South Africa Investors’ Approach to Precious Metals:
Are ETFs a Substitute For or a Hedge Against Mining Equities?

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I. Introduction
Thanks a lot. Good afternoon. My presentation is going to be the other side of the coin to
Charles’, because he was talking about investing in precious metals from a miner’s point of
view and I am going to talk about the same issue from the point of view of investors in ETFs.
My topic is the South African investors’ approach to precious metals, to investing in equities
or in ETFs and the trends there.

II. Outline
This slide gives you a synopsis of the whole thing.

III. South African ETF Space
I am not going to go into this slide in huge detail, but basically the South African ETF
industry is a relatively developed one for a market of this size. It has about 40 ETFs with
about US$5 billion in assets under management, so it is a standard story. However, when
you look at the composition per asset class, you will see that the two commodity ETFs,
NewGold and NewPlat, are basically over 50% of the total assets in ETFs. This shows that in
South Africa investment in commodities is extremely popular amongst investors, institutions
and retail investors. Obviously, there are several reasons for that, but just to give you a few
data points on the regulatory framework:

- In South Africa, only physically backed ETFs are allowed, so you cannot have
  swap-based ETFs.
- Our rules are slightly stricter than the UCITS rules.
- ETFs are generally structured as collective investment schemes or mutual funds.
- We also have a regime of exchange controls. There are limits on offshore assets and
  commodities are deemed to be offshore assets. NewGold and NewPlat are a bit of an
  exception and I will talk about that later.
- There are prudential limits that limit overall investments to different asset classes and of
  course there are limitations on commodities, so all that needs to be taken into account.

IV. South African Commodity ETFs
1. NewGold ETF
The first commodity ETF in South Africa was NewGold, which was listed in 2004; we were
the third to list a gold ETF globally after Australia and the UK. It is the largest ETF in
South Africa with $1.9 billion in assets under management and close to 42 tonnes of gold. We have been doing secondary listings of this product in various South African countries, such as Nigeria, Ghana, Botswana, Mauritius and we are going to continue to do that. It is a very popular product. It is the largest ETF in South Africa and Africa. However, when you compare it to the global ETF space it is tiny: it is 4% of, say, the US gold ETF.

2. NewPlat ETF
The NewPlat ETF is different. First of all, it was only listed in April this year and in a couple of months it has grown to be the second largest ETF in South Africa. On this slide it says 640,000 ounces; in fact, it is now 680,000 ounces and it is the largest platinum ETF globally. If you do the same exercise and compare it to the US ETF, you will see that the picture is completely different: it is bigger than that. Therefore, there is a bit of a bias in the South African investment space towards platinum as compared to gold.

One point that I also want to make is lots of people talk about gold ETFs and that there is a dramatic drop off in the assets. This has not been experienced in South Africa. There has been a relatively modest sell off and, in fact, there are lots of people who were buying at the dip. One of the things that we see in South Africa, therefore, is that there is a fundamental long-term holding horizon for institutional investors for commodity ETFs, for gold definitely; we will see we did not have enough time to observe the behaviour of the platinum ETF. It is interesting to note that South African investors are still relatively stable holders of the gold ETF.

V. Statistics
1. Global Platinum ETF Holdings
I am showing this slide just because it looks nice. It shows the global platinum ETF holdings from 2008 and there is a similar story here.

2. NewPlat ETF vs Other Platinum ETFs
This graph and the next one illustrate the rapidity of growth in the NewPlat ETF. We have been working on the platinum ETF for a while. There are obviously lots of regulatory obstacles to bringing such a product into the South African context. We knew from our discussions with institutional investors that there was a demand, but I do not think anybody expected that the growth of this product was going to be quite so rapid; you can see that compared to some other globally successful platinum ETFs. Thus, again, there is something about platinum and the South African investment market and I will make a few guesses as to what that is.

VI. Where is this Demand Coming From?
A question we ask is: who are the people who invest in these products? The answer is everybody. They are predominantly institutional investors. Obviously, we have quite a wide spread of investors for platinum, about 2,500, and a similar story holds true for NewGold. However, when you break it down into the size of holdings, you will see that basically 96.3%
hold in blocks more than 10,000 securities; 24% hold more than one million securities. Hence you are talking about a significant proportion being relatively large investors. In addition, less than 0.5% of the total number of the holders of NewPlat securities holds 25% of the assets. The holders of these ETFs are asset managers, pension funds and insurance companies.

I want to mention here something that is important for the ETF industry in South Africa. The reason why commodity ETFs are disproportionately popular compared to, say, equity or fixed income or other types of asset classes is that asset managers invest in these things because it is difficult for them to replicate it. It is very difficult to sell an equity ETF to an asset manager, because they could do it themselves and, possibly, do it better. For them, this is an asset that they can only access in this particular form.

VII. Some Questions

1. Why are Commodity ETFs so Popular in South Africa?

I have already started to discuss this. The reason is that they are difficult to replicate in other formats. In addition, because South Africa is a resource country, there is a history of holding commodity equities in the institutional space. Therefore, given the issues that have been mentioned with the mining sector, it gives institutional investors another tool, another way to diversify their holdings. They do not have to have all their assets with the miners; they can put some of that money in the ETF itself.

2. Why ETFs?

You can invest in commodities in various ways: in ETFs, in ETNs, you can invest directly into an ETF versus indirectly into mining equities.

VIII. Data Point 1

The story about ETFs versus, say, ETNs as a format is a relatively straightforward one and it is driven by structural and regulatory issues. First of all, as I mentioned, in South Africa we have an exchange control regime that limits investment in so-called offshore assets, which for institutional investors is up to 25%. Much of that money is taken out of the country and invested in global equities or fixed income or other types of investment. The South African exchange control regime deems all the investments tracking commodities to be foreign assets and subject to this, except NewGold and NewPlat. The reason why these two are exempt from that regime is because the regulators require the metal to be of South African origin, so it is not part of that regime. Obviously, there are other regulatory constraints:

- We have pension fund regulation that limits assets’ exposure to commodities overall to 10% and that can be either 10% to gold or 5% to platinum or any other asset.
- South African mutual funds can invest up to 10% commodity ETFs and ETNs, but only if they are physically backed, which basically excludes, in essence, ETNs from the picture.

Commodity ETNs are treated as foreign assets, so they are subject to that limitation. If they are futures-based, they are not allowed in CIS portfolios and obviously there is an issuer risk.
Therefore, from that point of view, for investors looking to invest in a commodity ETF or a commodity ETN the choice is relative simple: they would always invest in an ETF.

**IX. Data Point 2**

The second point – and we heard the same story with gold in the previous talk – is platinum equity versus the platinum itself. For the last couple of years we have seen quite a significant underperformance of platinum equities. I am not a platinum analyst, so I asked one of our analysts to give me a one-slide description of why that is happening and here it is. It looks quite complex, but it is really a simple story. Basically, on one side is the demand, which is relatively stable; you obviously have recycling of platinum from vehicles. There is a relatively stable demand and a relatively steady price on one side and you have quite significant cost inflation on the side of producers, which results in a significant margin squeeze and therefore equities are underperforming both the metal itself and the other low-cost producers. We do not know how the story will continue.

**X. Why is Platinum Equity Underperforming?**

There are two dynamics in play. One is the effect of substitution, what happens when people start selling off mining equities in order to invest in an ETF on one side. The other is what happens when the demand for the metal itself starts supporting the price or pushing the price up. That obviously has a positive impact on the companies’ performance, on the margins and, ultimately, on the share price. The jury is still out and I am not sure that the mining companies themselves are quite certain what to think about it. From our discussions with the mining companies, there is overall support for this product, because I think people realise that over the long run this is good for the mining industry.

**XI. Going Forward**

This is my last slide. I was asked about what happens next and about palladium. Obviously, that is the next one on the menu. The question is how big it is going to be. Is there a demand for yet another PGM ETF in the South African market? We will see. Is it going to be as big? Again, we will see. Just remember there is an overall 10% limit for all the commodity investments, so if people invest too much in gold and platinum there is not much room left for palladium. In addition, platinum is really a South African story. Most platinum comes from South Africa and it is not the same with palladium, so the understanding of the palladium versus the understanding of platinum is not on the same level.

What happens when the exchange controls are relaxed? That is, if you can invest anywhere, why invest in South African ETFs or ETNs? Then it becomes a cost game of how cheaply you can provide this product and how effectively you can market make it. Again, that is something that all the people who are in the market or want to get into the market need to think about.

That is the end of my presentation. Thank you.
John Reade

We have about 10 minutes for questions and I would like to thank most of you for sending your questions in. Some of them are quite amusing and you know who you are. I am going to try to go through one question each with each of the speakers and then we will keep going until we run out of time.