Gold is expensive. Don't waste it!

Published 12 April 2023

Pierre Debru
Head of Research, Europe

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 future

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% (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 2023, that is, only 0.66% of the time.

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.

Historical performance is not an indication of future performance, and any investments may go down in value.

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.

What about silver, then?

Silver futures' behaviour is very similar to gold futures. The average roll yield between the first and third futures for silver is -2%. The curve was in backwardation only 81 days between January 1975 and February 2023. Over the last 15 years, a futures-based investment in silver has underperformed on average by 1.29%[1] per year compared to a physical investment.

WisdomTree is the leader in Europe for commodity exposure in exchange-traded products. As such, we aim to offer our investors the most innovative strategies to invest in commodities.

WisdomTree Core Physical Gold & WisdomTree Physical Swiss Gold

WisdomTree is the creator of the longest running physically-backed gold exchange-traded commodity (ETC) and the largest provider of physically backed precious metals ETCs. Gold ETCs are backed by physical bullion and, in the case of WisdomTree's physical gold ETCs, the bullion is held by the custodian within a secure vault and inspected twice a year by an independent entity.

From launch (17 Dec 2009) to end of February 2023, the WisdomTree Physical Swiss Gold returned 3.47% annualised returns when the Bloomberg Gold Subindex Total returned only 3.07%. The WisdomTree ETC outperformed by 0.4%[1].

From launch (30 Nov 2020) to end of February 2023, the WisdomTree Core Physical Gold returned 1.42% annualised returns when the Bloomberg Gold Subindex Total returned only 0.7%. The WisdomTree ETC outperformed by 0.72%[2].

[1] Source: WisdomTree, February 2023

[2] Source: WisdomTree, February 2023

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.**

2. Source: WisdomTree, Bloomberg. From 4 June 2007 to 31 January 2023. The PCOM strategy is a portfolio comprised of investments in physical gold and silver and the BCOM ex-precious metals over time rebalanced monthly to the weight in the BCOM index. From 3 December 2021, the WisdomTree strategy is live in the WisdomTree Bloomberg Broad Commodities UCITS ETF. This includes backtested data. **You cannot invest in an Index. Historical performance is not an indication of future performance and any investments may go down in value.**

Related blogs

+ Commodities are more than just an inflation hedge

+ What's Hot: Gold gets a safe-haven bid as banks shake confidence

+ What's Hot: Moderating inflation could further reinforce gold and silver

Important Risks Related to this Article

Important Information

Marketing communications issued in the European Economic Area ("EEA"): This document has been issued and approved by WisdomTree Ireland Limited, which is authorised and regulated by the Central Bank of Ireland.

Marketing communications issued in jurisdictions outside of the EEA: This document has been issued and approved by WisdomTree UK Limited, which is authorised and regulated by the United Kingdom Financial Conduct Authority.

WisdomTree Ireland Limited and WisdomTree UK Limited are each referred to as "WisdomTree" (as applicable). Our Conflicts of Interest Policy and Inventory are available on request.

For professional clients only. The information contained in this document is for your general information only and is neither an offer for sale nor a solicitation of an offer to buy securities or shares. This document should not be used as the basis for any investment decision. Investments may go up or down in value and you may lose some or all of the amount invested. Past performance is not necessarily a guide to future performance. Any decision to invest should be based on the information contained in the appropriate prospectus and affer seeking independent investment, tax and legal advice.

The application of regulations and tax laws can offen lead to a number of different interpretations. Any views or opinions expressed in this communication represent the views of WisdomTree and should not be construed as regulatory, tax or legal advice. WisdomTree makes no warranty or representation as to the accuracy of any of the views or opinions expressed in this communication. Any decision to invest should be based on the information contained in the appropriate prospectus and affer seeking independent investment, tax and legal advice.

This document is not, and under no circumstances is to be construed as, an advertisement or any other step in furtherance of a public offering of shares or securities in the United States or any province or territory thereof. Neither this document nor any copy hereof should be taken, transmitted or distributed (directly or indirectly) into the United States.

Although WisdomTree endeavours to ensure the accuracy of the content in this document, WisdomTree does not warrant or guarantee its accuracy or correctness. Where WisdomTree has expressed its own opinions related to product or market activity, these views may change. Neither WisdomTree, nor any affiliate, nor any of their respective officers, directors, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any use of this document or its contents.