

Glistening gold gives ETF investors protection against future inflation

The growing expectation that central banks will start to remove their stimulus packages is lifting the yellow metal, says Jessica Mead

EARLIER this week, gold powered through the psychologically important \$1,000 an ounce level, rising as high as \$1,007.45. December 2009 US gold futures rose to \$1,009.4 per ounce. The rise in interest in gold has also caused ripples in the world of exchange-traded commodities (ETCs), where gold ETCs have seen the biggest inflows this year of all exchange traded commodity products.

Providers are expecting more interest too, as the market is now targeting £1,032 and gold bugs are not alone in forecasting a rise to \$1,500 and beyond.

More and more ETF providers have recognised the potential of gold and a number have launched ETCs based on the yellow metal in the last few months. ETF provider Source launched an ETC backed by physical gold at the end of June, while Lyxor also launched its gold exchange-traded note (ETN) a few months ago.

Gold ETCs are either backed by government bonds or by physical gold and while there are slight differences in terms of capital gains tax, the performance of the two types is very similar and both are effectively trying to deliver gold exposure. Michael John Lytle at Source says that physical gold ETCs have addressed counterparty risk by giving investors a direct exposure to gold bullion.

So why have investors been flocking back to gold in recent weeks and pushing the price higher? Rather than investor uncertainty boosting the price of gold – although lingering fears about the sustainability of the recovery and the likelihood of a decent-sized correction in equity markets in the next month or so have played a part – its surge has been primarily caused by fears of future inflation as central banks unwind their monetary stimuli.

While such unwinding is not yet on the cards, the market is already pricing in rate hikes by the Reserve Bank of Australia and even by the Bank of England's Monetary Policy Committee as early as the first quarter of 2010.

Lytle says that monetary stimulus is estimated to have a delayed effect of about six months, which means that the expansionary stimulus could well be working its way through when the economy starts to pick up again. This would stoke inflation, he warns.

Dan Draper, global head of Lyxor ETFs, says that with all this government spending and stimulus in the economy, inflation is sure to make a comeback, and more and more investors will want to buy gold ETCs as a hedge against future increases in the price level.

Gold ETCs have a distinct advantage at the moment for investors looking to diversify their portfolios in that they are physically backed by either bonds or actual gold, meaning that you have collateral if the recovery goes pear-shaped, says Draper. And of course, if you are worried or uncomfortable with your position in a gold ETC, then you can simply sell it on the exchange at a competitive price.

While buying gold ETCs might seem like an obvious strategy at the moment, Dan Draper warns that if we experience a slower economic recovery and therefore don't get the spike in inflation that investors are anticipating, then that would be a disappointing scenario for gold.

But with a secular bull market developing in commodities and gold benefiting from fears of inflation, gold ETCs look sure to remain attractive in the near future for private investors looking to gain access to the precious metal for both speculation and hedging.



Gold is shining once again for ETF investors.

Picture: REUTERS



FIXED INCOME AND REGIONAL ETFs BOOMING

NIZAM HAMID

their allocations towards fixed income assets.

Over the last 18 months, UK and European investors have realised that having a diversified portfolio will pay off over the longer-term and have returned to the historical trend of giving a higher weighting to fixed income than they had previously done. As a result, assets in fixed income ETFs have jumped from €3.5bn four years ago to €32bn now. I actually think this could be a longer-term trend where risk-averse investors may remodel their portfolios to include fixed income ETFs which are cost efficient, transparent and liquid.