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The Case For Gold In Asia's HNW Portfolios

Executive summary

With regard to preservation of wealth, gold has an immensely long track record; providing a hedge against inflation, geopolitical risks, natural disasters and other crises.

Currently private banks and wealth advisers might typically advise their HNW clients to hold about 3-5% gold in their investment portfolios.

While an ETF provides gold exposure and is an excellent tool for short-term trading, physical gold is preferable for medium to long-term investment as it is highly liquid, lacks counterparty risk and affords investors more flexibility. Unlike property or stock funds, physical gold is a highly efficient wealth management tool for estate planning. In banks client's liquidity can also be maintained via leverage. The banks may lend up to 80% against the value of the gold holdings and will probably charge a marginally higher interest rate than for other loans backed, for example, by property assets.

BY:
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In late January 2018, Hubbis, together with INTL FCStone, conducted research - including a high-level roundtable discussion, interviews, and a survey on physical gold. The Hubbis Gold Survey 2018 went out to 174 private banks, family offices, wealth management advisers and other market experts in Asia who provided their views on the opportunities to buy and hold gold in HNW portfolios.

Commentary on whether they prefer paper gold or physical gold, and perceptions into their reasoning are included within this article

GOLD HAS AN IMMENSELY LONG TRACK RECORD with regards to preservation of wealth. It provides a hedge against inflation, geopolitical risks, natural disasters and other crises. Gold is a portfolio diversifier. It is also easy to leverage, implying that liquidity can be maintained for the HNW individuals.

Currently, private banks and wealth advisers might typically advise that their HNW clients hold about 3-5% of gold in their portfolio.

Some of the more bullish advisers attending the Hubbis gold markets discussion in February 2018 and replying to the gold market survey, propose that their HNW clients put between 5% and 10% of any portfolio in gold because it has a diversifying effect on the other 90% of assets. In the long-term, it has also produced solid returns compared to other asset classes.

Using 1971 as a starting point, when the US exited the gold standard and measuring to the gold price of approximately US$35 to the price of US$1,325 per ounce as at the end of Q1 2018, a price appreciation of roughly 3,700% was returned. This compares favourably to the Dow Jones Industrial Index, which in the same period, appreciated by approximately 2,800%.

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Gaining exposure to gold

There are numerous ways to gain exposure to the gold market without owning or taking physical delivery. This includes via the futures markets, unallocated over the counter (OTC) swaps, exchange-traded funds (ETFs), or through the shares of gold miners, Nevertheless, physical gold has continued to attract high demand.

For historical and cultural reasons, Asian people, as a broad generalization, like to physically store, show or wear their wealth. Underpinning this is the widespread sentiment in Asia that gold provides a hedge against uncertainty in politics, currency, finance, and can also provide security against natural and other disasters.

There is already a vast and growing retail demand for gold in Asia, where a large proportion is for investment purposes. As wealth increases, experts believe so will investment demand for gold; especially in massively populous countries such as China and India where there is a traditional inclination to own physical assets. Both countries have been critical drivers of the bar and coin physical gold market in recent years.

The case for physical gold vs paper vs etfs

Once a decision has been made to commence or increase exposure to gold, the investor must next decide the format for that investment, whether to purchase 'paper' gold or the physical asset itself. The typical paper avenues are margin trading accounts, ETFs, shares in gold mining operations, or the gold futures and options markets.

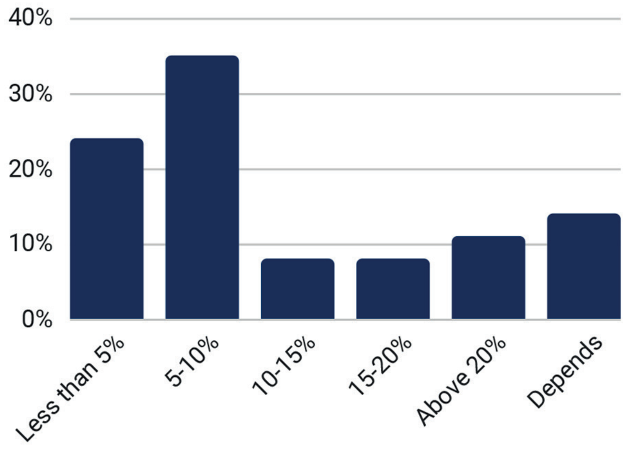
Experts agree that physical gold not only affords the investor more flexibility, but it is highly liquid and lacks counterparty risk. It is high-quality collateral especially during times of extreme uncertainty and volatility. While an ETF is an excellent tool for short-term trading, as a wealth preservation tool some of the experts canvassed in the research for this report agree that physical gold is far preferable for the medium to long-term.

Also, ETFs are promises on paper and are not always backed by physical gold. And even those with gold supporting them might not have sufficient gold to match their market values, implying that there could be a shortfall if everyone ran for the exit.

Moreover, while many ETFs do have gold backing them, accessing that physical gold, if required, is

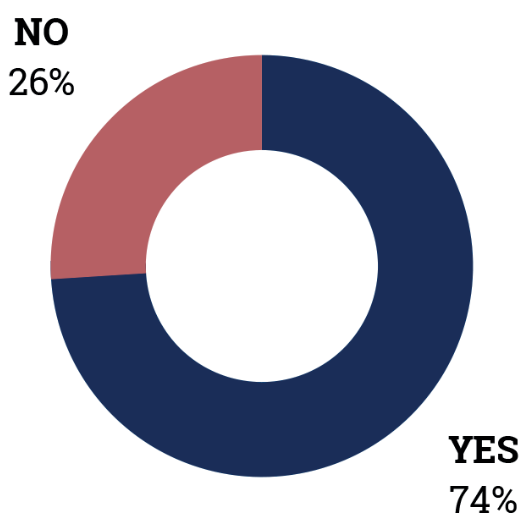
Tab. 3.2 Hubbis Gold Survey Result

WHAT PERCENTAGE OF ANY CLIENTS ASSETS SHOULD BE PHYSICAL GOLD?



Tab. 3.1 Hubbis Gold Survey Result

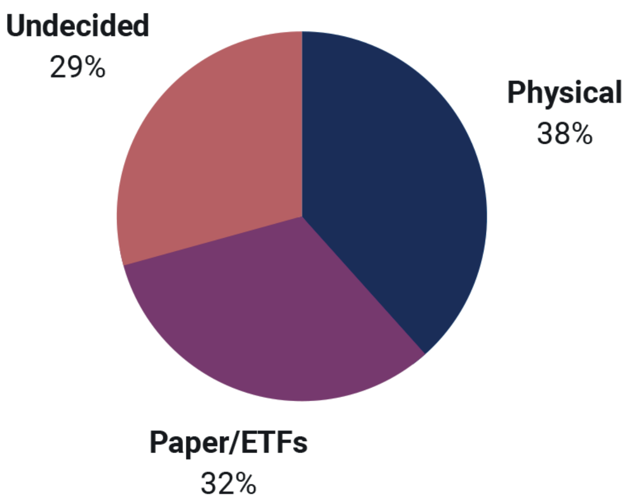
DO YOUR CLIENTS BUY GOLD?



PAPER GOLD	PHYSICAL GOLD
No physical underlying gold	Client holds title to physical gold
Counterparty credit risk	Decentralized asset with no credit risk
Regulated market	Can be held outside of the financial system
Cannot be easily used as collateral	Can be readily used as collateral or leverage
Low cost holding – margin requirements	Vaulting and insurance costs
Chain of custody – broker and exchange	Bi-lateral/Tripartite relationship with Vault Provider/Operator

Tab. 3.3 Hubbis Gold Survey Result

WHAT PERCENTAGE OF ANY CLIENTS ASSETS SHOULD BE PHYSICAL GOLD?



not easy. This is limited to substantial investments (approximately USD12.5 million at the time of publishing for SPDR ETF) and even then, access to the physical gold remains at the discretion of the Trustee. If the physical gold is accessed, the investor may not know the details of the underlying asset, for example, the purity of the gold, the format, the brand, the location etc. Another unknown of ETFs to be considered is the inherent counterparty risk in the chain of custody.

> **"Paper gold is suitable for short and medium term hedging and speculation. Physical gold is more for long-term investment purposes."**
> **Source: Hubbis Gold Survey**

When you buy an ETF share, you transact with an authorised seller however that share is a promise of ownership from the fund's trustee who also further distributes the responsibility of storage to a Custodian. Paper gold is therefore viewed as more speculative, albeit accommodating for people who are looking to trade in and out of gold rapidly.

Whereas on the physical side, it is considered more of a long-term hold, with HNW individuals holding it as part of a long-term balanced portfolio.

In building the business argument for why people should pay more attention to physical gold, there is a substantial case for gold as wealth protection and wealth preservation tool, as well as for wealth accumulation.

Estate planning, leverage, and diversification

Physical gold certainly has some advantages for estate planning purposes, for example, a HNW client might open a joint ownership account with an heir, which means that they do not need to validate the wealth with

Fig. 3.4 Gold Investment Pyramid

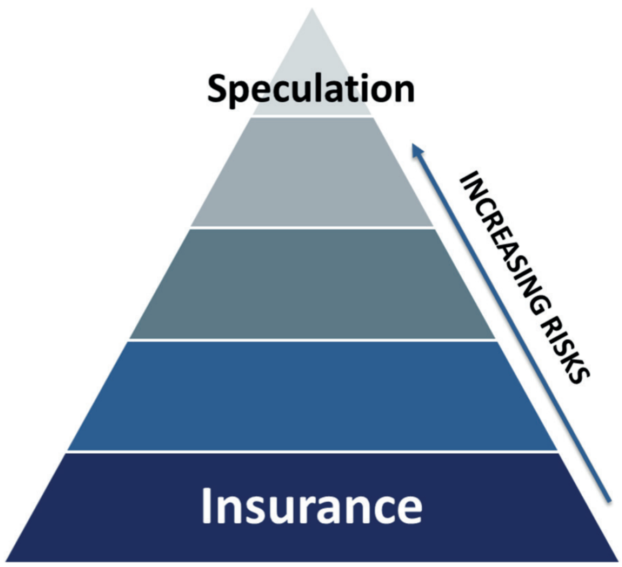
Gold Derivative/Shares in Gold mining companies etc.

Unallocated Gold ETF

Fully Allocated Gold ETF

Directly owned Gold held within the banking system

Directly owned gold held outside the banking system



FROM MINE TO VAULT..OR NECKLACE

A significant portion of the gold refining industry is still located in western nations, but the physical demand is increasingly driven by the Far East market, underlining the definite shift of the bullion market from West to East.

When a gold bar is produced by a LBMA accredited refinery, from whatever raw material source - whether it be dore from a mine [70%-90% gold ore] or scrap gold - the bar that emerges will typically be what the industry terms 'four 9s', which means 99.99% purity also known as 24 carats. 99.99% purity is the most commonly accepted and traded purity in the far eastern markets.

Whereas in India, 99.5% purity is the accepted norm. Physical gold bars are highly liquid and can be traded in a large bar - the 400-ounce (or 12.5 kilos) bar - that is most commonly delivered to the vaults, or in a kilogram bar (kilo bar).

The market also trades much smaller bars of 1 gram upwards, as well as coins. The kilo bar is the standard typically traded in Asia and India, while the 100-gram bar is also favoured in the Indian market.

any jurisdiction where the gold is stored. This can enable a smoother transfer of assets.

In a practical sense, gold bars, unlike property or stock funds, are highly efficient wealth management tools for estate planning. Gold bars are available in many sizes and as such are easily divisible, transportable, and highly durable. Many private banks that help clients buy and store physical gold recognise that the client's liquidity can also be maintained via leverage. Many banks will also offer to lend against the bullion, whereas only a few of the private, non-bank, firms will provide such a service.

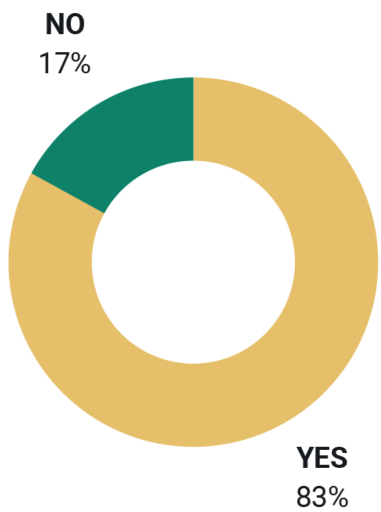
"A significant portion of the gold refining industry is still located in western nations, but the physical demand is increasingly driven by the far east market, underlining the definite shift of the bullion market from west to east."

The banks will lend, for example, up to 80% against the value of the gold holdings and will probably charge a marginally higher interest rate than for other loans backed, for example, by property assets.

A few private precious metals firms are also lending against gold that their clients have bought through them and that they then hold in one of the major logistics companies' storage facilities. ■

Tab. 3.4 Hubbis Gold Survey Result

DO YOU THINK THAT THEY SHOULD BE INCREASING THEIR WEIGHTING IN GOLD AT THIS MOMENT GIVEN WHERE INVESTMENT MARKETS ARE?



Tab. 3.5 Hubbis Gold Survey Result

DO YOU SEE GOLD AS A TRANSPARENT LIQUID INVESTMENT?