

What to look for when choosing a gold ETF



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Australia was at the forefront of the development of the gold ETF market, with the Australian Securities Exchange (ASX) listing gold ETFs, including Perth Mint Gold (ASX:PMGOLD), ahead of most international exchanges in 2005.

Bought and sold like a regular share, such products track the price of gold, offering the same economic exposure to investors as physical gold bars or coins, without the need for investors to personally store the gold bullion themselves.

This tends to make them easier and more liquid to trade from an investor's perspective, while the fact they are listed on a regulated exchange provides additional comfort.

Gold ETFs also tend to be the lowest cost way for investors to incorporate gold into their portfolio, with transaction spreads that are typically sub 0.10% to buy and sell. This means a AUD 50,000 investment into a gold ETF would likely only incur a cost of AUD 50 maximum plus brokerage.

Whilst most gold ETFs do a very good job of tracking the gold price itself, they are not all created equal. Below is a list of questions investors would be well served considering when it comes to picking a gold ETF should they decide to allocate a portion of their portfolio to the precious metal.

Questions to ask when picking a gold ETF – and the answer for Perth Mint Gold (ASX:PMGOLD)

What is the management fee?

Management fees paid to the product issuer eat away at the net return an investor earns on any asset class, including gold. All other things being equal, the lower the management fee the better, so if the gold ETF you are looking at charges more than its peers, it's certainly worth asking why.

ASX:PMGOLD charges a management fee of just 0.15%.

Who is the product issuer?

It is critical to know the background of the organisation issuing any financial product, including gold ETFs. When was it founded? Who owns the company? How big is its balance sheet? What expertise does it have in the precious metal market? These are all questions worth asking when assessing a gold ETF.

ASX:PMGOLD is issued by Gold Corporation (which trades as The Perth Mint). Gold Corporation has more than a century of experience dealing in precious metals. It is 100% owned by the Government of Western Australia, has more than AUD 6 billion in assets and turns over more than AUD 20 billion in precious metals each year.



Who are the counterparties to the gold ETF?

Apart from the product issuer, most, though not all, gold ETFs will have at least three other counterparties. These include the trustee, the custodian (where the gold sits), and the market maker (or market makers), who provide liquidity to the product.

ASX:PMGOLD is fully operated by Gold Corporation, which is the issuer, custodian and market maker for the product.

Who holds legal title to the gold backing the product?

This is arguably the most important risk factor to analyse when picking a gold ETF. In nearly all cases, investors in a gold ETF don't actually own title to the gold itself. They own a financial instrument, with that financial instrument backed by gold holdings.

The custodian of the gold might be the owner, or it might be a trustee company. It is worth asking that question and making sure you are comfortable with the answer, as that custodian or trustee is arguably your primary counterparty.

ASX:PMGOLD is backed by gold held by The Perth Mint on behalf of the fund investors.



How is the gold backing the product sourced?

It is worth asking the product issuer of a gold ETF where it sources the gold backing its product. Some may be entirely reliant on the gold custodian they use because they don't have access to gold themselves.

ASX:PMGOLD is backed by gold The Perth Mint sources in the marketplace. This includes gold from Australian gold miners, who produce more than 300 tonnes per year. Australia has been the second largest gold producing country in the world over the last ten years, with The Perth Mint refining the vast majority of this gold.

Where does the gold physically sit?

It is worth knowing where the gold backing an ETF is sitting. Most gold ETFs use reputable high-profile gold custodians, but there can still be a degree of jurisdictional risk if the gold is physically sitting outside Australia.

ASX:PMGOLD is backed by gold stored in The Perth Mint's vaults and across its operations, including both the refinery and minting divisions.

What form is the gold stored in?

Some gold ETFs are backed by allocated metal, which means numbered bars that typically sit in a vault, owned by the trustee, or custodian, on behalf of the product investors. Others are backed by unallocated metal, which can include gold that is in numbered bars, as well as gold that is being refined, cast or minted.

ASX:PMGOLD is backed by gold held in unallocated form in The Perth Mint's vaults and across its refining and minting operations.

How is liquidity provided to the product?

All gold ETFs require market makers to provide liquidity to the product, meaning they will be there to sell units to investors that want to buy them, or buy units from investors that want to sell them.

It is worth asking whether the product issuer does the market making itself (this alone is a good indication it has a sizeable balance sheet and expertise in precious metals trading directly), or whether or not it outsources this function.



ASX:PMGOLD market making is provided by The Perth Mint directly. As such, investors benefit from the more than AUD 20 billion in liquidity that The Perth Mint accesses in the global precious metals marketplace.

Can your investment be redeemed for physical gold, and if so, how?

A key attribute of a gold ETF is whether or not the ETF holdings can be converted into physical gold for delivery or not. Some can't be converted at all, whilst others may require overly complex processes that make it all but impossible to do.

While most investors who buy gold ETFs will likely end up selling them for cash, knowing it can be converted into physical gold is an additional level of security.

ASX:PMGOLD investors can redeem their holdings into physical gold bars manufactured by The Perth Mint. Investors simply need to fill in an Exercise Notice (which is contained within the PDS), and The Perth Mint will provide the gold bars the investor has requested, which can be delivered anywhere in Australia, or collected from its offices in Perth.

Are there any additional investor protections in place?

It is worth considering what investor protections are in place should something happen to the gold custodian who is storing the precious metals backing a gold ETF.

ASX:PMGOLD investors are protected by the unique government guarantee that protects all investors in The Perth Mint Depository.

This report has been compiled by The Perth Mint.

The Perth Mint is the trading name of Gold Corporation, an entity wholly owned and guaranteed by the Government of Western Australia which holds a long-term AA+ credit rating (S&P). The Perth Mint is Australia's largest fully integrated refining, minting and depository enterprise.

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