



Getting physical: inflation fears foment enthusiasm for gold bars and coins

Bar market

Safe-haven sentiment drives precious metals, but not all at the same speed or the same time

History never repeats itself exactly. While the Dow sank almost 90% from its 1929 high to its 1932 low, gold went nowhere. In those days, of course, the dollar price of bullion was fixed by executive fiat at \$20.67. But so many investors rushed to convert paper dollars into gold from September 1931 onwards that the stability of the financial system was threatened. On April 5, 1933, US President Franklin D. Roosevelt issued an executive order “forbidding the Hoarding of Gold Coin, Gold Bullion, and Gold Certificates”. Shortly after this so-called gold confiscation, the official price of gold was raised to \$35 an ounce, effectively devaluing the dollar by 41%.

Today, investors in a good number of countries can hoard as much bullion as they like, and many are making the most of this freedom. After starting the year at \$870, gold traded above \$1000 an ounce on February 20, not far from the record of \$1,030.80 hit in March 2008. With prices at this level, financial investors have crowded out jewellery buyers, a segment that appears to be wilting under the strain of high prices. While institutions favour physical holdings and metal accounts, private investors have piled into exchange-

traded funds. In February, inflows into gold ETFs exceeded the mine supply and more or less matched UBS estimates for total world demand for gold. ETFs now tower over the gold market like a colossus.

Private investors are also behind the soaring demand for coins. This reverses

Moving the metals

Every day, UBS ships gold, silver, and platinum group metals to clients all over the world from its precious metals vault. These physical capabilities underpin the bank’s metal account, custody and hedging services, as well as its metal deposit and leasing services. In addition, UBS offers a full range of precious metals-related forward, futures, options, swaps, and structured products. UBS is also one of a small number of universal banks to offer gold coins. In a recent *Risk magazine* survey, UBS was ranked top in gold options; gold forwards, averages, swaps to five years; silver spot; and silver forward, averages, swaps to five years.

the tendency in recent years for vrenelis and other specie to flow back to the refineries for sale and scrap. Limited availability has given prices an extra kick in this specialized market. The sudden popularity of coins reflects an enthusiasm for physical gold that is also manifested in a dramatic acceleration of gold bar sales.

Meanwhile, silver has lived up to its reputation as “the poor man’s gold”. Starting the year at \$11 per ounce, the metal rose to \$16.24 an ounce on June 3. However, its charms as a safe haven are limited by its bulk in bar form and its exposure to industrial consumption trends. When the bull market in bullion turns, these factors may cause silver to lose value faster than gold.

Industrial demand also haunts the outlook for platinum. Spooked by the sputtering auto industry, its price fell from \$2,276 per ounce in March 2008 to \$785 in November. For a time, this meant that platinum was trading at a discount to gold, an anomaly that past experience suggests cannot persist for long. Speculative demand has since boosted the metal to around \$1,250 (in early June). For the time being, though, platinum retains its somewhat commodity-like trading characteristics, which it shares with metals such as palladium.

Where next for precious metals? For those with industrial uses, it remains to be seen whether demand from financial investors will continue to outweigh sagging consumption in the real economy. Meanwhile, the dynamics of the gold market have moved into uncharted territory. Until recently, jewellery accounted for up to 80% of all gold demand, with industrial consumption, mainly electronics, taking another 10% and financial investors the remaining sliver.

Today, that market structure has been upended: investment demand for gold has more than replaced jewellery demand, while industrial consumption has shrivelled. Central banks too have rediscovered the yellow metal. In February, Russia and China announced that the proportion of gold in their official reserves had increased and would continue to do so. All this creates the potential for considerable volatility in either direction. Much depends on the outcome of the various initiatives to shore up the world’s financial system. The less the confidence that investors can muster in those efforts, the more they will revisit the historical playbooks for flights into safe-haven assets.

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