Understanding the Cost of Trading Allocated Gold

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Executive Summary:

While gold has been a store of wealth for thousands of years, it received renewed attention following the financial crisis, as confidence in the banking system was shaken. If a bank were to file for bankruptcy, electronically stored balances of cash and securities could get caught up in the proceedings, leaving them unavailable to their owner. With allocated physical gold, however, the account holder can pick up their bars from the shuttered bank and move them elsewhere.

This feeling of safety, along with central bank policy, drove the price of gold up to historic levels, despite the implicit and explicit costs that make investing in gold—whether as an inflation hedge or for its diversifying effects—more costly than other financial instruments. Gold has a negative cost of carry (gold bars pay no interest), and the need to store and protect this hard asset creates costs for the buyer that go beyond the market-driven bid-ask spread. But while prices kept rising, none of that mattered.

Today, with prices coming back down to earth, trading costs are more important than ever. Depending on the market participant, trading costs for allocated gold include fees for allocation, transportation (if required), and custody.

Methodology:

In October 2015, Greenwich Associates conducted telephone interviews regarding the U.S. gold market. Study participants included major banks, prime brokers, fund managers, leading trading firms, and exchanges.

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participants. Interviewees may be asked about their use of and demand for financial products and services and about investment practices in relevant financial markets. Crisil Coalition Greenwich compiles the data received, conducts statistical analysis and reviews for presentation purposes to produce the final results.

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