Bloomberg

SPDR Gold Wrests ETF Crown Away From S&P 500 Fund as Market Turmoil Reigns

By Sree Vidya Bhaktavatsalam and Christopher Condon - Aug 22, 2011 10:41 PM GMT+0100

Gold reached a new milestone in its role as an investment and haven, with the leading exchange- traded fund that tracks bullion surpassing its equities counterpart as the biggest ETF by market value.

SPDR Gold Trust's market capitalization rose to $76.7 billion on Aug. 19, according to the most recent data compiled by Bloomberg, driven by the rising prices of the metal, which topped $1,900 an ounce for the first time today. SPDR S&P 500 ETF Trust (SPY), which has been the industry's largest exchange-traded fund since 1993, stood at $74.4 billion, now 3.1 percent smaller. At the start of the year, the Standard & Poor's 500 Index-tracking ETF was 56 percent larger.

"Gold has become the portfolio antidote for the global financial crisis," James McDonald, chief investment strategist at Northern Trust Corp., the Chicago-based custody bank and money manager, said in an interview.

The metal is up 34 percent in 2011, which would be its 11th straight year of gains, while the S&P 500 Index (SPX), a benchmark of the biggest U.S. stocks, has lost 11 percent. Investors have accelerated the retreat from equities on concerns that European countries will struggle to repay their debts and that the U.S. economy is weakening under the strain of unemployment above 9 percent, falling home values and a decline in consumer confidence.

The SPDR 500 ETF rose 9 cents to $112.73 in New York trading today at 4:15 p.m. The SPDR Gold Trust rose $4.64, or 2.6 percent, to $184.59.

Multiple Investor Preferences

"We are seeing some lasting asset-allocation shifts to gold, including by central banks, as well as some safe-haven flows that could well be reversed in the months ahead," said Mohamed El-Erian, chief executive officer of Pacific Investment

Management Co., the Newport Beach, California-based manager of $1.3 trillion in assets.

“The dramatic surge in demand for gold reflects the aggregation of many investor preferences -- for example, from those seeking shelter from lower stock markets to those protecting against currency debasement by central banks,” El- Erian wrote in an e-mailed response to questions.

Gold underperformed U.S. stocks in the 1990s in an era of deregulation, Frank Holmes, chief investment officer and CEO of San Antonio-based U.S. Global Investors Inc., said in an interview. That trend started to reverse in 2002 as government regulation increased, and accelerated with the Dodd-Frank rules instituted after the financial crisis of 2008, Holmes said. Rising demand from emerging economies such as India and China has also contributed to higher prices of the metal, he said.

Fear, Love

“We’re on a hyper-speed of regulation, and that’s not the best thing for the stock markets,” said Holmes, who oversees more than $3 billion in funds including those that invest in gold-mining stocks. “The rise of China and India has set up a different dynamic for gold, so you’re seeing the fear trade as well as the love trade.”

The SPDR Gold Trust ETF, created by the World Gold Council in November 2004, is the biggest ETF tracking the price of the precious metal. State Street, based in Boston, is the sales and marketing agent for the fund, which is physically backed by gold bars deposited in a London vault. It’s one of at least three such U.S.-based ETFs. New York-based BlackRock Inc. (BLK)’s iShares Gold Trust had a market value of almost $10 billion on Aug. 19.

The growth in SPDR Gold Trust this year has been largely driven by the rising value of gold, as the number of shares outstanding in the fund increased by about 1 percent. Since July 1, the number of shares in Gold Trust has climbed by 7.1 percent, contributing to the gain in assets.

Haven With Risk

Investors turn to gold in times of financial and economic turmoil as an alternative store of wealth to stocks and the dollar and a hedge against inflation. Cash and Treasuries are also haven investments, and are considered safer than gold, according Northern Trust's McDonald.

"Gold is not a substitute for cash or Treasury bonds," he said. "Because of the lack of an earnings stream behind it, when sentiment shifts, gold can go in the other direction and will have more momentum behind it."

BlackRock's Russ Koesterich, iShares' global chief investment strategist, wrote in an Aug. 19 report that investors looking for a defensive investment amid concerns about the global market should consider a "strategic allocation" to gold even after the metal's rise over the past few weeks.

"Recent signs from Washington and the Fed point to a continued erosion of the dollar relative to foreign currencies," Koesterich wrote. "Gold tends to do best when the dollar is eroding."

Paulson's Stake

U.S. Global's Holmes said the value of the dollar relative to bullion has dropped 98 percent since President Richard Nixon dropped the gold standard in August 1971. As gold continues to rise, it's "prudent" for investors to hold about 5 percent of their assets in gold or gold-mining stocks, he said.

Paulson & Co., the hedge fund run by billionaire John Paulson, was the largest holder in SPDR Gold Trust as of June 30, with 31.5 million shares, or 7.4 percent of outstanding stock, according to regulatory filings.

The holdings are used for the New York-based hedge fund's gold-denominated share classes, which have outperformed the firm's dollar classes this year. The investment accounts for about a third of the firm's $35 billion in assets, according to a person familiar with the fund, who asked not to be named because the information is private. Most of Paulson's personal investments in his hedge fund are held in the gold share classes, the person said.

Access to Bullion

The SPDR S&P 500, opened in January 1993, is the oldest existing product in the ETF industry, which oversees $1.1 trillion in assets in the U.S. It's one of three U.S. ETFs larger than $1 billion that track the Standard & Poor's 500 Index, excluding leveraged and inverse funds.

Unlike mutual funds, ETFs create or redeem shares in large blocks at the request of big institutional investors, known as authorized participants. Small investors must purchase or sell shares on an exchange, where they trade throughout the day like stocks. U.S. mutual funds are priced once a day, after the close of regular trading.

The creation of ETFs to invest in gold has given investors a way to benefit from rising gold prices, without having to directly own or trade the precious metal. Research firm Morningstar Inc. (MORN) tracks about two dozen gold mutual funds in the U.S., all of which invest in gold-mining stocks or indexes composed of companies engaged in exploring and mining the precious metal. The stocks and indexes don't necessarily move in tandem with the price of the underlying metal.

'Scared' Away

"The market volatility has scared investors away from stocks," Paul Justice, an analyst with Morningstar in Chicago, said in an interview. "No mutual fund can offer what the gold ETF can, but the S&P 500 ETF has many competitors."

The S&P 500 index has tumbled 18 percent from this year's peak on April 29. The index returned an average of 1.9 percent a year including dividends in the decade ended Aug. 12, souring investors who counted on equities to resume their historic long- term gains of about 10 percent a year.

Morgan Stanley cut its forecast on Aug. 18 for 2011 global expansion, citing an "insufficient" response to Europe's debt troubles, weakened confidence and the prospect of fiscal tightening. The bank lowered its growth prediction to 3.9 percent from a previous forecast of 4.2 percent.

Slower Growth

Citigroup Inc. cut its growth forecasts for the world's largest economy and trimmed its earnings estimates for the S&P 500. The U.S. economy may expand less than previously forecast in 2011 and 2012 because of potential “political paralysis” and fiscal-tightening measures, Citigroup analysts wrote in a report dated Aug. 18.

The bank cut its 2011 gross domestic product growth forecast to 1.6 percent from 1.7 percent and lowered its 2012 GDP growth estimate to 2.1 percent from 2.7 percent. It cut its 2011 and 2012 per-share earnings estimates for the S&P 500 to $97 and $101 respectively.

SPDR Gold Trust has climbed every year since inception, including a 30 percent gain in 2011. The gold ETF has more than doubled in price since the collapse of Lehman Brothers Holdings Inc. in September 2008 roiled financial markets, while the SPDR S&P 500 ETF declined 4.6 percent including dividends.

Gold’s gains accelerated in the third quarter as record-low U.S. borrowing costs and a declining dollar boosted the appeal of alternative assets. Holdings in global ETFs backed by gold have grown 85 percent since the end of 2008, reaching an all- time high of 2,216.76 metric tons on Aug. 8, data compiled by Bloomberg show.

To contact the reporters on this story: Sree Vidya Bhaktavatsalam in Boston at sbhaktavatsa@bloomberg.net; Christopher Condon in Boston at ccondon4@bloomberg.net