

# Gold/Silver ETF Stickiness

Despite gold and silver consolidating in June, investment demand for these precious metals remains robust. This is evidenced by continuing growth in the bullion holdings of the leading precious-metals exchange-traded funds. Both GLD's and SLV's physical metals held in trust for investors have edged up to new all-time record highs this month!

These popular precious-metals ETFs are radically changing the investment landscape. They have created conduits for massive pools of stock-market capital to quickly and easily migrate into gold and silver. They are enabling non-traditional PM investors, including pension funds, mutual funds, and hedge funds, to instantly add PM exposure to their portfolios. Since this is the first time such vehicles have even existed in secular PM bulls, no one knows what their ultimate impact will be. But it should be revolutionary.

GLD, the world's premier gold ETF, was only born in November 2004. Yet its meteoric rise since has led it to become the most successful ETF in history. By the end of last month, GLD had grown into the second-largest ETF on the planet (behind only the SPY S&P 500 ETF). No other ETF has ever grown so big so rapidly. Investors who cannot or will not participate in more traditional forms of gold investing like coins have eagerly flocked to GLD to add gold-price exposure to their portfolios.

And though SLV is even younger, launched in April 2006, it is following in GLD's big footsteps. It is already on the verge of entering the elite ranks of the world's top 25 ETFs in terms of market capitalization. SLV is nearly as large as XLF and XLE, the popular ETFs that track the financial stocks and energy stocks of the S&P 500. This silver ETF's spectacular rise to prominence is second only to the gold ETF's.

Because these unique vehicles have greatly widened participation in PM investing, they are fascinating and exceedingly important. No PM investor, whether they own these ETFs or not, can afford to ignore their rapidly growing impact. If you'd like some background on either, I've researched and written about both the [GLD gold ETF](#) and [SLV silver ETF](#) extensively. These past essays explore these ETFs' methodologies, performances, limitations, and concerns in depth.

But today I want to concentrate on another aspect of GLD and SLV, their "stickiness". Before these ETFs were launched, there was [considerable opposition](#) to them in the traditional PM investor community. One concern among many was that stock investors buying ETFs would be fickle, they would overtrade and add to underlying metals volatility. But interestingly, so far they really haven't. Once stock investors buy GLD and SLV, they have tended to stick with their investments.

This is evidenced by the bullion holdings of these ETFs. GLD and SLV are probably the most transparent ETFs in the world, they provide extensive data on their operations on a daily basis. This includes reporting how much physical bullion they are currently holding on behalf of their shareholders. Charting this data over time yields valuable insights into PM demand from stock investors.

Like all ETFs, the PM ETFs are designed to track the prices of their underlying assets. To accomplish this, their custodians must expand and contract the ETFs' assets in order to neutralize any differential supply and demand. Both gold and GLD have unique and independent supply-and-demand profiles. Just because futures traders are selling gold doesn't mean GLD shareholders are selling their ETF at the same rate. If *differential* supply or demand develops, the ETF will decouple from its underlying asset price and fail.

Consider SLV to illustrate this. If there is a surge in demand for SLV shares without a corresponding increase in demand for silver itself, SLV's price will rise faster than silver's. But it is supposed to *track* silver, not decouple to the upside. So SLV's custodians will immediately issue new shares to neutralize this excess demand. When investors buy these shares, SLV's custodians then use this new capital to buy more physical silver bullion. This mechanism shunts excess SLV demand directly into silver itself.

Opening such a conduit for stock-market capital is a double-edged sword though. If differential SLV selling develops, the ETF owners are selling faster than underlying silver selling, the ETF will threaten to decouple to the downside. SLV share supply exceeds silver supply. The custodian must buy back these excess shares since market demand isn't there. To finance these purchases, it sells some of its physical silver. Thus excess SLV selling bleeds into the underlying silver market as well.

The ETF holdings act like a sponge to smooth out surges and dips in stock-market demand relative to underlying metals demand trends. When these holdings are growing, stock investors are buying GLD and SLV at faster rates than futures traders and physical users are buying gold and silver themselves. When these holdings are contracting, stock investors are selling the PM ETFs at faster rates than the metals. So watching GLD's and SLV's holdings offers great insight into stock-investor demand trends.

Now last autumn's stock panic, the first [in 101 years](#), was inarguably the scariest financial-market episode anyone alive today has ever witnessed. In less than 4 weeks in October, the flagship S&P 500 stock index plummeted 27%! Almost all investors were terrified, the great majority truly thought the sky was falling. And gold and silver got sucked into this maelstrom of selling too. It was a universal bloodbath, brutal.

If there was ever an excuse for GLD and SLV shareholders to panic, that was it. Over that exact 27% 19-trading-day stock-market-plunge span, gold fell 15% and silver 25%. The PMs certainly failed to live up to their safe-haven reputations when general financial-market fear was the most extreme. If GLD and SLV owners were less committed, more excitable than investors directly owning physical bullion, the stock panic would have revealed it. Yet the PM ETF owners held on during this ultimate acid test.

The next two charts illustrate GLD and SLV holdings over the last 18 months or so, encompassing the panic and its aftermath. Physical bullion held in trust for ETF investors is rendered in red off the left axes. The price action in the underlying metals themselves is superimposed over the top in blue. The stickiness of PM ETF holdings in the abyss, and their subsequent surge to record highs, is nothing short of amazing.



Gold peaked just over \$1000 in March 2008, the pinnacle of excitement over the last 18 months for PM investors. After failing to break decisively above this crucial psychological resistance, the metal consolidated sideways until the bond panic of August. The bond panic, like the stock panic that followed, led to massive flows of flight capital flooding into the US dollar. This enormous dollar buying hammered gold.

But despite gold's generally weak behavior between March and August, GLD's holdings were pretty stable on balance. Yes, differential ETF buying demand (GLD has to buy gold to equalize) was more likely when gold was rallying. And differential ETF selling pressure (GLD has to sell gold to sop up) was more likely

when gold was falling. But despite gold rolling over and sliding down from around \$1000 to \$750, the GLD ETF holdings remained sticky. GLD shares' supply and demand mirrored gold's own pretty well.

The formal stock panic (VXO fear gauge staying above 50) started in early October. Gold initially fared quite well in this carnage, surging 10% to \$916 in just 4 trading days. But then the mass exodus of capital fleeing into cash and Treasuries, driving up the dollar, caught up with gold. The unprecedented [dollar rally crushed it](#). Gold plunged 22% over the next 5 weeks. It was extremely disappointing to see this metal perform so poorly during a stock panic, the very time it should have shined brilliantly.

I really expected GLD owners to get discouraged. Their faith in diversifying a fraction of their stock portfolio into GLD for gold exposure (to counterbalance stock risk) should have been shaken. But amazingly, they held strong. GLD's custodians only had to sell 2.2% of its gold bullion over the 5-week span where gold plunged 22% along with everything else in the world (except the dollar). GLD's holdings were stable during the stock panic, there was no differential selling pressure!

By mid-December when the stock panic formally ended and the extreme fears started to abate, gold really caught a bid. Stock investors started buying GLD at a faster rate than futures and physical traders were buying gold itself. GLD's holdings broke above 800 metric tons for the first time ever in January. And they just accelerated from there, soaring vertical and breaking 900t and 1000t in short order in GLD's best month ever in February.

That month alone, GLD's holdings rocketed 22% higher! Demand for this ETF's shares was so great that its custodians had to buy 186t of gold bullion in the open market. This was such a fascinating episode that I devoted the entire March issue of our subscription newsletter to it. Our current Zeal Intelligence subscribers can download this "GLD Rush" issue from the Archives section of our website. Because of the explosion of GLD demand from stock investors, February was one of the most interesting months of this entire gold bull.

At the time there was no way to tell who was buying GLD so fast, so I used the generic term "stock investors". But thanks to SEC filings in mid-May, the biggest GLD buyer was finally revealed. It was one of the world's biggest, best, and most-highly-respected hedge funds! This fund, discussed in the current June issue of [Zeal Intelligence](#), bought an 8.7% stake in GLD by the end of Q1! It also bought large stakes in major gold stocks. Elite mainstream investors were flooding into GLD to get gold exposure in their portfolios, a fantastically bullish development.

GLD had to buy so much physical gold so fast to keep this hedge-fund buying from driving an upside decoupling that physical gold shot up just shy of \$1000

again. It was very exciting at the time, even before we knew who was buying. GLD's total holdings soared over 1000t, a huge milestone. But once this elite hedge fund was positioned, the differential buying pressure tapered off and gold started consolidating again.

After those February highs, gold spent a couple months drifting lower then a couple months rallying. On balance it has been a high consolidation, not very exciting. Yet during this time, GLD's holdings have still usually been stable or growing. Stock investors owning GLD not only *didn't* sell it faster than gold itself was being sold, but they bought and drove GLD holdings to new all-time record highs of 1134t by early June.

To put this into perspective, according to the World Gold Council 2407 metric tons of gold were mined globally in 2008. So this GLD ETF alone, while admittedly the world's largest gold ETF by far, has already absorbed the equivalent of 47% of an entire year's worth of world mine production! And GLD buyers are not the hardcore investors who traditionally buy physical coins, but new investors who probably wouldn't or couldn't invest in gold if the GLD ETF hadn't made it so quick, easy, and cheap.

Some investors, when they learn how massive GLD has grown, wonder if it can possibly get any bigger. But it still has vast room to grow. *Every* investor should have *at least* 5% of their investment portfolio allocated to gold. At the end of May, GLD had a market capitalization of just \$35b. On the same day, the S&P 500 stocks had a collective market cap of \$8246b. Thus GLD was running just 0.4% of stock-market capital in the S&P 500 stocks alone. This ETF could grow 10x, *from here*, and still not hit the minimum 5% gold portfolio allocation!

The stickiness of GLD's holdings, and the increasing interest large mainstream investors have in using this ETF to gain gold exposure, are very bullish. As long as stock investors are willing to buy GLD, it can continue to grow indefinitely. And as long as demand for GLD shares grows, this ETF's custodians will have to shunt excess demand directly into physical gold. GLD buying drives gold buying, which pushes gold higher, which gets more stock investors excited to buy GLD. It's a beautiful virtuous circle!

While the SLV silver ETF wasn't fortunate enough to see a major hedge fund deploy into it like GLD, SLV's holdings have still been steadily growing. And these bullion holdings have been at least as sticky as GLD's. The stock investors buying SLV are generally not selling it faster than silver itself when the metal is falling, so SLV's holdings are remaining stable during such episodes.



Of course the stock panic was the ultimate test of SLV owners' resolve. If anything should have spooked them, that would have been it. From late September to late November silver plunged 34%. While it had been trading in the high teens for most of 2008 before the panic, it was suddenly under \$10 in October and November. Yet even though silver is highly speculative, SLV owners held strong. Over the span of this 34% selloff SLV's holdings only fell 0.6%. Dead flat in the face of extreme silver fear!

Since the panic ended in mid-December, SLV has seen increasing stock-investor interest just like GLD. In February SLV's total silver holdings surged above 250m ounces for the first time ever. And even when silver started consolidating with gold over the last 4 months or so, SLV's holdings stayed high. Stock investors continued to buy SLV faster than silver was being bought, driving a series of new record highs in its holdings. The latest was seen just last week, a staggering 281m ounces!

To put this into perspective, according to the Silver Institute 681m ounces of silver were mined worldwide in 2008. So SLV, barely 3 years old now, has already absorbed the equivalent of 41% of an entire year's mine production. And just like GLD, these SLV buyers are not traditional physical-silver investors. They are people and funds who wouldn't or couldn't buy silver in its usual coin and bar forms.

This wouldn't and couldn't is important. Sure, every individual can buy physical coins. But for many it is just too much of a hassle. They have to find a reputable coin dealer, learn about the coins, buy the coins (paying a hefty premium over

spot), and store the coins. For hardcore investors like me, this is no problem. But for many newer or casual gold and silver investors, the ability to add GLD or SLV to their portfolios instantly for trivial commissions is irresistible. These ETFs are attracting new investors, broadening PM participation.

Some investors, particularly funds, usually cannot buy physical metals. Their charters explicitly limit them to buying stocks. So these new ETFs are the only way they can get PM exposure. Pension funds are deploying into GLD, and probably SLV, to diversify in a way they traditionally couldn't. And even if some elite hedge fund could buy physical, it probably wouldn't want to. That fund that took such a massive GLD stake in Q1 plowed nearly \$3b into gold. Where would a hedge fund physically and securely store \$3b in bars? It's far easier to let the ETF's custodians store the gold, plus it can be traded instantly in the future.

While I personally prefer traditional physical investing, my coins in my own immediate physical possession, I am a huge fan of these new PM ETFs. The more investors "discover" gold and silver, the bigger their bulls will ultimately be. These ETFs are creating a big tent where everyone with a standard stock account can participate in these gold and silver bulls. The more the merrier, and the more profitable! The more capital that has easy access to gold and silver exposure, the higher these metals will ultimately climb.

Still, there is one key thing lacking in these ETFs. *Leverage*. At best in GLD, an investor will mirror gold's performance less GLD's 0.4% of assets annual management fee. At best in SLV, an investor will match silver's gains less SLV's 0.5% annual expense ratio. For many investors, especially those diversifying a small fraction of their total portfolio into PMs, coming just shy of parity with the metals' performances is just fine. But I want to amplify the gold and silver gains.

So even though we currently have profitable short-term trading positions deployed in both GLD and SLV in our newsletters, I prefer the gold and silver producers. They have immense profits leverage to the metals they produce. If silver goes from \$15 to \$20, silver investors earn a 33% gain. But if a silver miner is producing silver for a cost of \$10 per ounce, and selling at market, its profits *double* in such a silver move. And ultimately stock prices follow profits. Thus gains in producer stocks far exceed their underlying metals'.

In our [monthly](#) and [weekly](#) subscription newsletters, we usually attempt to leverage expected moves in gold and silver by buying elite producer and explorer stocks. This strategy has been exceedingly profitable over the years. If you are interested in investing and speculating in these secular gold and silver bulls, with high-potential stock trades deployed when times look opportune, [subscribe today](#).

On the silver-stock front, we just finished a comprehensive deep research project looking at the universe of publicly-traded primary silver companies. Over

hundreds of hours we whittled this list down to our dozen favorites. My business partner Scott Wright, a world-renowned commodities-stock analyst, just finished an outstanding 33-page [report](#) detailing the fundamentals of our 12 favorite silver stocks. In addition to being a fascinating read, this awesome piece of work will get you up to speed on what we believe are the best silver stocks in the world to own in this new post-panic environment. [Buy your copy today!](#)

The bottom line is the investors buying the gold and silver ETFs have been far more committed than anyone ever expected. Even during the most frightening market episode of modern times, PM ETF selling didn't materially exceed the rates of selling in the underlying metals. Thus the ETF holdings have been sticky, they've remained stable on balance even through sharp and scary selloffs in gold and silver.

Part of this resilience reflects increasing mainstream stock-investor interest in adding gold and silver exposure to their portfolios through GLD and SLV. These ETFs' expanding popularity has enabled both to grow to record holdings in recent weeks even though gold and silver have been consolidating for months. And while GLD and SLV are already large compared to the gold and silver markets, they remain very small relative to the vast pools of stock-market capital. They still have lots of room to grow.

Adam Hamilton, CPA

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So how can you profit from this information? We publish an acclaimed monthly newsletter, [Zeal Intelligence](#), that details exactly what we are doing in terms of actual stock and options trading based on all the lessons we have learned in our market research. Please consider joining us each month for tactical trading details and more in our premium Zeal Intelligence service at ... [www.zealllc.com/subscribe.htm](http://www.zealllc.com/subscribe.htm)

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