

Session 2: Issues Facing the Jewellery Industry

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Good morning. Timing is everything in life, and I have joined the World Gold Council at a spectacular time, and whether that is foresight or happenstance, I suspect it is the latter. Also this morning, it was happenstance that everyone set the gold industry up in such a positive way. The only interesting point would be how much further I can take it.

The agenda item was for me to talk about the issues facing the jewellery industry. Frankly, I'm not going to talk about that. The issues are much broader than jewellery. It's about structural shifts in the nature of demand and critical imperatives that the gold industry faces. I am a recent convert to the gold industry, having never worked in it prior to a year ago. I joined the World Gold Council as Chief Executive in January this year. The Gold Council for those who may not know is about stimulating and sustaining the demand for gold. It is about intervening in markets to create structural change. It is not a traditional trade association. It is about being the source of leadership in this industry as well as the advocate for gold.

Looking ahead, and I won't give you lots of statistics (we produce a very comprehensive quarterly analysis of gold demand trends, which is available on our website www.gold.org and all of the comments are available there if you would like further details), what is clear is that the gold industry is going to be quite different in the next five to 10 years and it is not because of Lehmann's; there has been a gradual movement, some fundamental shift in the market and in the last 20 years, the jewellery sector of the market has defined the price. That has now changed, it is now investment that is deciding the price. As you heard

earlier, the central banks are now net buyers of gold and investment demand has accelerated very dramatically. So what does this all mean and what is going to happen?

We firmly believe in the World Gold Council that we are entering a new era, a new prominence for gold. As I read in the *FT* a few weeks ago, it's like pressing the reset button. There are seven key trends, which I am going to talk to you about briefly today, as to what these are, and very briefly mention what the World Gold Council is doing.

The first is about preservation: preservation in the sense that we have an aging population in many jurisdictions, inadequate pensions, massive wealth destruction and there has been a real paradigm shift in terms of how people look at gold. The last 20+ years has been all about an average, all about risk taking, all about wealth creation, and I think many people forgot that you need to protect your wealth as well. That is what we are seeing being picked up across the board. It is an asset of last resort. Of course gold will remain a safe haven but it is the move in territorial wealth preservation. It preserves the long-term purchasing power as Paul mentioned this morning from a central banker's point of view and there is definitive research by many academics,

including Roy Jestrup looking at the long-term trends in gold. It is actually referred to in the *Alchemist* brochure you have today.

Wealth preservation from our point of view is three things, which the Council is actually working on. The first is for gold to become an asset class in its own right. If you looked at the total assets under management worldwide, it's about \$120 trillion. Only 0.4% of that is held in gold and, of that, 68% is held by mining stock, and though we have spectacular success in ETFs, it is only 13%.

Assets under management held in gold could easily be 1% if not 2+%. If you look at the risk-adjusted return on the portfolio, some would say that you should hold an average 5%. So the potential is vast. This asset is classed as critical because, in pension markets, very few pension companies are holding gold. What we have seen however, in the US in particular, is that some substantial companies are beginning to hold gold as a long-term asset – a very significant shift.

In terms of ETFs, and I know we are going to talk about it this afternoon, just to mention the highlights. It was launched just under five years ago, it is the 5th anniversary in two weeks' time. It represents about \$50 billion of assets under management, about 1,500 tonnes, which is larger than the national reserves of most nation states in the world. Many commentators would say that ETFs have already become the People's Central Bank. What is interesting, however, is that the ETF market today is mostly purchased by individual investors, not institutional markets. As the institutional reassesses its profiles and looks at the enduring qualities of gold and the value that gold retains, we are going to see that market potentially increase dramatically.

The market for ETFs is primarily the USA at the moment and it is essentially through the IFAs (the advisory community in the US), and we are actually working to extend that to the institutional side, but if you look at 13

countries that have ETFs, the take-up has been very small. Therefore, the potential for this to grow even further is very substantial.

Thirdly, universal access. I don't want to fix on the UK market but just take that for a second; the UK market in ETFs is very low relative to the investment potential and access to products is pretty abysmal. Therefore, the World Gold Council is actively working to identify new investment vehicles, not ETFs but these would be savings products backed by allocated gold, which we have already done in Japan, and to bring this to North America and Europe – initially UK and Germany. Also trading on the Internet with allocated gold. If I was to use the same analogy as ETFs being the People's Central Bank, we are looking to create products that will help create the People's Savings Bank. Too ambitious? I suggest not.

The second key factor is relevance; relevance particularly in the jewellery sector. Clearly, we have seen the huge emergence of the great nations. Hugely ambitious populations who want to assert their success, and particularly women to demonstrate their independence in all the different societies, particularly in the Middle East, China and India, which are by far the largest consumers of gold jewellery worldwide. They are looking for iconic solutions and there is a risk that the demand in India over the next five to 10 years will be at risk as you get the younger population coming through, highly educated and typically working in information industries, who aspire to Western iconic products and not their parents' desires. Having said that, what is key is to maintain that relevance in those markets. It is true that demand has dropped quite dramatically in India, partly because of the rupee against the US dollar has made the price of gold prohibitively expensive. There has been the need for economic purposes to sell gold by some households, obviously affordability. I wouldn't forget that Indians are the world's most sophisticated gold traders, trading through the vehicle of

jewellery. When the price drops a fraction, they buy; when it goes up a fraction, they sell. So there was a lot of profit-taking in the sale of gold jewellery.

Looking at the West, frankly over the past 20 years, we have lost the desirability of gold in the mature countries – North America and certainly in Europe. We have really lost that passion for gold jewellery; the passion has been tarnished. It is emblematic that people are not wearing jewellery, and if you go to India now, some of the 20-year-olds aren't wearing any. So the real issue is do we sustain demand in the mass markets and secondly to create premium markets in the West. When I talk about the premium market, this is a market which really doesn't exist anymore because gold jewellery has been commoditised, and you get the JC Penney, Walmart, the television purchasing of gold, thus market in the US, but actually quite cheap. And then you get the luxury market – Tiffany, Bulgari, Cartier, etc. The mid market is typically small, individual jewellery stores, which don't have volume. And it's to create an 18-carat gold market in North America, high design, highly aspirational. We are working with a couple of partners looking at the options around that. That is the third trend – desirability, the need to reignite desirability.

Fourthly is responsibility. It is the single largest particular issue that we are facing around the world. We all know it. I won't discuss it further, other than to say that we are beginning to see a shift, partly because the economic problems we have have focused people's minds, but we've moved from conspicuous consumption to conscientious consumption and therefore not only in the day-to-day purchases but in purchases like gold, people want to know the origins or the credentials of the product. It's social and environmental credentials. Consumers are demanding it, the distributors are demanding it, the NGOs are arguing it and the media is reporting it, and we cannot ignore it. In the next few weeks, there will be a *60 Minutes* programme of the

investigative journalist programme in the US, the fourth-largest audience in North America, which is going to be broadcasting a report on blood gold in the Democratic Republic of Congo, where gold is produced illegally by war lords. That gold is finding its way through to Switzerland and into North American markets. Highly emotional, it's the illegal side of the industry; the professional side of the market that we represent has no association with this but the point still remains that there is a risk of it tarnishing the image of gold. Therefore, it is critical that we find ways, which the mining industry is already doing very very actively, of sustaining gold mining, which is advanced. But the second is traceability, which involves the whole value chain in the gold industry.

The fifth is innovation. In the last 15 years, what staggered me when I joined the Council, is that research into uses of gold has increased quite dramatically because of its catalytic converter capabilities as well as nano technologies. So there are technologies now that are well advanced in car catalytic converters, containing Alzheimer's, cancer diagnosis, and water purification. It's not going to increase demand but it adds to very importantly, the social credibility and social responsibility of gold.

The sixth is intervention. Paul Mercier of the ECB set it up beautifully this morning and thank you for the four factors you set out. The fact is though that the monetary system, certainly the US dollar, is being threatened and the President of the World Bank said recently that "the US would be mistaken to take for granted the dollar's place as the world's predominant reserve currency", and you have seen much of the press. There is serious discussion as to the role of gold in what will emerge as the new monetary system, or systems of the world. In terms of reverse asset management, we are going to see gold not only stopped being sold, if you like, being net sellers. It is likely that we will become net buyers. If

you take the ECB's targets, historically, these were 15% of the national reserves should be in gold, and today we heard it is about 13%; if you take the world at large, it is less than 2%. So I believe that central bankers will be net buyers over time.

Regulation, I think this is clear both in the financial services industry and continued opportunities with deregulation.

Lastly, the new access. What is staggering for the Gold Council as we look out is that it is no longer North America that is critical, but India, China and the Middle East. We operate there at the moment but those are the markets that we have to focus on. There is a huge potential for continued demand.

So I have gone through the seven key structure shifts that I believe will have a profound effect on the gold industry and I believe it will represent, and we are seeing it today, a new prominence for the gold industry.

Thank you.