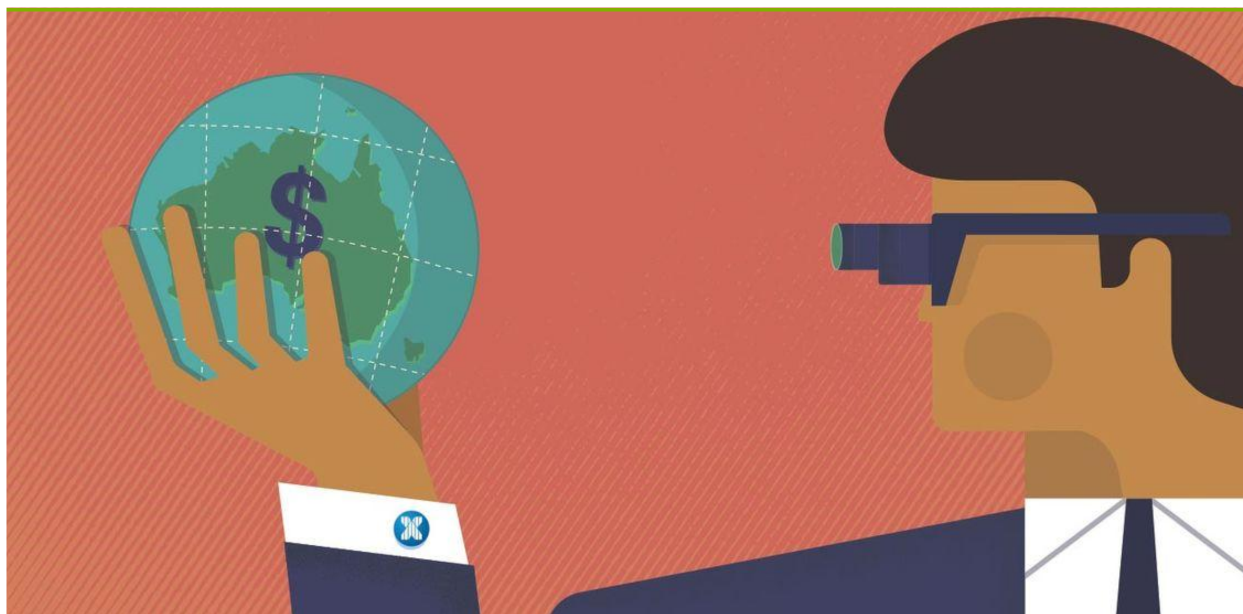
MiningJournal

Which gold is best?

Perth Mint's massive US$44 million, 1 tonne gold coin perched on the forecourt of the New York Stock Exchange (NYSE) graphically underscored how easily investors can access gold exposure without going near a mining investment.

John Robertson*



25 July 2019

Last week, the Perth Mint chief executive rang the closing bell on the NYSE floor to publicise the Mint's listed gold bullion fund. And, to make as big an impact as possible, the mint brought its spectacular big coin to the Big Apple.

The mint has added to a host of choices for investors looking for portfolio bullion exposure in a market that struggles for differentiation.

The World Gold Council (WGC) tracks 110 open-ended funds and ETFs holding 81.9 million ounces. Other unlisted and smaller funds are too numerous and private to count. Physical gold transformed into coins and medals, contributing to total private investment gold holdings approaching 1.3 billion ounces, are another physical investment medium.

Investors looking to gain exposure to gold, whether as a safeguard against financial Armageddon or as a portfolio risk-management tool, also have access to futures, options on futures and forward markets among the array of investment structures developed over many decades by financial institutions and bullion traders.

The Perth Mint, founded in 1899, refines 90% or more of the gold mined in Australia and stores precious metals valued at some $2.5 billion for clients. Prior to its New York listing in August 2018, the Mint had operated an ASX-listed gold fund with similar attributes since May 2003.

Despite its pedigree, the 94,351oz Perth Mint fund has made only modest progress. Worldwide investment-fund gold holdings have grown by 5Moz since the launch of the Perth ETF, according to the WGC, giving it less than 2% of the growth.

The mint is pinning its hopes for market share on two distinctive features. For a start, the Perth Mint investment comes with a government guarantee - at least for the cash equivalent of gold due. The state government of Western Australia stands behind the mint financially through an act of the state parliament.

A government guarantee should offer an extra layer of investor protection, though perhaps not in the minds of those who want to use gold as a bulwark against the failure of fiat currencies and the accompanying collapse of governments.

The best equity price response to higher gold prices is likely to occur in the aftermath of recession

The Perth Mint offering also allows investors to take physical delivery of as little as one troy ounce of gold. Each listed share is backed by one-hundredth of an ounce of gold sitting in the vaults of the mint in Western Australia.

Gold is being democratised. Investors can just as easily and cheaply buy gold as shares in any stock exchange-listed company. In the process, the investment competiveness of gold miners has been gravely eroded. No other industry finds its future so seriously imperilled by the popularity of its customers.

Gold miners also fail to meet the needs of investors in one important respect. Anyone buying an ounce of gold today will know they will have an ounce of gold in 10, 20 or 30 years. No-one buying a single gold stock today will know what they will own, if anything, over such long investment horizons.

Truly passive holdings in a constant portfolio of gold companies, or the buy and hold strategies urged on investors by company executives, are among the least effective ways for investors to replicate the portfolio benefits of bullion.

The complexity of the equity-price response to bullion price moves also works in favour of pure bullion holdings.

Between the start of 2000 and the end of June 2019, the 385% rise in the US dollar gold bullion price was accompanied by rises of 24% and 162% in the Philadelphia Gold/Silver Sector price index and NYSE Arca Gold Bugs index, respectively.

The ASX All Ordinaries gold index has risen 558% since 2000 while the Australian dollar equivalent gold price has gone up 352%. ASX index returns benefit from the periodic culling of struggling producers and their replacement with more quickly growing companies.

Gold equities are supposed to offer a leveraged response to higher gold prices. Earnings of marginally profitable gold companies gain disproportionately from gold price rises, underpinning disproportionate investment returns for any investor astute enough or sufficiently lucky to make the right choice.

The leverage to higher bullion prices is more clearly evident within short time frames. The average monthly response of the three share indices to a 1% gold price change has been 1.6% over the past two decades.

The US indices have been more sensitive to downside moves than higher bullion prices. The opposite has been true of the Australian index, which is an additional explanation for its outperformance.

The strongest equity price gains have occurred when they have been reinforced by macro trends at the time. Over the past 20 years, the US gold indices have risen by more than 30% in a month on five occasions. Generally, on these occasions, equity markets have been on the rise backed by loosened liquidity strings as recessionary conditions are overcome.

The best equity price response to higher gold prices is likely to occur in the aftermath of recession, with low or falling interest rates as the prospects for growth begin to improve.

In the absence of a post-recession bounce and with tightening liquidity conditions, the response of the price indices to monthly gold price variations since the start of 2018 has been very close to the longer-term averages.

The complexity of the gold miner investment decision, the uncertain connection with bullion prices, the enhanced practicality of bullion for everyday investors and the tumbling costs of bullion access are changing the competitive landscape for the gold miner.

**John Robertson is the chief investment strategist for PortfolioDirect, an Australia-based equity research and resource stock rating group. He has worked as a policy economist, business strategist and investment professional for nearly 30 years, after starting his career as a federal treasury economist in Canberra, Australia*