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Mythbusting: What's Behind the Gold ETP Outflows

By Dodd Kittsley

Excerpt: In February, gold exchange traded products (ETPs) experienced \$5.6bn in outflows – their worst month on record. Dodd Kittsley takes a closer look to find out what's causing the exodus, and what it means for investors.

When we report out on exchange traded product (ETP) flows each month, investors are naturally very interested in the asset classes that have attracted large inflows. But sometimes the big story isn't where the money is going, but rather the asset class it's exiting. This was the case in February, when gold ETPs experienced \$5.6bn in outflows - their worst month on record since the first gold ETP was launched nearly a decade ago.

Any time you see a record number like this, it generates a [fair amount of discussion](#). But while ETP flows can certainly provide insight into shifting investor sentiment and emerging trends, it's important to put them in perspective. February's gold ETP outflows still only represent less than 4.5% of the \$128.2bn currently invested in the products. And even though this has been the second consecutive month of outflows in the category, gold ETP assets are still double what they were three years ago (see below).

Global gold ETPs: Annual AUM history

That said, it's worth a closer look into what's causing the selloff. First, there's the recent weakness in gold spot prices, which have fallen nearly 6% year-to-date and about 17% from a record high of \$1900.20 a troy ounce hit in September 2011. Another factor is a growing belief that monetary tightening from the Fed may occur earlier than originally expected, causing interest rates to rise. Add that to a stronger US dollar, continued demand for equities and a general shift away from traditional "safe haven" assets (such as Treasuries), and you can see why some tactical investors are pulling back on their gold exposure.

But while some investors may be reacting to the current environment, it's clear that a significant number are standing their ground. While gold has historically been seen as a potential cash alternative in periods of economic uncertainty and a hedge against inflation concerns or a weakening dollar, many invest in gold as a long-term holding due to its diversifying properties (gold has historically shown [little to no correlation with other major asset classes, including commodities](#)). In fact, while my colleague Russ Koesterich acknowledges that gold typically performs relatively well in a low rate environment, he also [advocates a small \(1-3%\) strategic allocation to gold](#) regardless of where rates go this year.

The bottom line: Whether you're a tactical or strategic investor, gold ETPs can give you an easier, more flexible way to access gold than was previously available. Before these products came along, retail investors could only gain exposure to gold through the ownership of things like bullion, jewelry, coins and gold certificates, or by investing in mining stocks and precious metal mutual funds as a proxy.

In fact, gold ETPs now represent the fourth largest institutional holder of gold in the world. And with markets like China looking into launching their own versions, we'd guess that it will take more than just a few bad months to reverse the incredible momentum this category has built up.

Sources: BlackRock, Bloomberg

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Investing involves risk, including possible loss of principal. The iShares Gold Trust (the Trust) is not an investment company registered under the Investment Company Act of 1940 or a commodity pool for purposes of the Commodity Exchange Act. Shares of the Trust are not subject to the same regulatory requirements as mutual funds. Because shares of the Trust are intended to reflect the price of the gold held by the Trust, the market price of the shares is subject to fluctuations similar to those affecting gold prices. Additionally, shares of the Trust are bought and sold at market price, not at net asset value (NAV). Brokerage commissions will reduce returns.

Shares of the Trust are intended to reflect, at any given time, the market price of gold owned by the Trust at that time less the Trust's expenses and liabilities. The price received upon the sale of the shares, which trade at market price, may be more or less than the value of the gold represented by such shares. If an investor sells the shares at a time when no active market for them exists, such lack of an active market will most likely adversely affect the price received for the shares.

Following an investment in shares of the Trust, several factors may have the effect of causing a decline in the prices of gold and a corresponding decline in the price of the shares. Among them: (i) Large sales by the official sector. A significant portion of the aggregate world gold holdings is owned by governments, central banks and related institutions. If one or more of these institutions decides to sell in amounts large enough to cause a decline in world gold prices, the price of the shares will be adversely affected. (ii) A significant increase in gold hedging activity by gold producers. Should there be an increase in the level of hedge activity of gold producing companies, it could cause a decline in world gold prices, adversely affecting the price of the shares. (iii) A significant change in the attitude of speculators and investors towards gold. Should the speculative community take a negative view towards gold, it could cause a decline in world gold prices, negatively impacting the price of the shares.

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