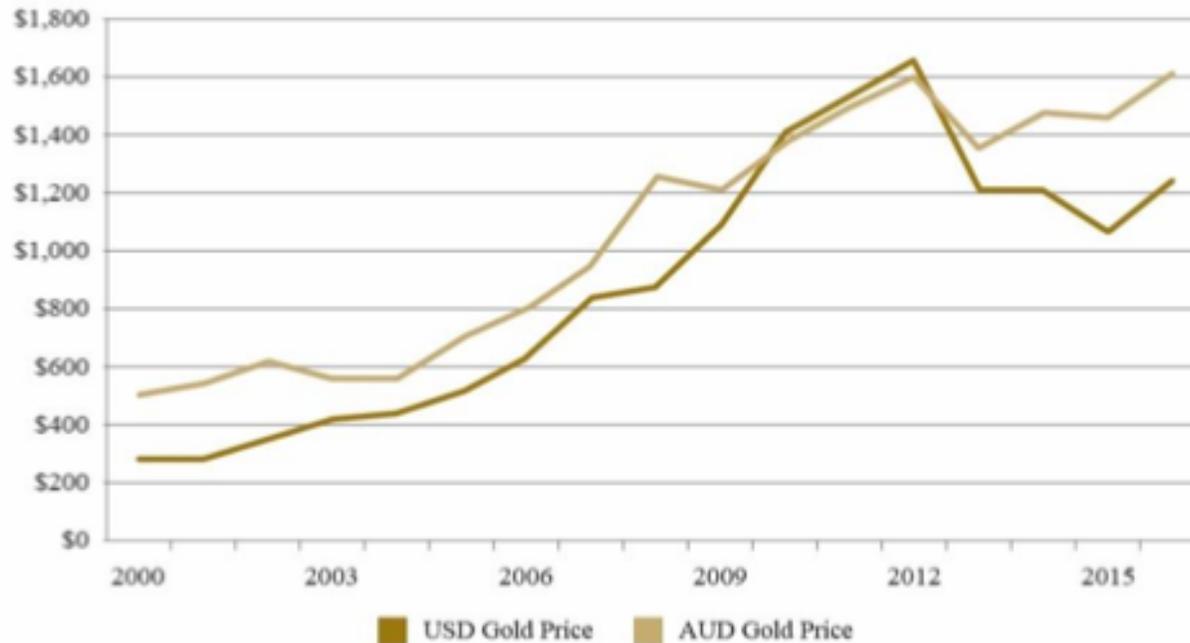
Source: RBA IRESS, ABC Bullion – Data from 1972 to end 2014

- Gold best performing liquid asset class when the ASX falls
- More profitable than traditional defensive assets (bonds and cash)
- Particularly relevant considering current yields on traditional defensive assets



Gold: Natural Foreign Currency Exposure

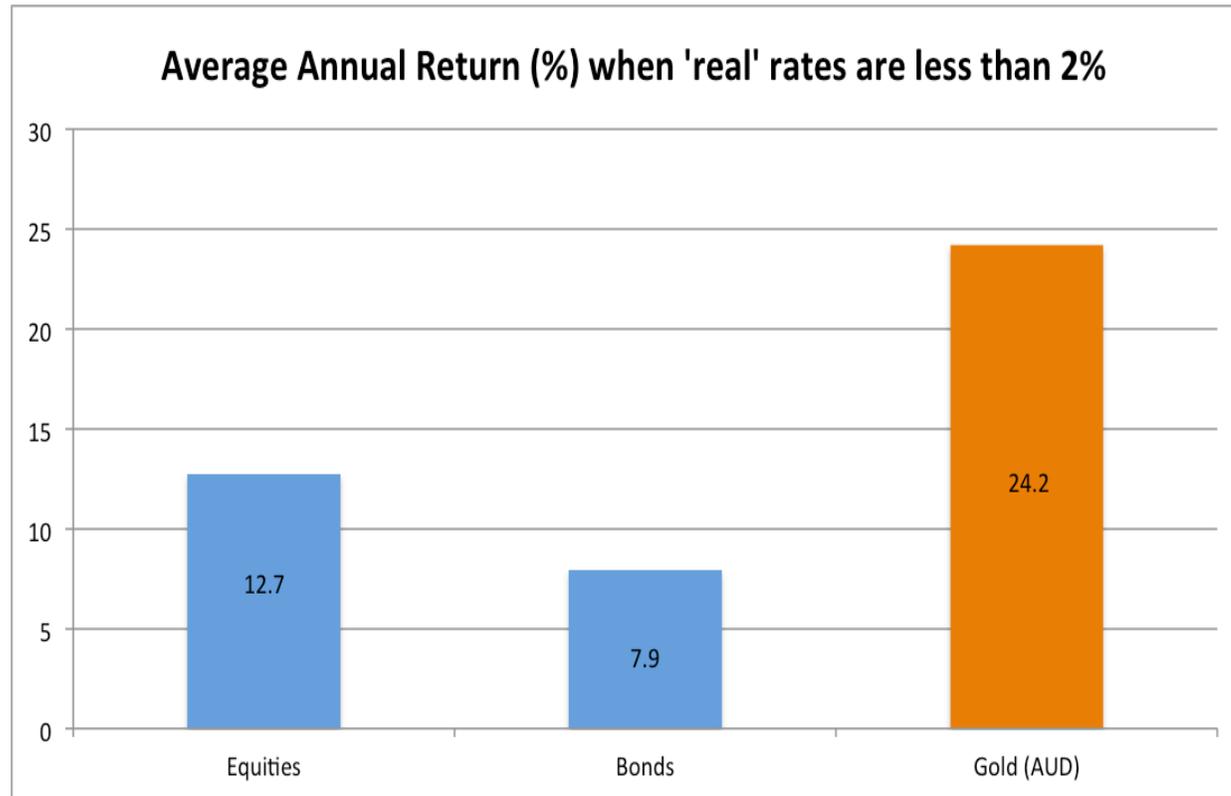
AUD & USD gold prices since 1999



- Gold benefit from any fall in the AUD
- AUD cushions volatility of gold price return for local investors
- Over the past 15 years, annual volatility of returns in USD was over 16%
- In AUD terms, annual volatility was less than 12% over the same time period

Source: World Gold Council, Global Financial Data.

Gold: Thrives when 'real' rates are low



Source: Cor Capital, RBA, IRESS, Chant West, ABC Bullion

- Natural that gold would do well in low 'real' rate environments for two reasons
- Low 'real' rates are response to economic weakness (limit returns on traditional assets)
- Lower 'opportunity cost' in terms of income foregone

Outlook: Why Gold will Outperform



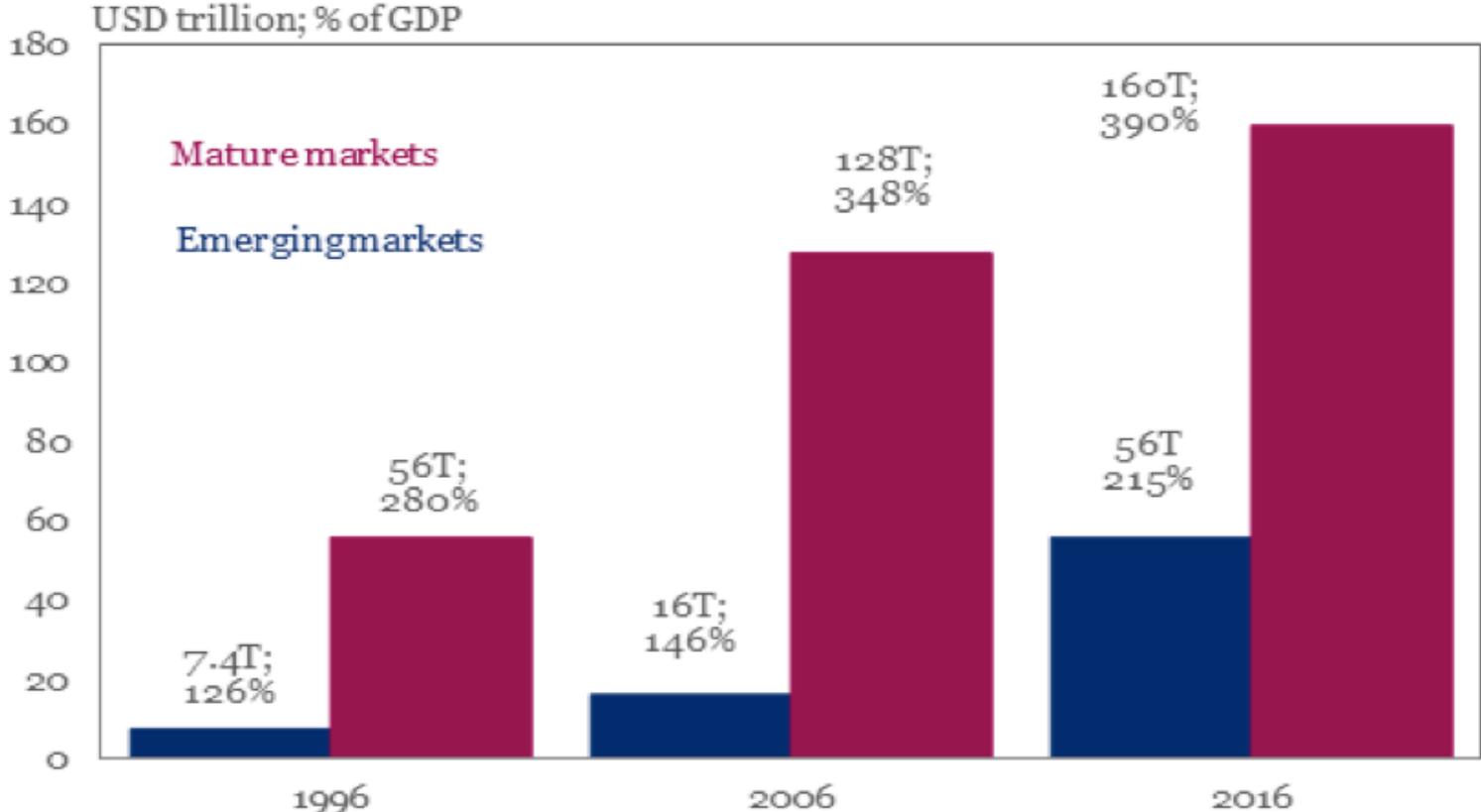
Why to Buy Gold

- ▶ Portfolio Diversification
- ▶ Economic and Geopolitical Crisis Hedge
- ▶ Cash Alternative
- ▶ Profitable investment with chance of strong relative outperformance



Macroeconomic Factors

Total Global Debt (all sectors)



Source: IIF, BIS, Haver.

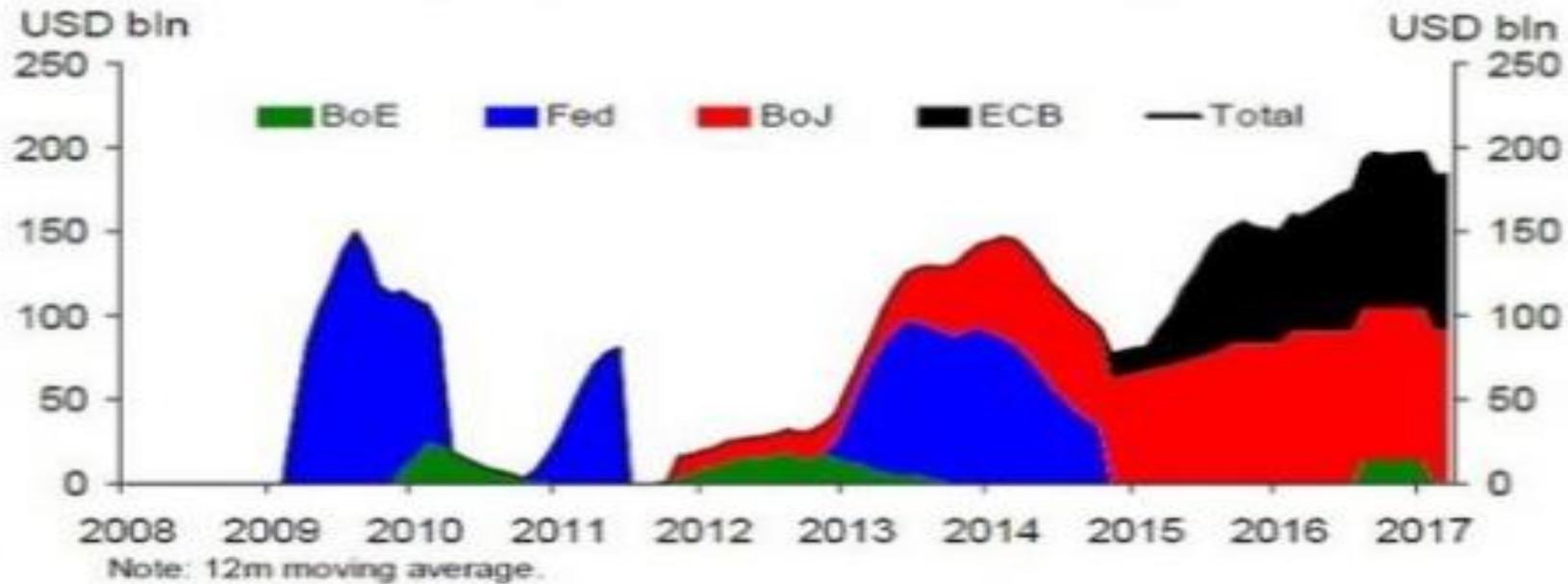


Monetary Factors

Still plenty of liquidity being added to markets:
ECB, BoJ, and BoE buying a combined \$200bn every month



Monthly Fed, ECB, BoE, and BoJ asset purchases



Source : DB Global Markets Research

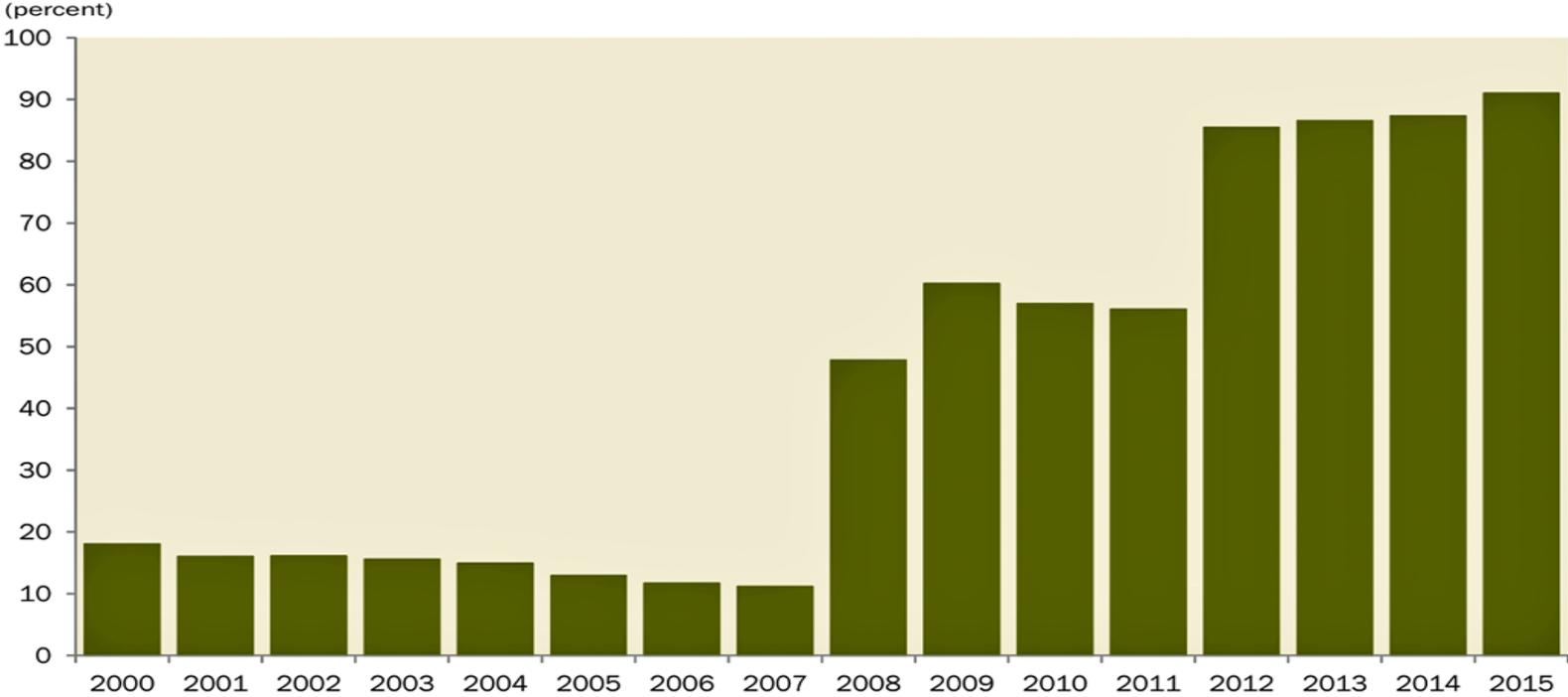


Monetary Factors

Markets  Chart of the Day

90% OF INDUSTRIALIZED WORLD ECONOMY IS ANCHORED BY ZERO RATES

World: Share of Industrialized Economies' GDP with Policy Rates Near or Below 0%

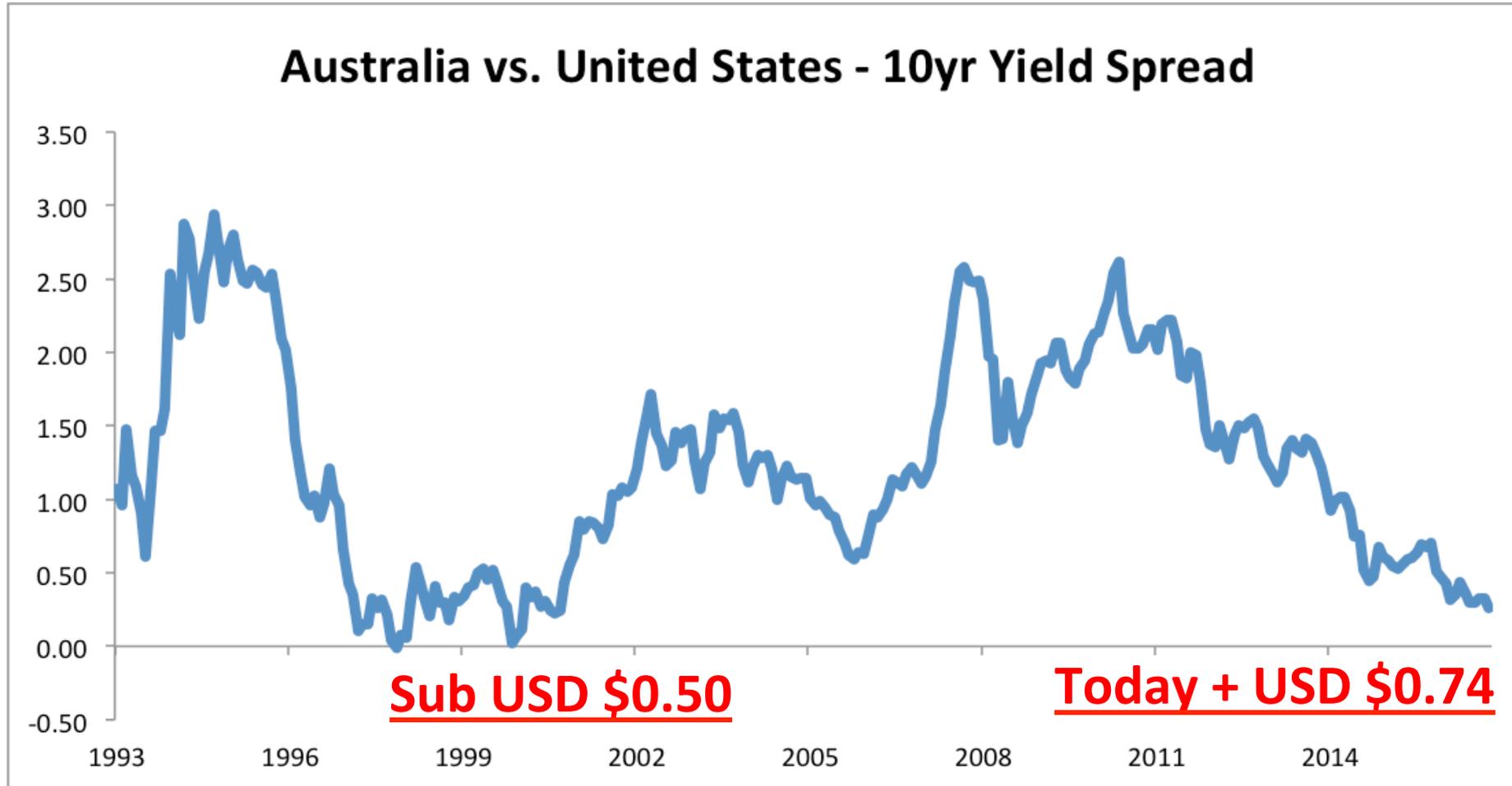


Notes:
Source: International Monetary Fund, Bloomberg, Haver Analytics, Gluskin Sheff

BUSINESS INSIDER



AUD: Heading back to USD \$0.50 ??



Market Factors – Fixed Income

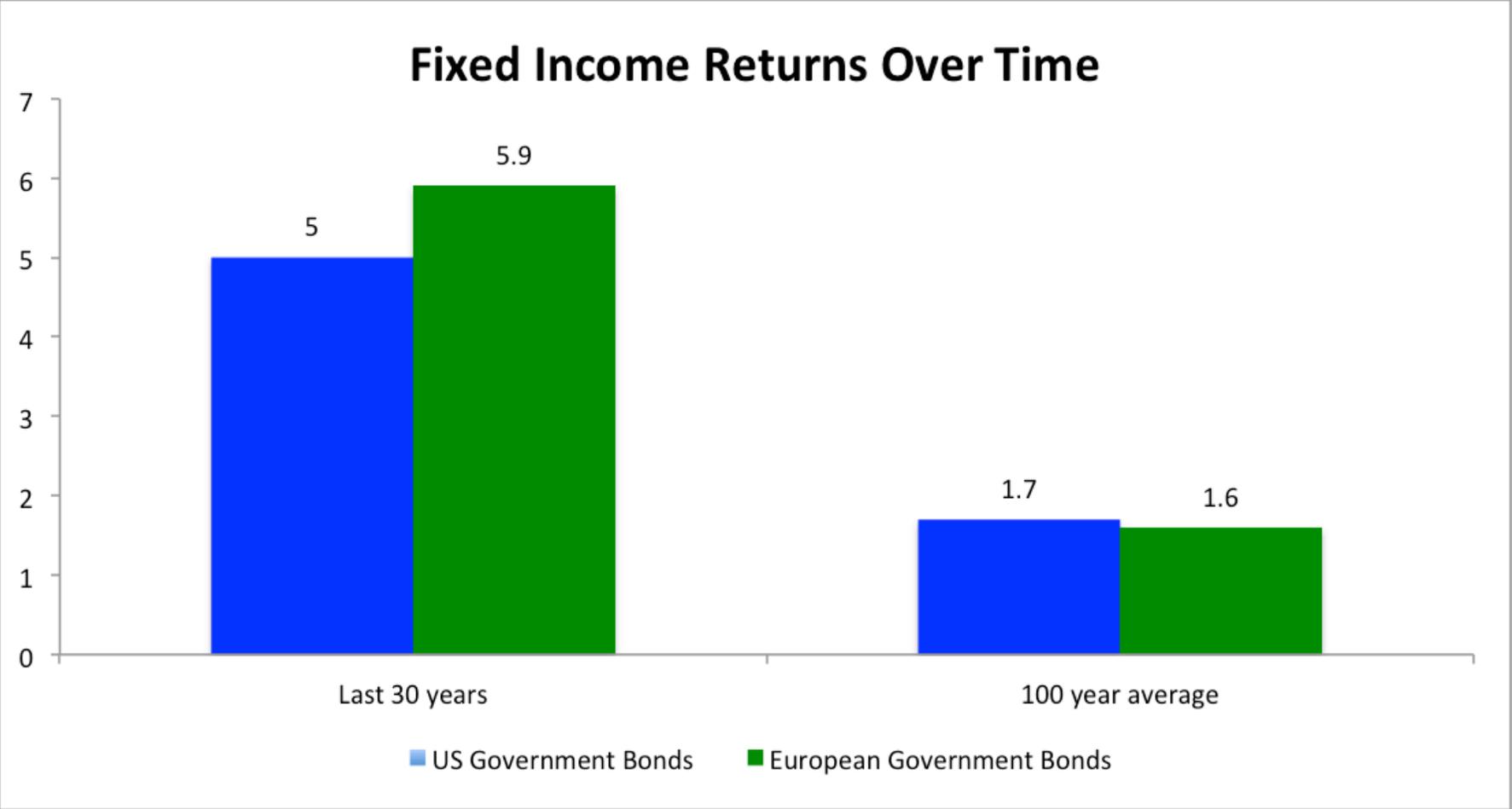
Chart I: Bloomberg Barclays Capital U.S. Agg Total Return Value Unhedged



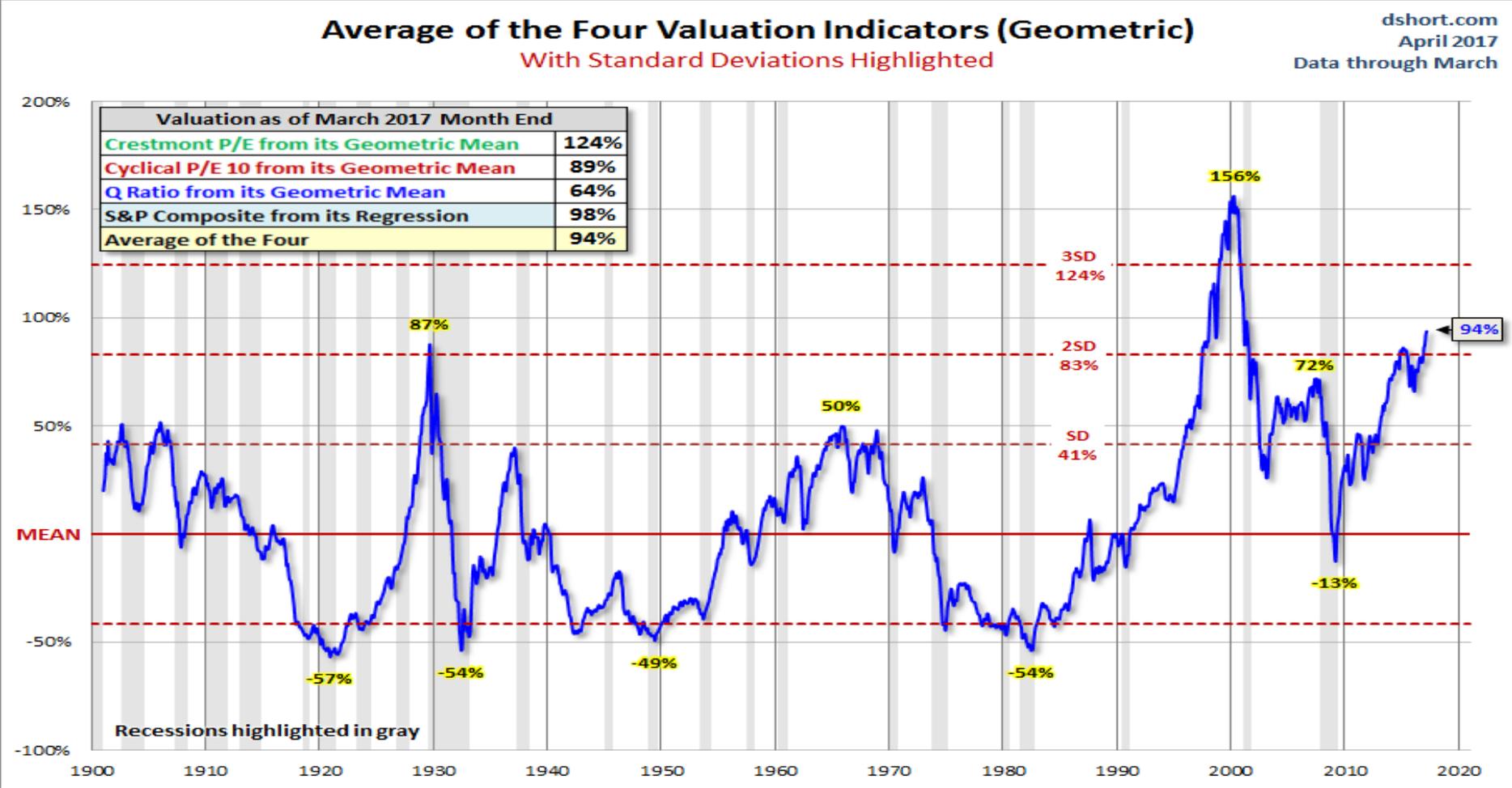
Source: Bloomberg



Market Factors – Fixed Income

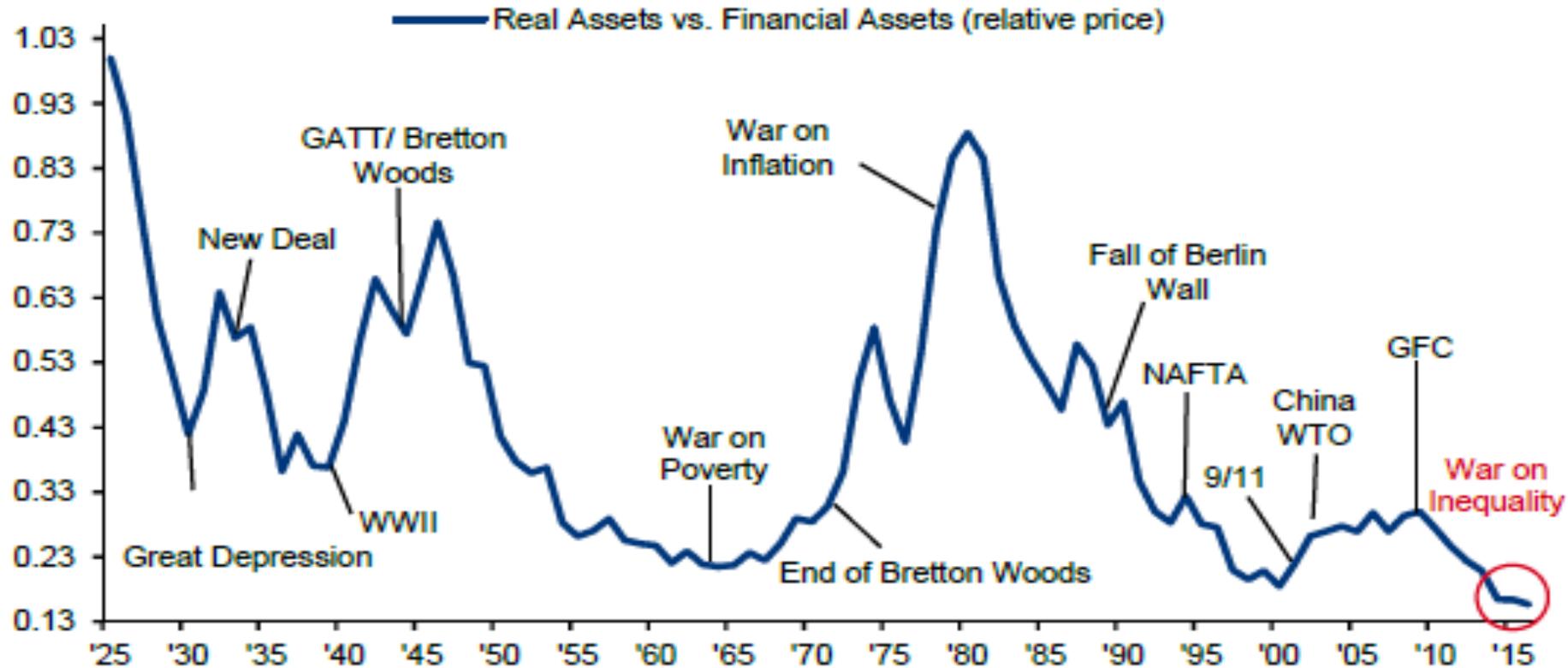


Market Factors - Equities



Market Factors – Real Assets are Cheap

Chart 1: Real Assets at all-time lows versus Financial Assets



Source: BofA Merrill Lynch Global Investment Strategy, Global Financial Data, Bloomberg, USDA, Savills, Shiller, ONS, Spaenjers, Historic Auto Group. Note: Real Assets (Commodities, Real Estate, Collectibles) vs. Financial Assets (Large Cap Stocks, Long-term Govt Bonds)

Why to Buy Gold

- ▶ Portfolio Diversification
- ▶ Economic and Geopolitical Crisis Hedge
- ▶ Cash Alternative
- ▶ Profitable investment with chance of strong relative outperformance



Find Out More

Jordan Eliseo:
Chief Economist

Mobile: 0422 734 988

Email: jordan.eliseo@abcbullion.com.au

Twitter: @JordanEliseo

John Feeney
Senior Sales Executive

Mobile: 0422 269 984

Email: john.feeney@abcbullion.com.au

Twitter: @JohnFeeney10

Nicholas Frappell
Global General Manager

Mobile: 0409 863 594

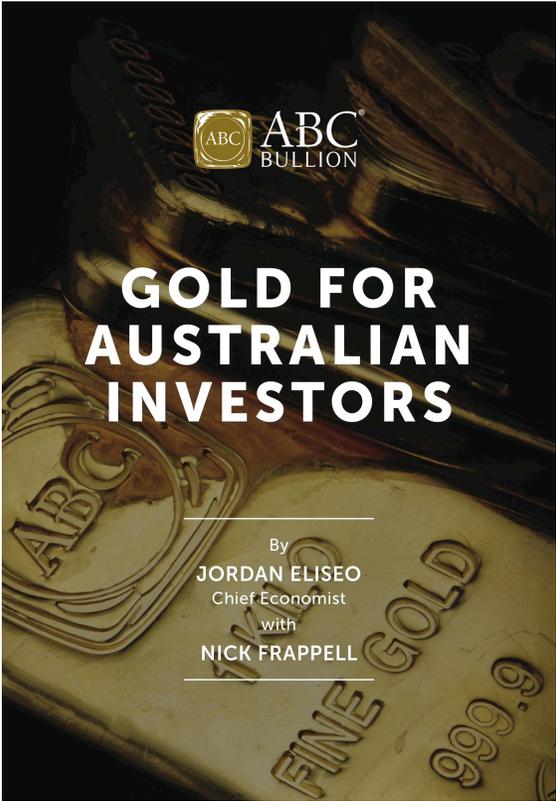
Email: nicholas.frappell@abcbullion.com.au

ABC Bullion Investor Centre

- Regular Market Updates
- Weekly Technical and Market Positioning Report
- Key Research Reports
- Annual SMSF Physical Bullion Guide
- Regular contributors to Financial Media



Find Out More



Disclaimer

This publication is for educational purposes only and should not be considered either general or personal advice. It does not consider any particular person's investment objectives, financial situation or needs. Accordingly, no recommendation (expressed or implied) or other information contained in this report should be acted upon without the appropriateness of that information having regard to those factors. You should assess whether or not the information contained herein is appropriate to your individual financial circumstances and goals before making an investment decision, or seek the help the of a licensed financial adviser. Performance is historical, performance may vary, and past performance is not necessarily indicative of future performance. Any prices, quotes, or statistics included have been obtained from sources deemed to be reliable, but we do not guarantee their accuracy or completeness.