Introduction to Session Two: Investment

Katharine Pulvermacher

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The last few years have seen a quiet revolution in gold investment with flows into what we term identifiable gold investment increasing by 186% in tonnage terms since the beginning of 2003, quite a remarkable figure. That does not include investment in the sector as a whole, whether through gold mining equities or the majority of transactions conducted on the over the counter (OTC) market. The evidence suggests that the positive trends we have seen in investment in coins and small bars that grew by $5.9 billion last year and a further $1.5 billion in Q1 of 2006 alone, and in the gold ETS and similar instruments that attracted net inflows of 208 tonnes in 2005 and a further 129 tonnes to the end of May this year, have also been apparent in other forms of gold investment. The picture has not been uniform, however. Some countries still appear as net disinvestors in the statistics. Because of the nature of the information, it is not terribly clear whether this is in fact a trend of disinvestment or simply because the investors in those countries choose to invest in instruments for which it is hard to trace the geographical location.

Nonetheless, the trend has been overwhelmingly positive. Identifiable investment's "market share" of gold demand has risen from 9% of total gold demand in 2001 to 16% last year and once again that does not include OTC transactions. What lies behind this trend? Who is investing and how are they doing it? Most importantly, how long is the trend of growing investment demand likely to continue, and what is really driving it? To what extent have the inflows come from the short term, speculative end of the market? Most importantly for those of us on the marketing side seeking the holy grail of long term strategic holders, are they actually responding to our attempts to woo them?

Our panel of speakers will address many of these questions eloquently this morning. I will hand over to the first, Arun Assumall from Goldman Sachs. Arun has worked in European commodity investor sales for a number of years now and runs the desk in London. He has been active marketing to institutional investors in that space and, prior to joining Goldman Sachs in 2000, worked for Deutsche Bank, also in London. Arun holds a BA from Cambridge University.

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Next, we will hear from Cyrille Urfer, who has been working at Lombard Odier for a number of years, since 2002. Prior to that, he was at Credit Suisse. Most recently at Lombard Odier, he has set in place a manager research function that has been extremely successful and aroused a great deal of interest as a model. You will find what he has to say extremely interesting and quite a different viewpoint to Arun's.

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I would like to welcome our last speaker, Albert C Johnson III, who has quite a varied background in precious metals. I say varied because, unlike our other speakers, he has experience not just in investment but also in jewellery. Since 1995, Albert has been a broker at the Monex Deposit Company in California. Monex, as I am sure you are aware, is one of North America's largest and oldest retail precious metals houses. I would like to welcome Albert. His talk today is focusing on retail investment demand in North America. ■

Investing in Commodity Indices and Baskets

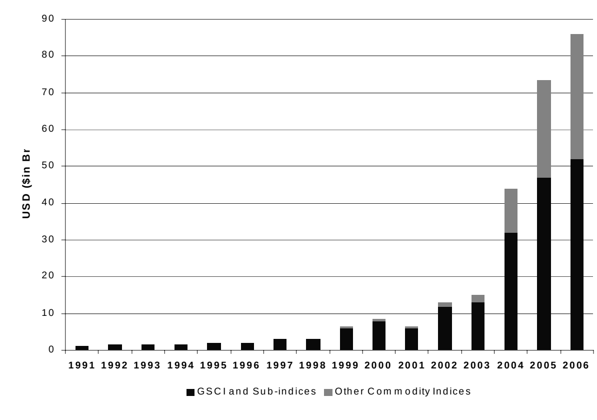
Arun Assumall

European Head of Investor Sales, Goldman Sachs International

Good morning and thank you for inviting me to speak today. Reluctantly, I must admit I am no expert on the gold market. Given that I speak to some of the largest commodity investors globally, this says quite a lot. I wish to express three main issues. 1. Over the last few years, we have seen both the amount of investment and the numbers of investors in gold increase, and my personal view is very bullish. 2. That said, I believe there are limitations to the amount of precious metals being bought by large institutional investors, due to the vehicles through which they are investing, which I shall address in due course. 3. The view that investor activity is responsible for driving commodity prices to their current levels is widely held by the press. I hope to provide you with the statistics to enable you to draw your own conclusion.

Prices are generally at record highs across the asset class, but investor interest has never been higher. If we consider the amount of money that currently tracks commodity indices, in 2001 there was just under $10 billion invested into the asset class. Today, we think this number is in excess of $90 billion.

Passive Commodity Linked Investment Activity: 1991 to 2006



Source: Goldman Sachs

* Investment in $ billions are estimates only. A very large percentage of the total commodity investment is over-the-counter and therefore can not be tracked precisely.

On top of that $90 billion we believe there is another $20-25 billion invested into non-indexed investments. While the total volume has grown, so have the types of vehicle that investors can invest in. In 2001, the investment was largely in the Goldman Sachs Commodity Index (GSCI). Today the GSCI is still a meaningful part at 65-70% of total index investment, but there has been growth in a number of other vehicles as well.

If we look at the composition of the GSCI, it is a production-weighted index. This means that it is largely weighted to energy and the amount of precious metals is very small. There is just under 2% gold in the index, which is in the region of $1.3 billion.

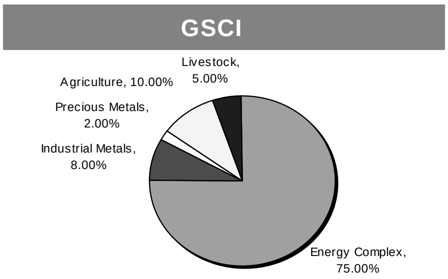
GSCI Composition (Percentage $ Weights on 31-Jan-06)

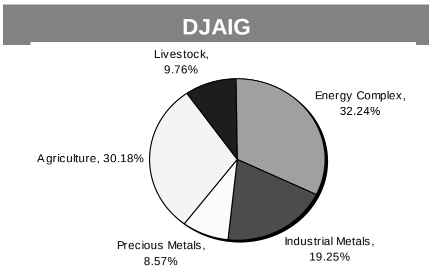
Energy		Livestock		Agriculture		Industrial Metals		Precious Metals	
Crude Oil	30.85%	Live Cattle	2.48%	Wheat	2.13%	Aluminum	3.12%	Gold	1.84%
Heating Oil	7.98%	Lean Hogs	1.40%	Corn	2.02%	Copper	2.83%	Silver	0.22%
Unleaded Gas	7.57%	Feeder Cattle	0.65%	Soybeans	1.42%	Zinc	0.80%		
Brent	14.34%			Kansas Wheat	0.85%	Nickel	0.65%		
Gasoil	4.30%			Cotton	0.90%	Lead	0.33%		
Natural Gas	10.34%			Sugar	2.07%				
				Coffee	0.72%				
				Cocoa	0.18%				
Total	**75.39%**	**Total**	**4.53%**	**Total**	**10.29%**	**Total**	**7.74%**	**Total**	**2.06%**

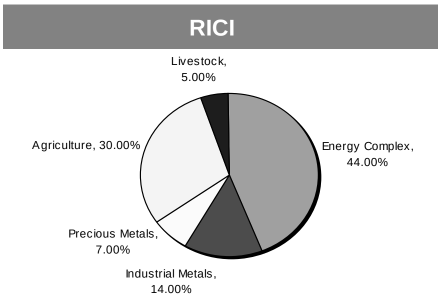
Year that Each Commodity Entered the GSCI

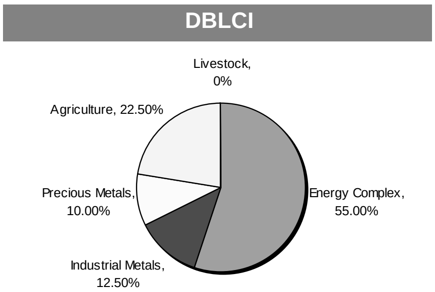
Energy		Livestock		Agriculture		Industrial Metals		Precious Metals	
Crude Oil	1987	Live Cattle	1970	Wheat	1970	Aluminum	1991	Gold	1978
Brent	1999	Lean Hogs	1976	Corn	1970	Copper	1977	Silver	1973
Natural Gas	1994	Feeder Cattle	2002	Cotton	1977	Zinc	1991		
Heating Oil	1983			Soybeans	1970	Nickel	1993		
Unl. Gasoline	1988			Sugar	1973	Lead	1994		
Gas Oil	1999			Kansas Wheat	1999				
				Coffee	1981				
				Cocoa	1984				

In the last few years, investing in commodities has become much broader than just investing in the GSCI. There are a number of alternative indices in the market. Their main theme is a lower energy weighting but there are also many more market makers in this type of underlying.









Source: Goldman Sachs

I think that the combination of more vehicles and more market makers has enabled the investor market to grow. If you take the remaining index money that is not in the GSCI and work out the relative amount of gold in these indices, you will see there is another $2.25 billion worth of gold invested, so in total when I look at the $90 billion investor money in the commodity market, I approximate that there is about $3.5 billion worth of gold going to the index investors.

On top of this are the non index baskets, but gold has been a relatively small percentage of these baskets, as I will show you. The $3.5 – 4 billion of gold being invested is a large, growing number, but compared to numbers in some of the other vehicles, this additional buying has been relatively small. There is $9 – 10 billion alone invested in the ETF, and when considering the amount of de-hedging in the last couple of years, in the region of $30 billion, you could argue that the incremental buying from investors has been relatively small.

The emergence of the non index investor market has been interesting. This includes vehicles like the ETF, the most significant by far for gold, but also baskets of outright commodities further down the curve. In addition to a large percentage of growth in the index money – which is money more or less invested at the very front end of commodity future curves – what we have seen is a significant amount of volume invested in the forward curves, the three- to five-year forward. This implies a couple of things for the precious metals market. Firstly, it has made available metals which have not ordinarily been in commodity indices, such as platinum and palladium, to the investor community. It also means a lot of investor money that has historically been at the front end of commodity curves is now moving further down the curve.

Who have we seen invest? Every asset-side investor has been taking a look at this asset class. Of the $110 billion in total in commodities, I would estimate that 80% of the volume comes from pension funds and insurance companies, institutional buy-and-hold strategic investors. The remaining $20 billion is quite evenly split amongst private banks, asset managers, high net worth individuals and retail.

You will read a lot of press that suggests this increased investment is a bubble and that the moment the market has a negative year we are going to see $110 billion of selling. We argue very strongly against this. When speaking to pension funds across the world, it is clear that commodities have emerged as a new asset class. There are very strong strategic reasons for holding commodities in a diversified portfolio. Over the long run, commodity returns are negatively correlated with financial assets, so over entire business cycles, the returns of commodities are approximately negative 20% correlated with bonds and equities. This means that putting 3-5% of commodities into a financial asset dominated portfolio goes a long way to increasing the overall returns and reducing the risk in that portfolio. Secondly, while there is no perfect hedge to inflation, studies have shown that commodities provide some effective hedge to rising inflation whether from a low or high base.

In light of regulatory changes and some extremely negative equity markets five or six years ago, there is a need for European institutions to diversify away from financial asset dominated portfolios. While we have seen a big growth in commodities, we have seen a similar growth in a number of alternative investment asset classes.

Over the next five to 10 years, the outlook for the asset class as a whole remains very bullish. Four or five years ago, when Jeff Currie, our Head of Global Commodity Research wrote his thesis “Revenge of the Old Economy”, he said that the lack of infrastructure across a number of the commodity markets required a sustained period of high prices. As very little has changed since he made that argument, we remain very positive about the outlook for the asset class over the next five, 10 and 15 years.

Finally, of the $110 billion invested in commodities, the amount of hedge fund investment is relatively low and the bulk of the investment is long-only and passive money Currently it takes a lot of persuasion for a pension fund to convince its board to invest in commodities. However, once commodities are accepted as an asset class – acknowledging that there will be volatility and years when the returns could be negative – it will take a lot for commodities or any other asset class to drop out of the benchmark. The average life of most of the structures investors are buying is three to five years in maturity. Our investor base is actively taking a very long-term view in the asset class.

This is quite relevant because it will give you some sense as to where investor money is having the biggest impact in the market. A common way of investing that has been very popular amongst European investors is buying a structure linked to the GSCI. Using this method, you buy an option on the GSCI and embed it into a structured note, so you are only exposed to the upside performance of the index and in the worst case scenario, even if commodities go to zero, you get your full principal back. In the case of a five-year bond where the participation to the upside is 110%, for every 1% the index goes up, you get 1.1%. Because a lot of the investments are option-based, the delta is not always 100%. For this structure, the delta will be around 50-55% but with respect to the impact of $100 million delta on the various commodities, what you see is 32 lots of COMEX gold, equivalent to $1 million for $100 million investment, so relatively small. Also, when one invests in an index, the underlying price exposure is to front month commodity prices. This is very much an investment into near-term prices as well as the returns from the monthly roll. With gold, this is not so relevant, but with some of the other commodities, this is investing at the very front end of the curve where I would argue the liquidity is by far the deepest across the curve. Even for something like energy, which is 75% of this investment, this volume is a very small percentage of the total open interest.

Structured Product Linked to the GSCI Indicative Terms

Indicative Terms	
Format	Bond
Currency	USD
Maturity	5 years
Issue Price	100%
Underlyer	GSCI Excess Return Index
Redemption Schedule	At maturity: 100% +Participation x Max (0, GSCI Performance)
Participation	110%
Strike	100% of Initial Level

Considerations
Underlying delta is hedged via front month futures contracts
Every $100mn of delta invested in the GSCI: ALM: 50 lots; CPL: 22 Lots; LED: 10 lots; NIK: 7 lots; ZIN: 13 lots; GLD: 32 lots; SLV: 4 lots
Option delta for this product would be around 50%

For illustrative purposes only. Pricing as of 1 Jun06

The other type of structure that has been very popular is options linked to baskets of metals. Here, the delta is much further down the curve. The example we have on the next page is a basket of copper, aluminium, silver and gold and the underlying delta is in all of the July 2011 contracts. One could argue that the liquidity is not as great five years forward as it is at the very front end, but generally, the commodities in which investors have been putting structures like this are the most liquid ones.

Why have investors been looking at participating in this type of investment? For many of these curves, excluding gold, there is a very heavy backwardation.

Structured Product Linked to a Basket of Metals

Indicative Terms	
Format	Bond
Currency	USD
Maturity	**5 years**
Issue Price	100%
Underlyer	Equally weighted between Copper, Aluminium, Gold, Silver
Redemption Schedule	At maturity: 100% + Participation x Max (0, Basket Performance)
Participation	250%
Strike	100% of Initial Level

Considerations
• Underlying delta is hedged via forwards (Jul 2011 exp)
• Option delta for this product would be around 25% ➔ Options are struck ATMS, which is deeply OTMF
• Pricing captures terms vol and backwardation in the fwd
• Investor also buying correlation between the basket components

For illustrative purposes only. Pricing as of 1 Jun06

This means that if you take the 2011 point, which is 30% or so lower than today's price, and strike the option at today's price at the money spot, you are buying a very cheap option. You can see in the participation to the option of 250% that this is reflected in the option price. As an investor, you are also buying long dated volatility and correlation between the four commodities.

In terms of where this market goes next, we have already seen the development of Enhanced Commodity Indices. The indices I have shown you so far are in the very front end of commodity forward curves. Given the current contango across a number of the markets, this can be expensive at times. Take energy for example, where there is currently a 2% monthly cost for the passive investor. As a result, a very strong theme in the market has been to look at enhanced indices that may mitigate the cost of contango by rolling further down the curve or other similar strategies. That means that a lot of investor money is now being shifted across the entire curve as opposed to historically being at the very front end. Over the last year, we have seen investor money come in across the curve which should smooth out any impact that investors are having on the market. Another enhancement is to change the window through which the index is rolled because presently, with so much volume being rolled through in the same period of time, the spreads during that period look as though they have been impacted slightly. Broadening or changing the roll window should even out the exposure across the curve and days of the month, and is something we are already seeing.

We expect the non GSCI and non index market to grow. ETFs away from gold have already been launched and this trend of providing commodity investors with access to non index products and single commodity products will become increasingly common as investors increasingly look to access new markets. Already we are seeing more investor activity in freight and power, plus ethanol is a quick and growing theme.

Investors have become more sophisticated. When we speak to our investors now, they look at volatilities and correlations in addition to the outright view they are taking. This means that we have seen the emergence of a whole new set of products where the investor may not even be taking a directional view on the asset class, but looking to trade correlation or volatilities of the underlying commodities. One of the speakers earlier mentioned that the average correlation of gold and some of the other commodities was 0.1 - 0.2%. Today, it might be as high as 0.5 - 0.7%. Showing that chart to an investor and allowing him to sell current correlation at very high levels relative to historical, yet taking an un-directional view on the market is becoming increasingly common amongst the more sophisticated investors and in time will feed down into others.

We have seen a very significant growth in the market in the last couple of years. However, we believe very strongly that this is only the start of the development of the investor market in commodities. We estimate there is $100 – 110 billion held by institutional investors. I do not know the exact number – I think it is higher than this – but someone earlier said that if every pension fund put 3% of their portfolio into commodities, that number would be closer to $500 billion. When I hear statistics like that and see the discussions I am having with my clients, it makes me feel strongly that this is only the beginning of the development of the investor market for commodities. ■

Gold Equity Fund Management

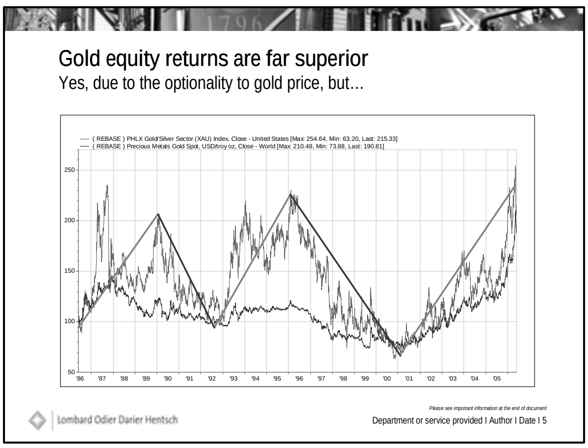
Cyrille Urfer

Head of Fund Research & Multi Management,
Lombard Odier Darier Hentsch & Cie

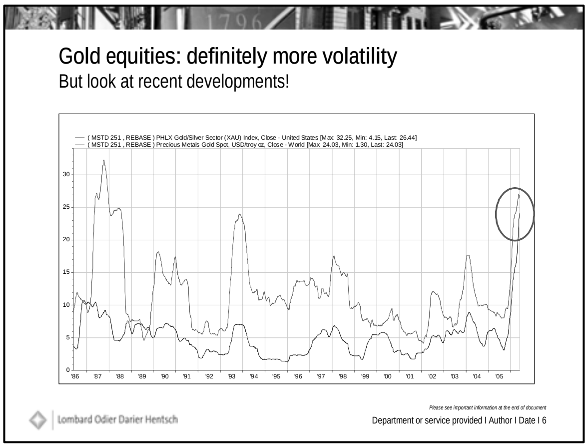
Thank you and good morning. My presentation will not address how to select gold stocks but how and with whom we and you should be exposed to this market. Like a geologist, we aim to detect ores and in our case, we are looking at the fund manager's skills. Like a developer, we aim to design solutions for our clients. As a manager, we have to allocate the wealth of our clients efficiently to generate above average returns. Since the decade long bear market of the 1990s, commodities as an asset class have been rediscovered by market participants including traders, speculators and more recently investors including institutional investors.

There has been a recent burst of euphoria. The old custom of keeping coins and bullion buried in the garden appears to have died out. The amazingly creative financial industry is recruiting new fans for investments such as structured derivatives of which we have seen some very clear examples in the previous presentation: ETFs, certificates, options and others. All of these products have eased access for most investors and encouraged others to join the party. The fund management industry has kept out of product creation and been active in offering new funds to investors, either in former specialised hedge funds or more common long only strategies.

There are differences between investing directly in gold and in gold equity. First, equities have a greater **return potential** than gold. This is what we are referring to when we talk about optionality to the gold price.

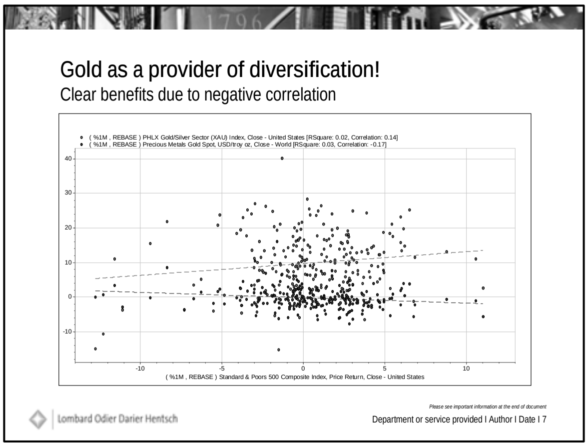


This attribute is very popular in bull markets, but works against investors in falling markets. It is worth noting that gold stocks have not reacted to the recent sharp uptrend in the way we might have expected. Are recent developments a sign sent by the market? I shall allow you your own answers there.



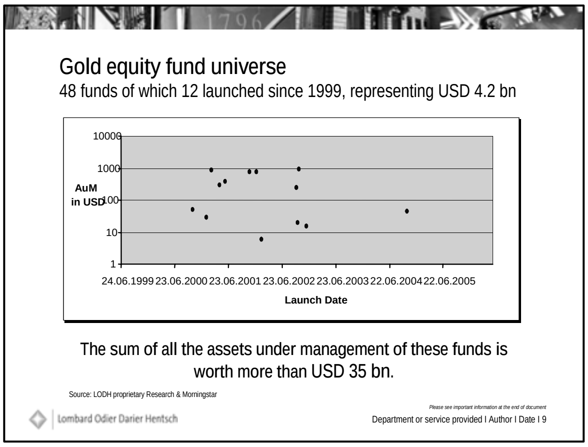
Secondly, gold stocks are indeed more **volatile** than gold. Again, recent developments are worrying, as gold has been as volatile as equity.

Some of the former speakers have mentioned the benefits of gold and gold equity in terms of **diversification**. It is not surprising that these two types of investments are providing diversification, as we can see in an analysis of the correlation of rolling gold stocks and gold price to an equity index, the S&P 500.

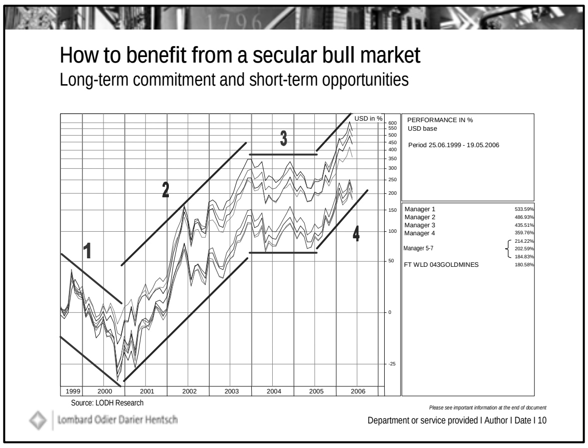


Again, the best provider of diversification remains physical gold. One explanation is the greater influence of financial market fluctuation as well as the impact of management decisions associated with any company.

We have looked at the different investment options and characteristics of gold stocks compared to gold. I would now like to turn to the mutual fund industry that all of us have access to as investors. Since the end of the bear market for gold price, at least 12 new long only mutual funds have been launched, expanding the universe by one third to a total availability to European investors of 48 funds. I refer only to the long only strategy and do not include the alternative and long short type of funds.

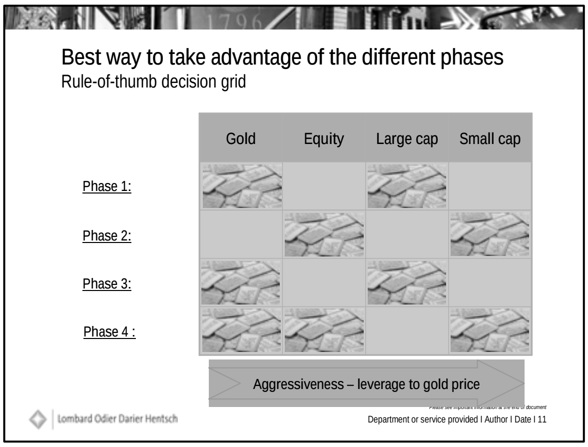


One question remains: does this greater depth also improve the breadth of this universe? With only 48 funds, are we able to get differentiated products to build an efficient portfolio? These two dimensions – breadth and depth – are indeed key factors when considering whether to invest in equity funds since they allow you to capture short and medium term opportunities that arise during a secular bull market. We have seen that the gold price and gold equity behaviour is volatile. That is a risk but also creates opportunity to add value in the long run.



Several decisions have to be made in order to capture this value. The first is to position your portfolio for that secular bull market. This structural alpha is crucial for the long term performance, as can be seen in the strikingly different performance between the index, the group of funds close to it which are index like managers and the best performer. I will discuss structural alpha later in my presentation.

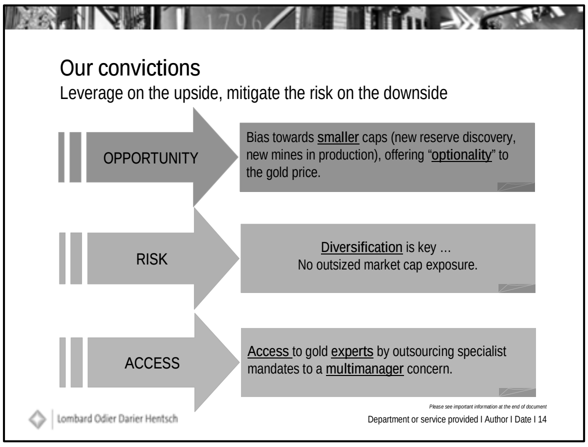
The second is to be nimble enough to allocate your wealth tactically to the most appropriate fund and managers. Different types of strategy are frequently associated with a specific part of the market: gold or equity, small cap or large cap, aggressive or defensive managers.



Different parts of the market perform well in different market phases. In phase one, gold and large cap equity companies perform the best. In phase two, equity out perform gold prices and small caps outperform the larger ones. During phase three, correction, gold prices are less volatile and protect your assets on the downside as well as the large cap types. Finally, the last phase we have experienced since the May correction was highly geared towards small cap exposure as well as gold. You saw earlier that gold has performed very well compared to equity during the last phase of that bull market. This means that as I stated earlier, each phase corresponds to a type of investment and therefore the managers have to be selected accordingly.

Our activity is not that far from that of the mining industry. The search for new properties, the exploitation and production of existing mines and the management of such companies require a strong commitment, proven processes and a great deal of experience. All of these attributes are what we are looking for year long when we select fund managers and manage multi manager portfolios.

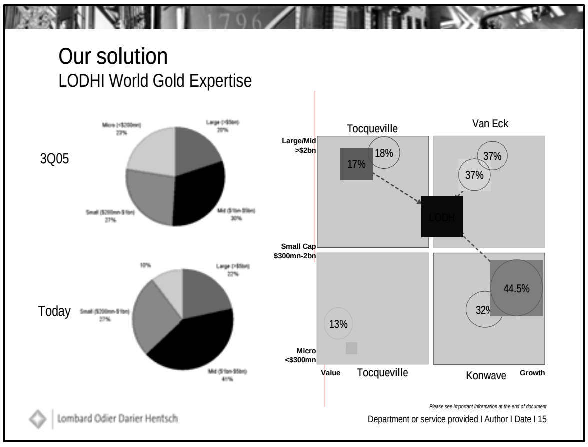
As a firm, we have identified the benefits – diversification – but also the growth potential of commodity prices, including gold. We have reintroduced gold and related commodities as specific asset classes within our private client asset allocation scheme. We then had to work out how to implement this decision. We instinctively and immediately recognised that we needed specialised managers to address this asset class.



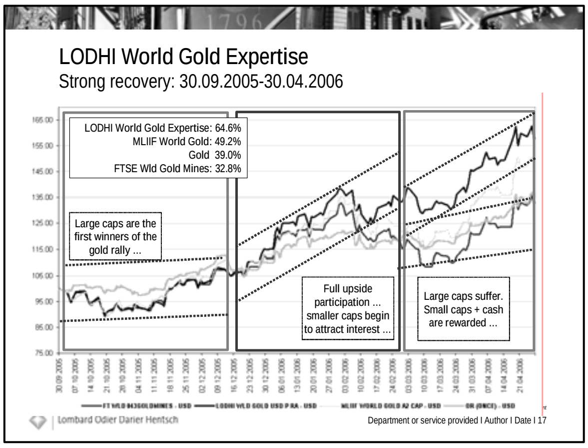
As we were convinced by the secular nature of the investment theme, we have designed our own investment vehicle based on the following convictions and features. First, leverage to the upside with a strong bias on small cap. This is what I referred to earlier as the structural alpha. We have mitigated the risk through a proper diversification and active management. Finally, we use best of breed managers in that field with segregated mandates but under one single fund and brand.

I asked a question regarding the depth and breadth of the gold fund universe. I have answered the depth part but not yet breadth. Do you really believe that the current universe of fund managers provide you with enough differentiating factors to adjust your portfolio and your allocation to the different managers to adjust the risk return parameters of your current exposure to the gold equity exposure?

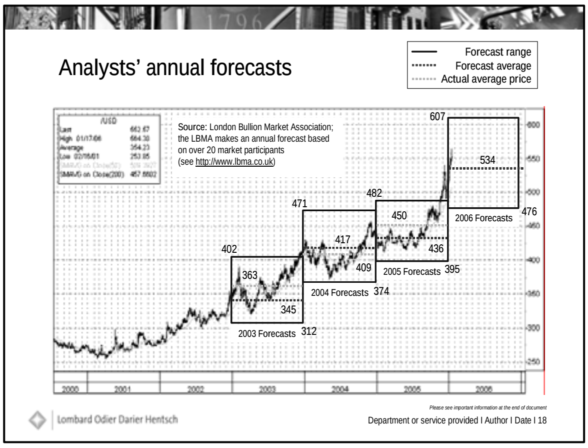
My answer is yes. Again, as for the mining industry, you need to know your managers and the competition in great detail and actively allocate between these different managers to adjust your portfolio according to your vision. We have changed the allocation between the three managers we have selected.



The three managers are managing four different strategies; one of them is managing both large cap and small cap portfolios. These different managers have different ways of managing money. Some are more geared towards growth characteristics; others are more geared to large and/or small caps. The combination of these managers provides diversification.



As an example, if I look at these different portfolios and holdings, a very small number of stocks are held in each of these manager's portfolios. Despite the tiny universe of stocks in the mining industries and markets, there is little overlap of stocks. For us this is a sign that you can find managers, portfolios and exposure that are highly differentiated.



To conclude, we believe that we are in a secular bull market, as does my colleague in the first presentation. We have positioned our portfolios to benefit from this market, but we are also aware that volatility will be part of the road to above average performance. We have mitigated that risk by diversifying our portfolios through different managers and different ways of selecting stocks in that universe.

Thank you very much. ■

Emerging Strength and Sentiment in the North American Retail Investment Gold Market

Albert C Johnston III

Precious Metals Broker

Ladies and Gentlemen: I am pleased and honoured to be here this afternoon. And I want to thank The London Bullion Market Association for this opportunity to share my observations as a retail broker of physical gold in the United States. I'm unable to offer you the formal argument and consistent formulas of an economist. But you know what they say about economists: "they can supply it on demand." But as a businessman, with day-to-day experience in the precious metals trenches, I can identify for you a conspicuous market pulse – a pulse which I have every confidence will be recognisable to you in the form of a robust market trend over the next several years.

Accordingly, I am also pleased to report that, after years of having been treated as the bastard child of America's investment community, gold is finding its way back to the American investor's home and – would you believe – through the front door.

It has not been an easy trip. For many years, gold has had to assert itself as a contender against America's two favorite financial children – the equities market and the real estate market. But as Sir Winston Churchill once observed:, "Americans always try to do the right thing – after they've tried everything else."

The special emphasis here though is on physical gold – not gold funds, options, futures or mining stocks, or for that matter, the new kid on the block known as the ETF. Sir Winston's observation notwithstanding, the song "Let's Get Physical" is really a very old one in America.

America's love affair with gold officially began with the great Gold Rushes in America from 1848 to 1899. This was the mania that built America's western cities, financed its railroads and put California on the map. The determination to accumulate was evident early on, as men who left their wives and children to go west and mine gold promised they'd return months or even years later with "a pocket full of rocks."

In 1929, a world-wide depression hit the United States and got in the way of most individual investment; then on April 5, 1933, President Franklin Roosevelt invoked his authority to make it unlawful to own or hold gold coins, gold bullion or gold certificates. On August 15, 1971, President Nixon unhinged the official link between gold and the US dollar, and the American investor later became legally free to own gold on January 1, 1975.

This is all familiar history to you. But I mention it here only to emphasise that the desire for the individual investor in America to own gold has never been totally lacking. It's simply been inhibited. And if that desire was inhibited by law between the era spanning the Roosevelt and Nixon administrations, it's been inhibited by gold's arch-competitors in the United States since then: the equities and real estate markets.

Since World War II, the American investor has become accustomed to a threefold partitioning of his personal finances: a) home ownership b) a bank account and c) a stock portfolio. For this seemingly steadfast investor, most other investments – certificates of deposit, bonds, mutual funds, pension funds and other types of retirement accounts, real estate investment trusts – have simply amounted to variations on the same themes.

Understandably, except for a minority of safe-haven and survivalist – or more properly, apocalyptic – investors, the United States' affinity for gold accumulation has been inconsistent and episodic. Unlike Europeans, we lack the well-reinforced memory of foreign invasions, worthless currencies and severely injured, if not wiped-out, economies. Enter 9/11.

My broker colleagues and I have noticed – not a sea change – but certainly a marked difference in investor awareness and interest in gold since the tragic events of 9/11, especially since investors had confirmation of gold's probable upside five months before that time. We began staying after hours to work with investors who began calling us to ask: what will become of that sacred cow, the American dollar, and, why is America beginning to export its jobs?

And frankly, my colleagues and I at first agonized over gold buying through ETFs. Would ETF investments obviate the need for holding physical gold? Our experience reveals a surprisingly different scenario. ETFs have stimulated in the investor's thinking an awareness of the importance of holding some physical metals. So too with mining stocks. Owners of mining stocks have begun to look at the possession of physicals – coins and bars – as an important piece of the puzzle.

Who, then, are these new American gold investors? Are they physicians and lawyers and other professionals? A few. Are they stock market investors? Most often – yes. Are they high net-worth individuals? Almost always.

Now consider that, as recently as 2003, the number of millionaires in the United States surged 14%, according to a survey released by Merrill Lynch and Capgemini. One in one hundred twenty-five people in the United States is a millionaire.

And the profile of my frequent late-evening callers, male and female alike, is very much like that of the millionaire portrayed in the best-selling book, *The Millionaire Next Door*, by Thomas J. Straley and William D. Danker: "married, three children, self-employed in fields often seen as 'dull/normal': welding contractors, auctioneers, rice farmers, owners of mobile home parks, pest controllers and paving contractors."

To further flesh out his portrait, we should note that this Johnny-come-lately gold investor is still reluctant to make substantial foreign investments, yet drives a Japanese or German car, is very anxious about escalating oil prices and interest rates, is troubled about the plummeting value of the American dollar, and is extremely sceptical about the curative ability of his or anyone else's government.

Typically, and depending on his net worth, he enters the gold market for a first-time purchase at one of three levels: a) from 50 to 150 oz b) from 150-500 oz. or c) 500 oz–plus. He invariably makes his initial investment/purchase in the form of coins for direct delivery. Had he been a first-time buyer, say, in 1996 or 1997, he would have entered the market for at least one third of his present gold purchase, if at all. And he would have spent much more time on the phone deliberating about the smaller purchase.

Ordinarily, I wouldn't have heard from a 1997 or 1998 first-time buyer again for at least another eighteen months. Now I will hear from him again for repeat purchases in two or three months. On subsequent purchases, he is more likely to buy kilo bars or 400-oz bars for depository storage instead of delivery. One in five 1997 buyers referred one new buyer to me. Now, two out of three buyers are each referring, on average, three to five additional new buyers.

My colleagues in retail dealers throughout North America are telling me that their volumes are up between 50-100%- plus…

These reports, of course, as well as this account of my own business, mainly represent secondary market activity – rumblings in the volcano before eruption – and, as such, fly in the face of official US Mint figures of new coin sales, which over the last several years have been relatively flat. Also, as the new gold buyer becomes more knowledgeable and sophisticated, he is taking advantage of the sell-back opportunities accorded him by market volatility. Such activity is more problematic to nail down in terms of a traceable market trend, but it is significant because it resides at the very heart of two-way trading.

The internet has been a boon to the retail precious metals business. A well designed website warms up, conditions and educates the gold investor/purchaser and renders him more able to negotiate by phone with a broker in a live market. It has broken down many of the geographic barriers of doing business. As we move to the next phase of a bull market, it's not difficult to foresee a public which will prefer the privacy and efficiency of an internet transaction over a visit to a coin shop or bank that will be ill-equipped to handle volume gold purchases in a rapidly moving market. Three years ago, we converted one out of five internet gold inquiries into a final sale. Now we convert one out of two. The internet client is confident, poised, determined and reliable. Amazon.gold, anybody?

As the cycle of the retail gold business goes, there seem to be three stages in a bull market. There is a primary accumulation stage when the price of the yellow metal seems to have bottomed out and only the stalwart, the cranky or the over-analytical buyer seems to want it. There's a "catch-on" stage when most investors seem to "get it" and begin diverting a pre-set percentage of their portfolios into physical gold. That's where we seem to be at this particular juncture.

And lastly, there is the stage when the general public begins swarming into the market. As I look around the room, I know that there are many of you here who remember when gold soared from $381 on November 1, 1979 to $850 on January 21, 1980, and when, as a result, the greatest wave of buying followed in the four weeks between Christmas, 1979 and that January 21, 1980 high.

Will gold soon test or surpass its 1980 high? That's not for me to say. I'm neither a commodities analyst nor an economist. But I do feel certain in asserting that there will always be a market for physical gold. A colleague of mine in this business used to have a special technique for dealing with a difficult person who would phone in just to say that, in his opinion, gold has no value.

Can you imagine that: "gold has no value?"

My friend would pause and then ask his caller: "Are you wearing a wedding ring?"

And if he'd get a yes, my friend would then ask the caller "would you like to sell your wedding ring?" My friend fielded hundreds of such calls. And you'll be pleased to hear that he received not one taker on his offer to buy a wedding ring. No one will accuse you of being cynical, I'm sure, if you conclude that my friend's failure to get an offer to sell a wedding ring has more to do with the durability of gold than the durability of modern marriage.

Again, there will always be a market for physical gold. Investors, to be sure, will thrive on gold futures and options and now the gold ETFs. But they will always buy physical gold. They will buy it because they're wise, because they're greedy, because they're afraid, because they're exorbitant, because they're generous, because…well…George Bernard Shaw put it best:

"You have to choose between trusting to the natural stability of gold and the natural stability of the honesty and intelligence of the members of the government. And due respect to these gentlemen, I advise you, as long as the capitalist system lasts, to vote for gold."

Ladies and gentlemen, it's been my pleasure. Thank you very much. Now I'd be pleased to address any nagging questions or thoughts which you may be entertaining. ■

Session 2: Investment

Questions and Answers

Katherine Pulvermacher: We have about 10 minutes for questions and answers. Please remember to state your name and where you are from.

Jim Steele, HSBC: Albert, we were very used to retail buyers of gold being over 50. Part of the reason for gold going down and the lack of retail activity in the 1990s seemed to be a generational issue, that people under the age of 50, and particularly under 40, were not keen on buying gold. In this latest pick up in retail activity, have you seen any generational change, or is it still primarily older buyers? Are younger investors getting interested in the market now?

A – Albert C Johnson III: You are very right because you are talking about a lot of people who were what we call 'gold bugs', who are over 50. Those people from the 1980 era that saw the $850 gold price are older, and some are gone by now. We have a whole new generation. The range can run from a very young person all the way up to an old person, and there is a tremendous amount of interest in people aged between 30 and 50.

Q – Kamal Naqvi, Barclays: I have a question for the panel. A number of you mentioned, through your speeches, that portfolio diversification and negative correlation with other asset classes was a major push for commodities, and gold in particular. Over the last few weeks we have seen a marked correction in share markets in market bonds and bonds more generally, and of course commodities. Does that not significantly weaken your argument?

A – Arun Assumall: When we look at commodities and the correlation with other asset classes, historically we have looked at it across entire business cycles. I think with respect to whether that argument has changed, in two or three years you will find out. If you look back in time, there are definitely times when the correlation between commodities and financial assets has been positive. There have been times when it has been negative by 70% or 80%. The point that we make is that across the entire business cycle, they tend to be correlated negatively by 20%. I think when we see times when this correlation changes, as we have seen in the past, it is not something that makes us question whether or not this feature exists with the asset class. If in three or four years time we have seen a consistent positive correlation, then yes, maybe we will need to revisit it.

A – Katherine Pulvermacher: I can just add that I think correlations are not some magic number. They exist for a reason, or they do not exist for a reason. It is important to understand the drivers behind each market. Has what drives commodity prices become the same as what drives other financial assets? If it has, then you would expect the correlations to increase. But if it has not, and if what, for instance, drives gold demand, is still different from what drives the S&P 500, then you would expect that to be a very short-lived phenomenon.

Q – Nicholas Kitikiti, Fidelity Printers and Refiners: My question has more to do with the speakers that have spoken about the current bull wave in gold being driven by investment demand. My question is what is the limit of that appetite for gold investment? Are we looking at a future where the volatility of the price of gold is going to be driven much by changes in investor perceptions?

Katherine Pulvermacher: The question really has two parts: first, is there a limit of the growth in investment demand that we have been seeing, and second, to what extent that has impacted the volatility of the gold price.

A – Cyrille Urfer: Most of us alluded to greater and greater market participation, especially on the investor side. Of course that will drive the volatility higher, and I think we have tried to demonstrate that where you see that gold price volatility has increased substantially, and is at levels that we have probably not seen over the last decade, it is very close to what you can find in equity markets. I think it is mainly related to the growth of different products that can really give access to a much wider range of investors. This includes not only investors but traders who can really hedge their positions and also speculate like some alternative types of investors. That means probably yes, volatility will continue to rise and will remain quite high in that respect.

The interest for investment demand is in most cases driven by the behaviour of the asset classes. We have mentioned diversification and lack of correlation. I think today the only reason to invest in gold and commodities is related to the lack of correlation. It is probably not a sufficient argument to really increase or to create an exposure to that asset class as a new portfolio, because at the end of 1998 and 1999, the lack of correlation was already something that you could have seen and found in alternative types of strategies, such as commodities as well as real estate. Right now private investors are looking at what has happened and, during the last two or three years, performance has really triggered most of the interest.

I think for us, of course, correlation and diversification are important. But it is not only looking at the numbers that is important, but also looking at the fundamentals that can explain this lack of correlation and behaviour of such asset classes versus more traditional financial asset classes. This means that, again, a lot of clients and investors – these could be high net worth individuals – will definitely take the benefit of all the different products and easy access to such investment to be exposed to this asset classes in their portfolios. This basically means that we will see much more demand on the investment side as we have alluded to from private high net worth individuals and institutionals. This might to some extent create a more prolonged bull market, but as I said earlier, the fact that you have more short-term types of market participants will increase volatility.

Q – Niall Ferguson: Excuse me if I abuse my position on the platform to ask the last pre-prandial question. As I listened to the speakers I was musing on the old Rothschild strategy of diversification, which was essentially a third in securities or cash, a third in land, and a third in art. It strikes me that given the scarcity of gold and the way in which it is bought and sold – particularly I am thinking here of India – that we might do well to look at gold rather as part of the art market then as part of a wider commodities market. Nobody has mentioned art, but there has been some very good work on art markets at New York University by some of my former colleagues there. I wondered if any of the experts on the panel wanted to comment on that, whether we are making a categorical error in thinking of gold as a metal rather than a stuff of which art is made.

Katherine Pulvermacher: Maybe, Albert, you would like to answer that question, with your varied experience?

A – Albert C Johnson III: An artistic question – I am not sure if I really know how to answer that. There are certain investors that are accumulating just to hold, as people do in the art world, who happen to have an addiction to it. I could correlate it in that realm, but anything beyond it, I do not know.

A – Andreas Maag, UBS: We do have a similarity to trading in art – I would consider the customers who are putting gold into a segregated holding for years to come. It is similar to buying pictures you are going to put aside for years. You are not buying for resale; it is something you like and want to look at, or you just want to have. I think you can compare this to those customers who are going to keep gold as a last resort, really in a segregated place, in a vault.

Katherine Pulvermacher: We are out of time now. If you have further questions, please feel free to ask the people on the panel over lunch, and thank you very much for staying awake and staying in the room. ■