GOLD IS EXPENSIVE. DON'T WASTE IT!

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Investing physically in most commodities is almost impossible due to operational constraints: they tend to be voluminous, expensive to store, move and insure, and can be very perishable. Most commodities investments are, therefore, made through futures contracts and therefore suffer, most of the time, from negative roll yield. However, this is not true for precious metals. Gold and silver are durable, they carry a high price tag per weight and, therefore, can be stored very cheaply in bank vaults. Overall, physical investments in gold or silver are easy and cost-efficient.

When investing in gold or silver, investors have the choice between:

- Physical holdings using, for example, physically-backed exchange-traded products (ETPs)
- Futures contracts (which can also be replicated in a synthetic ETP)

But which one is the most efficient?

When investing physically in gold, the cost of investing is known in advance. For physically-backed gold ETPs, the total expense ratio can be as low as 12 bps per year. On the contrary, when investing in futures contracts, the cost of investing is not known in advance as it is subject to a roll yield linked to the shape of the futures curve, which can change at any time. So, investors need to ask themselves ‘how often is the cost of investing in futures contracts above 12bps and how often is it below 12bps?’

In Figure 1, we compare the performance of:

- Physical Gold
- Fully-funded future based investing using the Bloomberg Commodity Gold sub-index Total Return Index as a proxy

The result is very clear. Over the last 15 years, a futures-based investment in gold has underperformed on average by 0.94%1 per year compared to physical investment. A lot more than 12bps!

Figure 1: Historical comparison of investment in gold physically vs through futures

	Physical Gold	Bloomberg Commodity Gold sub-index Total Return
Annualised Return	6.35%	5.41%
Volatility	17.46%	17.71%

Source: WisdomTree, Bloomberg. From 4 June 2007 to 31 January 2023. The Performance of the physical Gold was observed at 1.30 PM Eastern Time to match the BCOM sub-index calculation time.

You cannot invest in an Index. Historical performance is not an indication of future performance and any investments may go down in value.

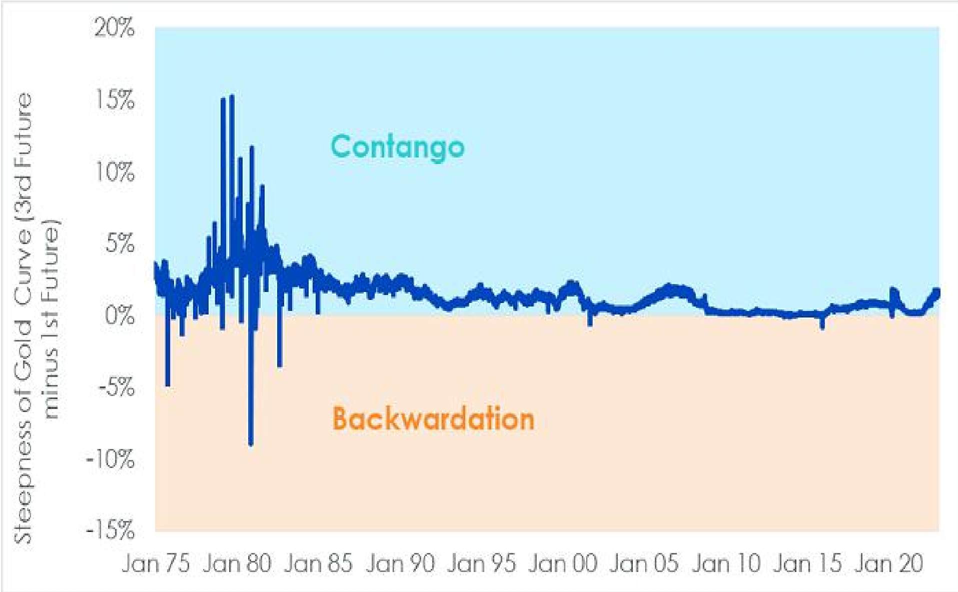
More importantly, looking at one-year holding periods, physical gold has outperformed futures-based gold 99.1%[1] of the time. Even considering the 12bps of costs of a gold ETP, physical gold outperformed 97.8%[1] of the time. Even on short investment periods, physical gold outperformed most of the time (89.8%[1] of 3-month investment periods).

Why is physical gold a more efficient investment?

The shape of the futures curve drives the cost of investing in futures-based gold. In contango, investors bleed money through the roll yield. For gold futures investment to outperform physical gold in the medium term, the roll yield needs to be under 12bps per annum. The curve needs to be in a very slight contango or in backwardation. In backwardation, the investor benefits from the roll yield (instead of paying it).

Unfortunately for investors in futures contracts, the gold futures curve is driven by very stable factors that lock it in contango most of the time. Looking at the long history, the average roll yield between the first and third futures for gold is -1.5%2 (that is, the third contract was 1.5% more expensive than the first one). The curve was in backwardation only 79 days over the 12,107 business days between January 1975 and February 20232, that is, only 0.66% of the time[2].

Figure 2: Historical roll yield between gold first and third contracts: Contango, contango, always contango



Source: WisdomTree, Bloomberg. 2 January 1975 to 28 February 2023. Steepness is calculated as the price of the third generic future minus the price of the first generic future divided by the price of the first future.

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When investing in gold futures, whether it's a stand-alone gold investment or as part of a broad commodity investment (like in the Bloomberg commodity index), investors are hoping that the gold curve will remain in backwardation for a large portion of their investment period. But, in more than 50 years of history, this has never happened for periods longer than 15 days[2].

What about silver, then?

Silver futures[3] behaviour is very similar to gold futures. The average roll yield between the first and third futures for silver is -2%[2]. The curve was in backwardation only 81 days between January 1975 and February 2023[2]. Over the last 15 years, a futures-based investment in silver has underperformed on average by 1.29%[3] per year compared to a physical investment.

Footnotes:

[1] Source: WisdomTree, Bloomberg. From 4 June 2007 to 31 January 2023. The Performance of the physical Gold was observed at 1.30 PM Eastern Time to match the BCOM sub-index calculation time. **You cannot invest in an Index. Historical performance is not an indication of future performance and any investments may go down in value.**

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[3] Source: WisdomTree, Bloomberg. From 4 June 2007 to 31 January 2023. The Performance of the physical Silver was observed at the same time as the BCOM sub-index calculation time. **You cannot invest in an Index. Historical performance is not an indication of future performance and any investments may go down in value.**

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