



Position Paper | Gold ETF versus Physical Gold ownership

Dear Investor,

The ownership of gold has its greatest merits in:

- ❖ Financial insurance;
- ❖ Asset class diversification;
- ❖ Currency diversification; and
- ❖ Gold price appreciation so as to retain real value.

Whilst gold mining shares, gold futures and gold ETFs provide varying degrees of association with the merits listed above, none of them comply 100% as does physical gold.

In order to attain all these merits through ownership of gold it is essential to reduce to a maximum the failure of exercise, counterparty and depository risk.

Overview of the South African gold ETF

The ETF provides a fairly good relationship to movements in the gold price and it provides good currency hedging. The ETF does not offer financial insurance by virtue of the fact that it is not gold but an unsecured debenture. The ETF does not provide asset class diversification as it is another listed financial instrument similarly to all the listed shares on the JSE.

The South African ETF and the issue of Financial Insurance

The ETF debenture does not entail ownership of gold and does not entitle the holder to any physical gold. The investor owns a debenture issued by a listed company that has no employees and that in turn is owned by a trust.

A Debenture Holder will, accordingly, not have or acquire any ownership, right or beneficial or other interest in or to any Gold Bullion held by NewGold from time to time.

NewGold Issuer Limited Prospectus p19, 27 October 2004.

Usually a debenture is secured by a mortgage over a property or other assets. In the case of the ETF the debenture is unsecured. Furthermore, in the event of liquidation of the issuing company, the ETF debentures hold the lowest ranking amongst creditors.



Priority of Payments:

- 9.1 the taxation liability of NewGold from time to time;
- 9.2.1 repayment of all amounts owing by Newgold to ABSA;
- 9.2.2 payment of all fees and expenses payable by NewGold;
- 9.3 payment of the redemption value of the debentures.

NewGold Issuer Limited Prospectus p51, 27 October 2004.

Gold is the only asset that is not the obligation of another party. In the case of the ETF there is counterparty risk that extends to the issuing company, to a trust and to a South African bank.

The South African ETF and the issue of Asset Class Diversification

It is a myth that the ETF provides asset class diversification. It does not provide the holder with gold ownership but rather with a bet on the gold price and with the risks that are commensurate with owning a listed instrument.

To provide asset class diversification the ETF would have to facilitate direct ownership of the commodity. Instead, the holder assumes counterparty risk and to believe that there is none [due to the structure of the issuing company and the nature of its activities] is to misunderstand markets.

The principal lesson learned from the failure of Long Term Capital Management in 1998 is directly applicable to understanding some of the risks attached to the ETF. In the case of Long Term with its thousands of different holdings, managed by recognized geniuses, brilliant professors and two Nobel Economics Prize winners, a default in Russia set off a financial storm that Long Term had not anticipated.

The lesson was that listed securities may be unrelated but the same investors and portfolios owned them, implicitly linking them in times of stress. It is in times of stress that the non-linkage of securities is most needed, but perversely most likely when the very strong linkage will be demonstrated.

The ETF provides much diversification of risk when pooled with bonds, property and cash, but little with regard to equities.

- ❖ If enough investors panic and sell their listed securities a dangerous undertow may distort the market.
- ❖ In a market in crisis you don't sell what you should. You sell what you can.
- ❖ The very concept of safety through diversification, ... would merit re-thinking.
- ❖ Liquidity is a straw man. Whenever markets plunge investors are stunned to find that there are not enough buyers to go around

When Genius Failed subtitled The Rise and Fall of Long-Term Capital Management - Roger Lowenstein.

In a broad and balanced portfolio physical gold provides asset class diversification in a way that ETF debentures are unable to. Securities can fail, especially in times of market stress, but gold will always be the last man standing.

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