Invesco Physical Gold ETC
Market Update - June 2020

For professional investors, qualified investors, and qualified clients only

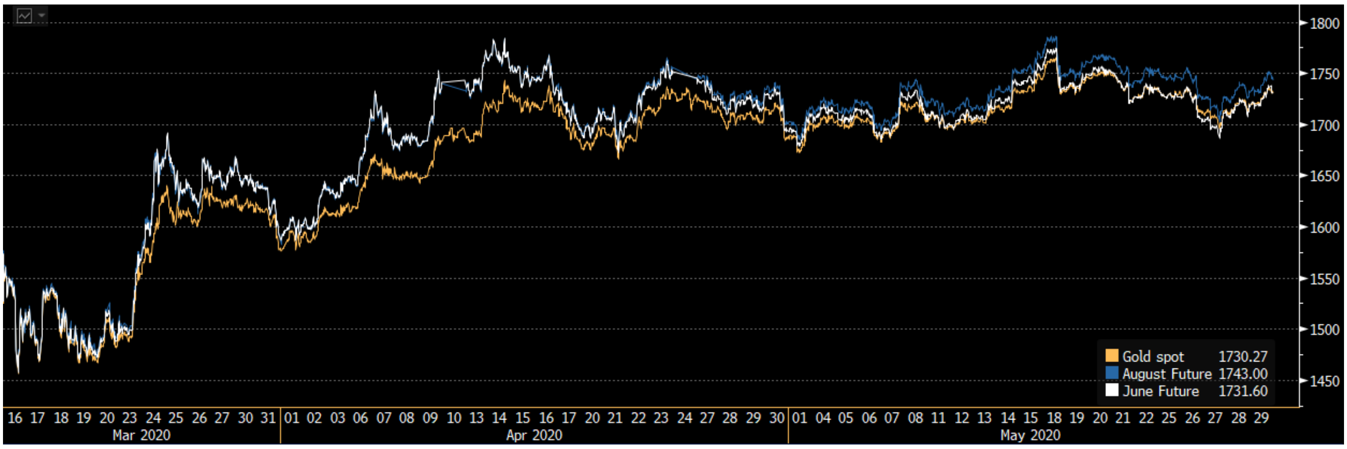
Market dislocation – two months on

Gold has been the best performing asset class so far in 2020, as investors continue to seek insurance against the uncertainty created by COVID-19. Demand for bullion has surged, driving global holdings in gold exchange traded products to record levels.

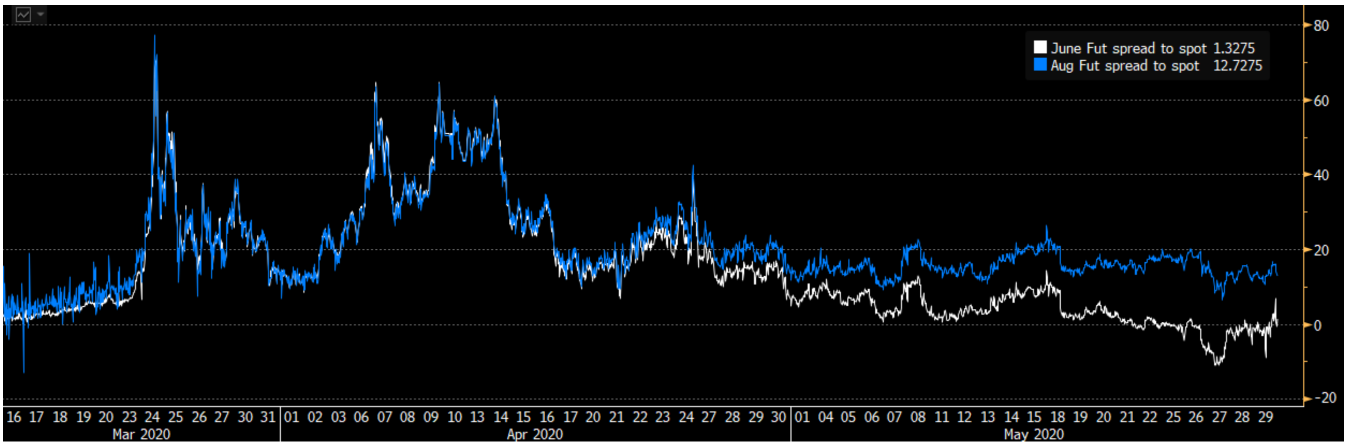
The gold market experienced an unprecedented dislocation in March (starting on 24 March) as gold futures diverged significantly from spot metal prices. In late March, the premium for New York futures over the London spot price rose above $70, the highest in four decades. This compares with just a few dollars during normal times.

The futures vs. spot dislocation has continued, although the nature of the dislocation has changed during May. As the June future approached expiry, the price has fallen relative to spot, dropping as low as an $11 discount while the August future continues to trade at a $10-20 premium to spot. This also means that the cost of rolling from the June to the August future is around ten times its normal levels.

Gold spot vs. futures price



Gold futures spreads to spot



Source: Invesco, Bloomberg, 29 May 2020.

There are a number of potential factors that have contributed to the dislocation.

1) **Supply of gold**: Disruption caused by COVID-19 to the refining and shipping of gold was a major issue. While distruption has eased, problems still remain. Normally, the futures and spot markets for gold around the world are closely linked, as traders can efficiently arbitrage between markets by shipping physical gold and converting gold bullion from one delivery standard to another (e.g. smelting 400 ounce fine bars that are used for good delivery in London to mint 100 ounce bars that are acceptable for delivery in New York). The shutdown of smelting facilities and the disruption to transportation caused by the response to the virus meant that this arbitrage route was distrupted.

   Market participants have taken steps to moderate these issues. COMEX, the futures exchange in New York has launched new futures contracts that accept 400 ounce rather than 100 ounce bars. The supply of gold in New York has also increased to a record 27.5 million ounces at the end of May, which is one of the reasons that the June future dropped to a discount to spot.

2) **Funding costs**: US dollar funding costs also rose during the crisis period, which makes it more costly to fund futures exposures, thus pushing up the price that banks will charge for offering futures exposures. A number of banks offering futures trading made losses on their positions during the dislocation between spot and future prices and as a result have reduced their willingness to make tight market pricing in gold futures.

The dislocation in the gold market has increased trading costs for gold and related products

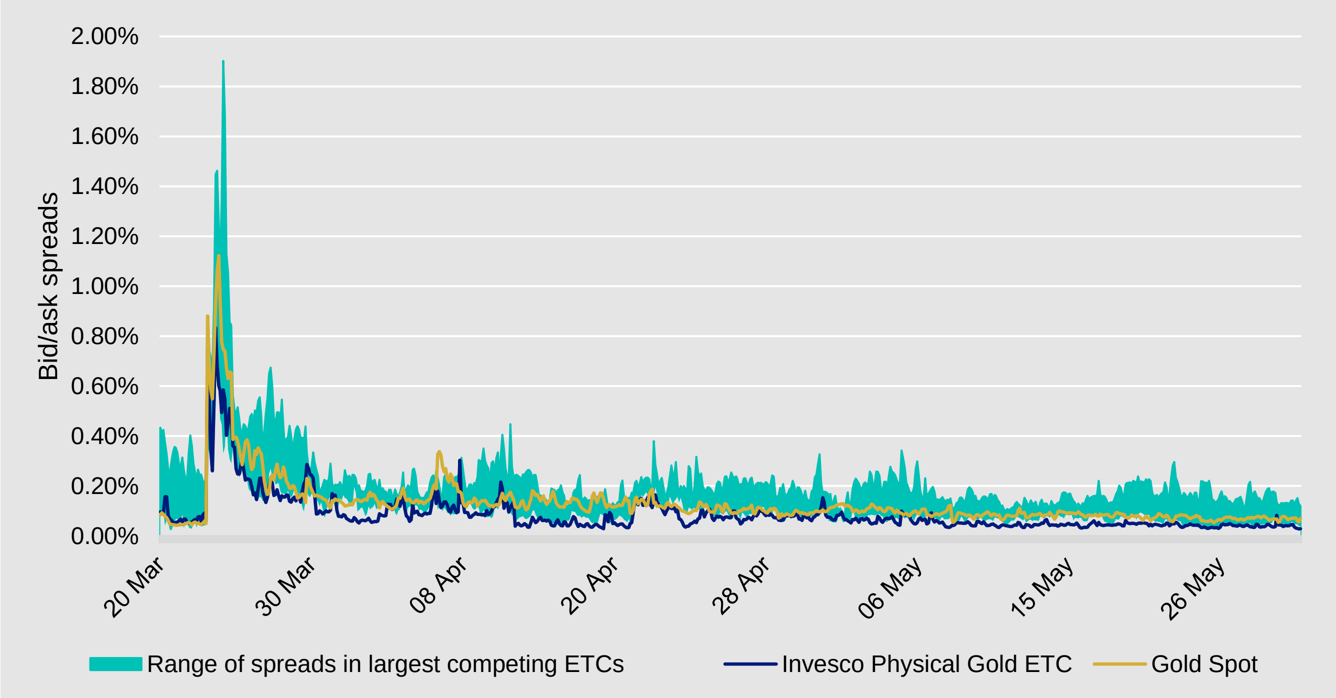
Spreads in the gold spot market blew out to more than 100bps at the end of March, drastically higher than the average of just 2 to 3 bps under normal market conditions. The market for exchanging futures exposure for physical gold (the “Exchange for Physical” or EFP market) has been particularly volatile, fluctuating in the $10-70/oz range over the same period. That is around 50-100x the historical norms for these markets.

Trading in the futures market has also been impacted. As noted above, the dislocation between spot and futures prices has declined but the depth of the futures market has been significantly weakened. Spreads in the active month gold contract have begun to come back to pre-dislocation levels ($0.10-0.20). However, the order book depth is still only a fraction of what it was. Prior to the dislocation there was around $100m of quotes available at +/-6bps from the mid price, currently there is only around $20m within that range, an 80% drop in at the touch or near the touch liquidity.

With reduced liquidity and higher and more volatile roll costs We belive that using ETCs to obtain exposure to gold is a more appealing option. Market participants can access the future market when pricing ETCs but in certain cases can also access the spot market which provides an additional dimension of liquidity that allows clients to trade large sizes in our ETC with ease.

That is not to say that Gold ETCs have been immune to the distrutions to the gold market. As the chart below illustrates, spreads on the majority of European Gold ETCs widened to around 200bps at the height of the dislocation, before narrowing. The **Invesco Physical Gold ETC (SGLD LN) fared better than most** in the market with consistently tight spreads, settling down to around 4 bps in the last week of May. This is still higher compared to the average 2 to 3bps that was typical prior to this blow-out in spreads but SGLD has demonstrated the tightest spreads across competing funds over the past month, and we saw AUM climb above $11bn for the first time.

Invesco SGLD has consistently shown very tight daily average spreads



Source: Bloomberg, Invesco, as at 20 Mar 2020 through 29 May 2020. Chart shows rolling 1h spreads in 30 minute intervals. During this period, Invesco Physical Gold ETC averaged 0.08% vs. range of 0.10% to 0.19% for largest 5 competing Gold ETCs in Europe.

Markets are still trading – but care is required

The unusual market conditions make trading intelligently more important than ever. As this situation is likely to continue to evolve rapidly, we would recommend contacting our **ETF Capital Markets team via** **etftrading@invesco.com** to aid with trading in the current market.

Investment risks

Value fluctuation

The value of investments, and any income from them, will fluctuate. This may partly be the result of changes in exchange rates. Investors may not get back the full amount invested.

Commodities

Instruments providing exposure to commodities are generally considered to be high risk which means there is a greater risk of large fluctuations in the value of the instrument.

Limited recourse

If the issuer cannot pay the specified return, the precious metal will be used to repay investors. Investors will have no claim on the other assets of the Issuer.

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Data as at 29 May 2020, unless otherwise stated.

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