The Extraordinary Rise of ETF holdings in 2020

BY JOHN READE, CHIEF MARKET STRATEGIST, WORLD GOLD COUNCIL

One advantage that exchange traded funds (ETFs) bring to gold market watchers such as me is their transparency.

It's relatively easy to track gold held by ETFs: Bloomberg even has a robot that does this for a limited set of funds and then automatically writes a news story based on the calculation. At the World Gold Council, we also monitor gold-backed ETFs and similar products – which we refer to as gold ETFs for short – tracking flows for approximately 90 funds worldwide and providing data and tables on our website. We also write a comprehensive analysis of gold ETF flows each month. These can all be viewed at **https://www.gold.org/goldhub/data/global-gold-backed-etf-holdings-and-flows**.

Inflows into gold-backed ETFs have broken all records in 2020 with total holdings reaching an all-time high of **3,785t** at the end of July

This analysis shows that inflows into gold-backed ETFs have broken all records in 2020, with total holdings reaching an all-time high of 3,785t at the end of July, leaving the value of global assets under management standing at $239 billion. Global net inflows of 899t ($49.1 billion) in the year to July are considerably higher than the previous record annual totals and the trend of inflows has continued in the first few trading days of August as the price of gold has breached $2,000/oz.

To put these flows and holdings in perspective:

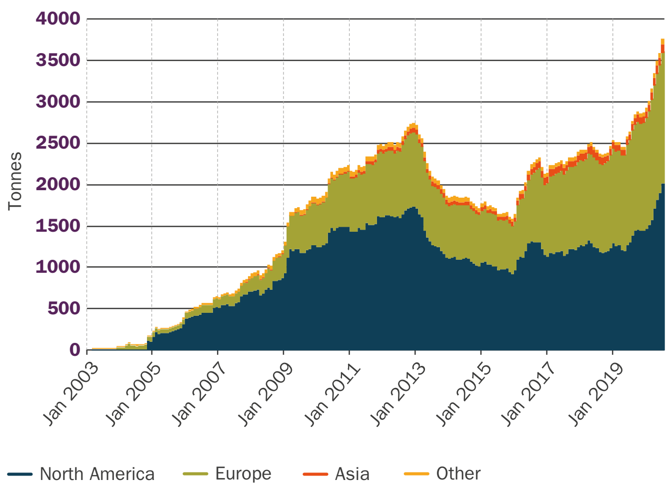
- ETFs now hold more gold than any one central bank barring the US Treasury.
- Inflows in 2020 have exceeded the record annual purchases by central banks seen in 2019 of 667t.
- ETF inflows in the first six months of the year were equivalent to about 40% of new mine supply.

Before we discuss these inflows in more detail, it's worth discussing the short history of physically-backed gold ETFs.

INFLOWS IN 2020 HAVE EXCEEDED THE RECORD ANNUAL PURCHASES BY CENTRAL BANKS SEEN IN 2019 OF 667t

Gold ETFs first came on the scene in 2003 with the listing of the first product by ETF Securities in Australia. ETFs grew steadily, both in the number of funds and in aggregate holdings, before being thrust into the limelight in 2009 when buying associated with the global financial crisis saw a surge of inflows. But once gold corrected from its then all-time high, heavy profit-taking saw holdings fall between 2013 and 2015, and gold-backed ETFs slipped from the headlines.

CHART 1: TOTAL GOLD HELD BY ETFs HOLDINGS



Sources: Bloomberg, Company Filings, ICE Benchmark Administration, World Gold Council

North American inflows outpacing European net purchases by more than 3:1

But investor interest hadn't gone, it was only sleeping: inflows into ETFs resumed in 2016, firstly into North American-listed products, but then European-listed funds saw strong inflows, becoming the main driver of net inflows, a trend that would continue until late 2019.

Only after the period of late March 2020 madness, which saw broad asset market weakness associated with the first palpable fears about the economic impact of COVID-19, did North American listed funds regain the lion's share of inflows. This has continued each month since March, with North American inflows outpacing European net purchases by more than 3:1.

SO WHAT'S CHANGED IN 2020?

We believe that there are two principal reasons why ETFs have seen such strong purchases in 2020, both connected to the coronavirus.

- As the global economy tipped into deep recession, falling bond yields – especially negative real US Treasuries' yields – have driven gold prices higher, encouraging investors to buy gold, sometimes via ETFs.
- The logistical issues that triggered the dislocation of the Comex gold futures market from the OTC market centred in London have reduced the attraction of investment on the Comex futures market, due to increased costs of ownership and higher premiums to the OTC price.

SOME INVESTORS WHO HAD HISTORICALLY OWNED GOLD VIA FUTURES HAVE SWITCHED POSITIONS INTO OTC HOLDINGS AND INTO ETFs

Anecdotally, some investors who had historically owned gold via futures have switched positions into OTC holdings and into ETFs. It is also possible that shortages of coins and small bars and/or the high premiums of these products have encouraged ETF buying instead.

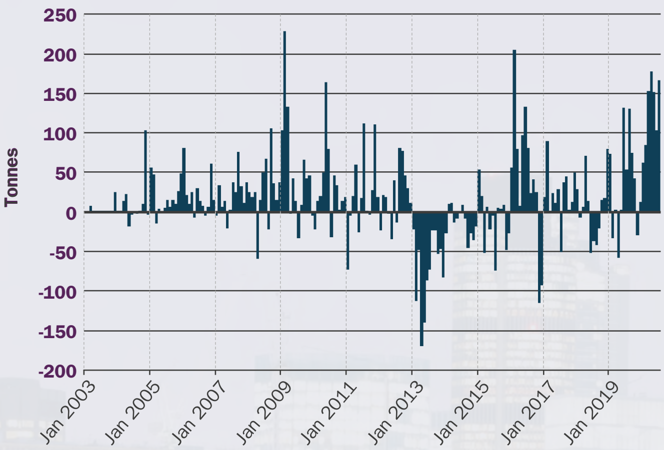
So, it's possible that a shift in the patterns of investment demand towards ETFs due to the logistical issues and the breakdown of the efficient connection of the OTC and Comex futures market may be exaggerating the impact of these strong ETF inflows.

WHERE'S ALL THE GOLD COME FROM?

We often get asked how it is possible for ETFs to see so much in the way of inflows, especially during periods when there are shortages of coins and small bars in some markets.

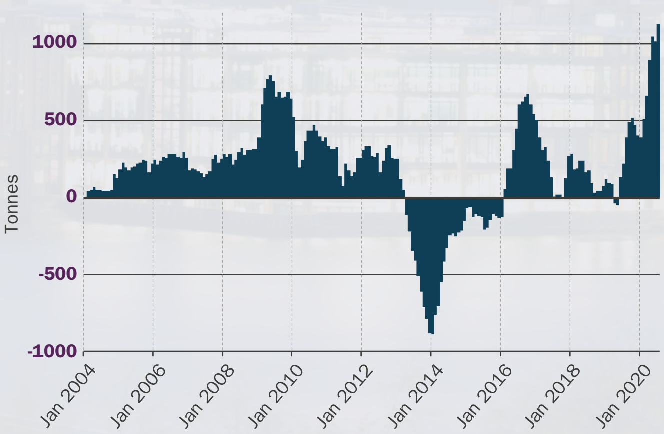
Firstly, I think it is important to differentiate between coins and bars in retail outlets and gold held in London, where most of the ETFs vault their gold, as London is the major centre of OTC market liquidity. It's much easier to get gold from refineries to London than it is to get small consignments of retail investment products to sales points around the world. According to comments from LBMA and from authorised participants we've spoken to, there has been no difficulty in getting gold to allow the ETF creations that have been seen this year, in spite of logistical challenges.

CHART 2: MONTHLY CHANGE IN ETF HOLDINGS



Sources: Bloomberg, Company Filings, ICE Benchmark Administration, World Gold Council

CHART 3: ROLLING 12M ETF FLOWS



Sources: Bloomberg, Company Filings, ICE Benchmark Administration, World Gold Council

Secondly, for all the strength in certain types of investment demand in Western markets, consumer demand for gold has fallen sharply in the first half of the year. In our Gold Demand Trends report for Q2 and H1 2020, published in late July, we reported that jewellery demand fell by 46% year on year to 572t "as markets remained in lockdown and consumers were deterred by the high price and a squeeze on disposable income". Total bar and coin demand fell 17% year on year, central bank buying slowed and technology demand fell 13% as "end-user demand for electronics collapsed". The weakness in demand from these sectors resulted in gold being available for the ETF creations we've discussed.

SOME INSTITUTIONAL-SIZED **ETF POSITIONS** MAY BE SWITCHED INTO ALLOCATED GOLD HOLDINGS

OUTLOOK

We recently published the Gold mid-year outlook 2020, which concluded that gold investment will likely offset weak consumption. Three of the four broad sets of economic drivers, namely:

- Risk & Uncertainty
- Opportunity Cost, and
- Momentum

should continue to support investment demand in 2020 and probably beyond.

The fourth gold demand driver, Economic Expansion, which is mainly a driver of consumer demand, will not support gold demand in 2020, although recovery in the global economy in the second half of 2020 and beyond may help consumer demand for gold be less weak.

If gold investment demand continues to be strong, will this result in continued strong ETF inflows? We think this is very likely, but not inevitable. If the linkage between the Comex futures market and the OTC market becomes more efficient, some ETF investors may migrate back to this market.

Also, based on conversations with investors, some institutional-sized ETF positions may be switched into allocated gold holdings, because for those permitted to invest in gold in this way, costs can be lower.

Gold-backed ETFs have hit the headlines for all the right reasons in 2020. It's unlikely that flows will stay permanently strong, but these products have demonstrated that allowing a broad spread of investors exposure to the gold price can support overall gold demand even if consumer demand collapses.

John Reade joined the World Gold Council in February 2017 as Chief Market Strategist. He is responsible for producing strategy and developing insights on the gold market; leading our global dialogue by engaging with leading economists, academics, policy makers, fund managers and investors on gold; and leading our research team.

John has over 30 years' experience in the gold industry and related fields, most recently as a partner and gold strategist with Paulson & Co for the past seven years. Prior to that, he worked as a precious metals strategist at UBS for 10 years; a gold equity analyst in South Africa for 5 years; and over 8 years held various positions in production and project evaluation in the gold division of Gencor, then a leading South African mining house.

John has a degree in Mining Engineering from the Royal School of Mines, a constituent of Imperial College, London.