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YELLOW FEVER

It is often derided as the yellow metal with no yield. But as real rates fall, central banks embrace more stimulus and the global monetary system shows signs of cracking, investors are catching the gold bug once again.

Against this backdrop, Merian Global Investors brought together a number of leading wealth managers to talk about prospects and purpose of gold – and why it is likely to shine in the future.

A great diversifier and proven store of value over more than five millennia, most agreed gold still has a vital role to play in investment portfolios (page seven). But what is likely to drive its fortunes in the future? And is it becoming a geopolitical and monetary hedge, rather than a simple defence against inflation? (Page 12).

We finish by taking a deeper look at bitcoin's threat to gold as volatility and digitization become the norm, as well as the curious role bullion banking plays in the fascinating and sometimes murky world of gold (page 15).

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NED NAYLOR-LEYLAND

PORTFOLIO MANAGER

Merian Global Investors

Ned Naylor-Leyland joined Merian Global Investors in 2015 and is a well-known figure in the world of gold and silver investing, with more than 17 years' investment experience. He is currently the portfolio manager of the Merian Gold and Silver fund. He joined the firm from Quilter Cheviot, having founded a dedicated precious metals fund for Cheviot Asset Management in January 2009. He previously worked for Smith & Williamson.

ROB MANSELL

PORTFOLIO MANAGER

Barclays Investment Solutions

Rob Mansell is a portfolio manager and fund analyst at Barclays. He has been responsible for commodity fund selection since 2014, having joined the firm in 2011. He started his career at Fidelity, working in the equity and fixed income portfolio management and trading teams, with responsibility for trade implementation and asset allocation across multi-manager and multi-asset class products. He holds a degree in Japanese and Asia-Pacific Studies from the University of Leeds and is a CFA Charterholder.

PATRICK THOMAS

INVESTMENT MANAGER

Canaccord Genuity Wealth Management

Patrick Thomas sits on Canaccord Genuity Wealth Management's portfolio construction, fund selection and alternatives committees. He specialises in managing investment portfolios for intermediaries, trusts, charities and pension funds, with a focus on discretionary mandates. He is a chartered wealth manager and a chartered fellow of the CISI.

JAMES PENNY

SENIOR INVESTMENT MANAGER

TAM Asset Management

James Penny joined TAM's investment management team in 2014 as an investment analyst and is now a senior investment manager. Prior to joining TAM, he worked for UBS in New York within the bank's options trading division. He later moved to UBS' investment banking division in London, where he specialised in global equities and derivatives within the bank's growing portfolio trading division.

MARTIN CRAWLEY-BOEVEY

DIRECTOR, HEAD OF FINANCIAL PLANNING

PK Group

Martin Crawley-Boevey is a director at PK Group and head of financial planning.
He has been an IFA for 25 years, assisting high-net-worth individuals in achieving their financial objectives. He started his career in the City in 1986 working for a futures and options brokerage, where he covered most commodity and financial futures markets in the UK and US. His first ever transaction was selling a gold call option. He was then involved in transacting a number of precious metal investments using futures and options during the late '80s and early '90s before becoming an IFA. In his spare time, he can be found running around a five-a-side football pitch to keep fit. He is married with three children.

CHARLIE LLOYD

INVESTMENT MANAGER

Skerritts Consultants

Charlie Lloyd is a member of the investment management team at Skerritts, with responsibility for asset allocation and fund selection for the firm's range of tactical model portfolios and OEICs. He studied financial services at Sheffield Hallam University and began his career in private client investment management at HSBC Investments. After 12 months, he moved to Brewin Dolphin, initially working in its London office. In 2007, he joined UBS Wealth Management, before returning to Brewin Dolphin to help establish its Brighton office.


1 KILO
GOLD
999.9

FINDING ITS PLACE: WHAT ROLE SHOULD GOLD PLAY IN A PORTFOLIO?

As monetary policies around the world begin to shift and investors wake up to the end of the bull market, gold investing is back on the table.

Gold has always divided investors on its nature and its role in portfolios: some believe the precious metal can help in market stress for its store of value properties, while others see it as a diversifier or as a tactical play. However, despite its multi-purpose characteristics, scepticism remains on how gold can really add value in a portfolio.

Merian Global Investors gathered investment professionals in London for a roundtable discussion to shed more light on why many preconceptions around gold and precious metals exist, and how to change them.

DIVERSE IDEOLOGY

One of the first assertions about gold is its value is driven by market sentiment. So in times of fear or geopolitical turmoil, its price risess as faith in governments falls. This leads many to invest in order to provide some protection over the long term.

James Penny, senior investment management at TAM Asset Management, is a case in point. He has always held gold in his portfolios and added more of the precious metal in 2018, on the back of the selloff in equities and increased volatility.

'We've always held gold as a short-term hedge against sentiment because sentiment seems to drive up gold at a very basic level. Last year, we saw prices becoming quite attractive in gold, more so than they have been in quite a while,' he said.

In a similar fashion, Charlie Lloyd, investment manager at Skerritts Consultants said gold proved attractive during a turbulent 2018, when equities looked expensive and bonds and absolute return sectors were underperforming. 'We don't own gold with a view to making money', he asserted.

'Gold remains one of the few genuinely uncorrelated asset classes still available to investors and perhaps, it goes through spells of being in and out of fashion, but for us, it's probably a core holding in our lower risk portfolios.'

But having a long-term position in gold and holding it consistently through many market cycles was not such a realistic option for other participants at the roundtable. The polarising ideology that surrounds gold was a particular hurdle for Patrick Thomas, investment manager at Canaccord Genuity.

Thomas has never allocated to gold, and prefers to avoid the asset class on sustainability grounds. He said: 'You've had to hold gold over a long-long period of time and be quite behaviourally disciplined to have made that add value to your portfolio. I haven't historically seen many wealth managers tactically add positions in gold.

'It's a very ideologically driven argument that frequently gets quite extreme viewpoints. It's very, very narrative driven and a lot of it is without substance.'

NOT A COMMODITY

One of the misconceptions around gold is that it is a commodity like silver. But Ned Naylor-Leyland, fund manager at Merian Global Investors argued gold is, in fact, primarily a currency, which is the main reason banks hold it in their vaults.

Despite the fact gold is mined and so carries a physical feature, gold trades in the foreign exchange markets like any other currency and it does so in large volumes against cash.

'What gold represents is sound money,' said Naylor-Leyland.

He argued it is 'the best kind of money over the long-term. While it can fluctuate.'

What matters currently is that monetary policy of the Federal Reserve has made a U-turn on the speed of its interest rate policy, leaving some uncertainty over how the dollar will move.

NO INCOME?

Another reason why investment professionals need to justify the presence of gold in portfolios is the fact that it does not pay any income. For financial advisers, especially, this is a difficult conversation to have with their clients, when market returns are currently so low.

Like many, Martin Crawley-Boevey, partner at financial planner PK Group uses gold as a hedge in portfolios. However, he warned that investors need to have clear conviction on the asset class to overcome its lack of income. 'When you're trying to

Five ways to allocate to gold

There are many ways to gain exposure to gold and many purposes it can serve within a portfolio, here are just a few of them

Hedge against risk
Gold has a low correlation to both equities and bonds, and has potential as a hedge both against known risks such as inflation, political and financial instability, as well as dollar weakness. Often, gold is used tactically in portfolios, so for short-term protection.

Diversifier
Gold provides useful diversification benefits as it historically has a low correlation with most major asset classes. This provides unique portfolio diversification benefits for long-term balanced portfolios. Gold has performed well during periods of significant changes in monetary policy as well as during the financial crisis of 2008, performing better than major indices, such as the S&P 500.

Core allocation
For many, physical gold should form part of a core allocation within a portfolio as it is cheaper, more liquid and less risky than many other asset classes such as equities and gold equities.

Strategic allocation
Many wealth managers allocate gold strategically over the long term to lower risk. Depending on the client risk profile, typically gold takes up to 5% for a long term strategic asset allocation.

Alternative asset
If considered as a commodity, gold is often included in the alternative portion of a portfolio. Despite the fact that the price of gold can be very volatile, holding it as an alternative investment can balance a portfolio when the market drops and can offer more value than bonds.

seek out returns and meet those financial planning objectives, we have to be very convinced gold is going to add value to client portfolios,' he said.

But Naylor-Leyland disagrees on the income quality of gold, and said that it can generate income if banks lend it into the market.

'Gold has lots of narratives swirling around it and a lot of them are just not right. This point on income is one of them. You can lend anything, in fact there's a very active lending market for gold.

'It's just that clients and the normal investor, rather than let's say, a financial services firm, they don't want to turn the only thing which isn't credit into credit.'

It's really crucial to understand you can't look at equities and gold and gold stocks without thinking about the cash market in the middle, because that's the hidden part – Ned Naylor-Leyland

ALTERNATIVE BUCKET

With many signals pointing to a potential recession globally, gold is still seen as a safe haven and some managers decide to allocate it within the alternative portion of their portfolios to better manage their risk.

But does gold sit comfortably in an alternative strategy? Thomas has reservations.

'Gold is used when people aren't really sure about bonds or equities and I just want to reiterate how massive a call that is to start saying: "I'm going to protect the portfolio using gold as my "crisis hedge",' he said.

'Make sure you define what that risk is because I think the risk of owning and trying to time your way into this kind of asset class has historically been worse than the risk that you're trying to protect against.'

Naylor-Leyland recalled that when the market collapsed in 2008, gold fell by 30% while gold stocks fell even more. But that was a result of a dollar appreciation, not of asset class correlation.

'If the equity market goes down hard, it's very likely that real interest rates will go down because the market will see that as needing further loose monetary policy, which will drive gold up and gold stocks up.

'But it's really crucial to understand you can't look at equities and gold and gold stocks without thinking about the cash market in the middle, because that's the hidden part. This is also why people get confused by the asset class.'

MORE THAN A DIVERSIFIER

Overall, most of the participants at the roundtable believed gold generally functioned better as a diversifier in a portfolio, rather than as a hedge against risk.

To seek an alternative source of positive returns to equities, Rob Mansell, multi-manager at Barclays Investment Solutions, recently moved his gold allocation from gold equities to physical gold and added more commodities to the mix through futures contracts.

'We see commodities as an asset class which can do something different, at different times, to equities and bonds. They're not 100% correlated positively or negatively. Even if you've got a correlation of zero, then potentially, it's just going up and down at different times to everything else in your portfolio.

'So, for us, it gives something else as a diversifier. It's not the only alternative asset class we allocate to and it's definitely not the biggest allocation. But on a strategic perspective, we very much see it as a diversifier in a portfolio.'

For Thomas, there are not many options for UK investors other than diversifying portfolios with an asset class such as gold, since bond yields are low and could go lower.

'As a diversifier, bonds might be worse than you would hope. Maybe you get more yield from treasuries, but again, you're taking currency risk that you might not necessarily want in your portfolio.'

'So, you do need something else. I think gold is a perfectly valid allocation, but again, you get to the point of making sure the percentage is meaningful and making sure you're allocating in the right way.' ●

ADVERTISEMENT FEATURE

Merian GLOBAL INVESTORS

GOING FOR GOLD

Ned Naylor-Leyland, manager of the Merian Gold & Silver Fund, has four tips for investors.

DON'T MISS A TRICK

Look up the International Monetary Fund/World Bank table of reserve assets and today's Western investors might get something of a surprise – gold sits at the very top of that list.

While gold remains the go-to primary reserve asset of the world's central banks, the global super rich, and even the developing world, the precious metal has long been shunned by most ordinary Western investors.

'Almost 40% of G7 central bank reserve assets are in gold'

Almost 40% of G7 central bank reserve assets are in gold – the US Federal Reserve holds 74% – and 18% of G20 central bank reserves are in gold, but the average investor's portfolio exposure is a measly 0.1%[1]. Quite some disconnect.

Academic studies suggest that 2-5% in gold, as a fixed allocation, is optimal for portfolio diversification purposes. Arguably a higher allocation is merited due to the need for systemic insurance.

Why is Western investor exposure so low? Well, for many, gold is a tiny element that sits within a basket of alternative assets. Not since the turn of the century has it been benchmarked in portfolios, or been seen as a core tenet of a balanced portfolio. They are missing a trick.

SECURE A SILVER LINING

We characterise gold and silver as monetary metals, not precious metals, per se. Why? Well, unlike commodities such as copper, corn or oil, gold and silver trade on the currency markets. Indeed, they have currency tickers: XAU for gold and XAG for silver.

But while both are currencies and commodities, silver is consumed in a number of ways in industry, such as in electronics, solar and medical instruments. Now, the benefit of this is that its return profile is roughly 2x that of gold, meaning that it is a very interesting portfolio tool for a gold investor.

NED NAYLOR-LEYLAND
Manager, Merian Gold & Silver Fund

Dynamically including silver in a portfolio offers the potential to achieve higher returns when the market conditions are right, as silver typically increases in value faster than gold when precious metal prices are rising, although it declines faster when prices are falling.

Right now, an ounce of gold is worth around 80x that of an ounce of silver but the natural geological ratio of around 10:1 suggests a structural bias in the valuation of gold and silver. We expect this value gap to close in the coming years.

‘Gold is the apolitical instrument that can replace the dollar as the world’s reserve currency’

GET PHYSICAL

According to the London Bullion Market Association data, turnover is in the hundreds of billions of dollars equivalent every day. But of that, a tiny 1-3% of overall daily traded volume is physical trading.

As such the majority of gold positions that come together to create price discovery in this market are actually various forms of credit instrument, rather than real metal. In some parts of the world, these gold obligations or credit gold instruments are openly described as ‘paper gold’, in others ‘unallocated gold’ and sometimes they are just called ‘gold’ – this is not an accurate description of the risks inherent to the instrument being offered.

Credit or paper gold is not true gold exposure; rather, it is the credit risk of the institution that issued the instrument.

An awareness of this problem and ensuring ownership of real physical gold can turn what’s otherwise a structural risk into genuine return potential. This is fundamental to the success of a gold fund manager, and needs to be taken seriously when selecting bullion instruments in a portfolio.

Being as close to physical gold and as far away from credit gold as possible is key to successful investing in the asset class.

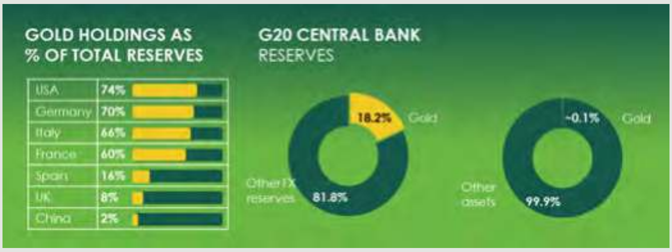
THE DOLLAR’S LOSS IS GOLD’S GAIN

Ever since the petrodollar system was imposed by the US on the rest of the world, the US dollar’s status as the world’s reserve currency has remained firmly entrenched, to the sole benefit of the US.

But the world has had enough, and gold is set to benefit. The metal is the apolitical instrument that can replace the dollar as the world’s reserve currency. Gold is not sovereign money, it can’t be issued, and it is not tarred by politics: as such, it can be the objective disciplinarian to the global monetary system. The world is waking up to this.

The likes of China and Russia are looking to gold to fill the role historically played by the dollar, for example to buy oil. These aren’t mere rumblings; they are signs of material change and all potentially supportive of the yellow metal.

Economic powers from China to the European Union are signalling that change is afoot. The long unspoken truth of the dollar being a political tool is finally being exposed. And the yellow metal’s re-emergence as genuine apolitical money is only good news for investors in the asset class.



[1] World Gold Council, Q3 2018

UNDERSTANDING GOLD'S VALUE IN A POLITICALLY UNSTABLE WORLD

From de-dollarisation to a new gold standard, investors debate the precious metal's ability to provide apolitical exposure and inflation protection

From the ashes of the financial crisis right through to the summer of 2018, investors rode the longest bull market since World War II.

However, the smooth ride was interrupted in Q4 when equity markets corrected. A combination of slowing growth and trade tensions, driven by the policies of unpredictable personalities behind the wheel in the US and China, had given investors the jitters.

Central banks, too, added their own degree of uncertainty by flip-flopping on the speed of their balance sheet unwinding. The status quo, it seems, is shifting.

TIME FOR A RETHINK?

So should investors' asset allocation follow suit? In February 2019, Merian Global Investors gathered wealth managers together in London to discuss this changing macro picture and whether precious metals such as gold should be on the agenda, as advisers seek to protect their clients against these unfolding risks.

Rob Mansell works in the manager and fund selection team at Barclays Investment Solutions, while he believed a weaker dollar, combined with macro uncertainty and equity volatility, has helped the investment case for gold, he has yet to make major adjustments across his clients' portfolios in respect to precious metals.

'From our perspective, with inflation where it is and growth where it is, we've tilted our portfolios towards equities, away from fixed income, and on commodities we've really been neutral for a long time. We haven't really got a strong view either way and that extends into gold.'

'So, while we have some exposure, we're definitely not running away with overweights or underweights to specific commodities at the moment.'

Ned Naylor-Leyland, who manages the Merian Gold and Silver fund, was keen to communicate what he viewed as a fundamental shift in central bank policy and heeded investors to take notice.

'We've had this big narrative change in terms of Fed policy, which is effectively making the cash market worry about forward-looking

real interest rates. So gold is your hedge against dollars held forward. That's what it's all about.'

However, with inflation still refusing to raise its head, investors around the table were at odds with how best to communicate to their clients a need for protection against a problem that is not showing up in the data.

Charlie Lloyd, investment manager at Skerritts Consultants, said: 'The truth is, we're 10 years into this business cycle with QE, and there's still no inflation. I think the Fed are completely perplexed by this. All their models are flashing red because unemployment is less than 4%. The Phillips Curve says wages should start soaring and then that will feed through to prices. That's not happening.'

He added: 'I'm not declaring inflation's dead, but I think people rely on economic models, which were fit for the 1970s, 1980s, 1990s. We're in a completely new era now. So, I think everyone needs to assess the future in a slightly different manner.'

Martin Crawley-Boevey, director and head of financial planning at PK Group, highlighted that inflation was also off the agenda in discussions with his clients.

'We have more conversations as to whether we should hold gold, and, certainly, this reflects my recent meeting with a client, where the discussion was about the political environment and the fears around what potentially could blow up in the world as we move into very, very uncertain times, politically.'

'So, it's more of a hedge against political and economic risk, rather than just pure inflation risk. The client's view was to go and buy some gold bars and put them in the safe at home.'

Risk is a big factor in how you incorporate gold mining stocks into your allocation

– James Penny

Charlie Lloyd at Skerritts Consultants agreed gold had been a 'nice hedge' and he had implemented a strategic allocation to the metal across his lower risk portfolios.

However, for James Penny, senior investment manager at TAM Asset Management, gold served more tactical purposes, especially at the end of Q3 when he took a position in the equity market and in the mining sectors for his higher risk clients.

'We started to add to that a little bit and then there was a conversation around it with our clients. Risk is a big factor in how you incorporate gold mining stocks into your allocation. That's what we've been doing, and that's the conversation we've been having. Less around the stability, diversifying element of it, and more around what we're doing more recently on the tactical side.'

DE-DOLLARISATION AND YOU

Fund manager Ned Naylor-Leyland pointed to another dynamic he viewed as an important aspect to the gold debate, saying: 'There's a really obvious de-dollarisation trend going on, which is overlaying or underpinning all the geopolitical stuff you're reading about, ex-Brexit.'

He added: 'I think the analogy of trying to quietly leave the room is a good one.

'If you remember 'what's the time Mr Wolf?', the children's game where someone faces one way and you try and creep up on them. Well, for a year now, sovereign nations have been playing a reverse version of that. The US is facing one way as everyone tries to leave the room.'

Naylor-Leyland said this was happening as emerging economies such as China were attempting to diversify their reserve holdings away from dollars, while also creating alternatives to dollar settlement, such as the petroyuan.

'I remember the language Nixon used when they closed the gold window was, "this is a temporary suspension of the convertibility of the dollar". It's just been temporary for 50 years.'

According to Naylor-Leyland, now that we're in a situation where it's no longer a unipolar world, gold makes sense, as it's no one's sovereign money.

'Gold was what used to settle international trade before the dollar jumped on it in the early 1970s. I think all of that is super important and it's now being looked at all over again.'

So how should investors react to these shifting sands beneath markets? For Naylor-Leyland, it presents an opportunity, particularly given how underweight most investors are.

'I genuinely think this is the right place to take benchmark risk at the moment. If you agree even slightly with the de-dollarisation trend then gold is a good place to take benchmark risk, relative to what other people are doing and the data on the screen.'

DISRUPTING HISTORY? GOLD, BITCOIN AND BULLION BANKING

It has been mankind's obsession for more than 6,000 years. Wars have been waged over it, love is expressed through it, and it has changed the landscape of history and civilisation around the world. But could gold – the one "true money", according to banking giant John Pierpont Morgan – soon be disrupted? That is the assertion of Bitcoin enthusiasts, who believe a new type of gold, a digital replica of sorts, is set to take its crown.

For investors, and the participants of the recent Merian Global Investors roundtable debate on 15 February, the future of gold – and the threat posed by Bitcoin – has become a hot topic of discussion. So just what does the future hold? And is this the end of gold's six millennia reign at the top?

THE BITCOIN THREAT

In 2008, as stock markets crashed and the financial system was teetering on the brink of collapse, a mysterious white paper suddenly emerged. Written by an anonymous computer programmer called Satoshi Nakamoto, the paper called for a "peer-to-peer electronic cash system".

Months later, Nakamoto himself released the first software that would underpin the project. Partnering with developers and coders, the Bitcoin ecosystem grew rapidly in the following years, before Nakamoto seemed to vanish – taking roughly 1 million bitcoins with him.

But his legacy lives on. Even before its parabolic price rise in 2017 caught the world's attention, Bitcoin had drawn in millions of enthusiasts, and its threat to gold became more realistic.

'The thing to recognise about bitcoin is that it is expressly designed to replicate gold without gold,' explained Ned Naylor-Leyland, fund manager of the Merian Gold and Silver fund. 'That's not true of anything else in the world. The other stuff around cryptocurrencies – the distributed ledger technology and the cost cutting around remittances and transfers – is something different.'

Others concurred, pointing to the glaring resemblances. 'What makes it similar to gold is there are a limited number of bitcoins out there. Just like there's a limited amount of gold out there,' Martin Crawley-Boevey, director at PK Group, argued. 'So you could say bitcoin aims to replicate gold in that way. That's certainly its purpose.'

What makes it similar to gold is there are a limited number of bitcoins out there. Just like there's a limited amount of gold

– Ned Naylor-Leyland

Its immediate threat to gold, though, has waned as the price of bitcoin has dramatically collapsed. Having peaked at nearly $20,000 a coin in late 2017, it has slowly sunk to less than $4,000 today (March 2019).

Several reasons have been put forward for the stunning change of fortune. These include less liquidity globally, the ability to short bitcoin futures, and China's crackdown on capital flight. More than 95% of bitcoin settlement was CNY-based until China's capital flight crackdown, according to the Bank for International Settlements.

Gold has remained mostly steady, while bitcoin has collapsed more than 80%. That should give would-be investors pause for thought about bitcoin's store of value going forward.

'There is no denying volatility has been horrendous over the last few years,' Rob Mansell, portfolio manager and fund analyst at Barclays Investment Solutions, said.

Until bitcoin can establish a clear multi-year track record, 'you'd have to ask yourself some serious questions about what it's going to do in a portfolio and why you'd be putting it in there,' Mansell added. 'Clients don't talk about it as much as they did a year or two ago for obvious reasons. Everyone wants to know about it when it's going up, very few people want to know when bitcoin is crashing.'

A TECTONIC SHIFT

Even so, the rise of bitcoin has cast a spotlight on many of the issues – and increasing shortcomings – of our current monetary system.

TALE OF THE TAPE

 CHAMPION		 CHALLENGER
AT LEAST 5,000 YEARS (ANCIENT EGYPT IN 3000BC)	**AGE**	11 YEARS
~244,000 TONS	**TOTAL EXISTING SUPPLY**	21 MILLION COINS (PROVIDED NO MORE ADDED)
187,000 TONS (76.6%)	**HOW MUCH HAS BEEN MINED SO FAR?**	MORE THAN 17 MILLION (80%)
MORE THAN $7.5 TRILLION	**TOTAL VALUE**	$68.6 BILLION
WIDESPREAD	**INSTITUTIONAL TAKE-UP**	PARTLY
YES	**CENTRAL BANK RESERVES**	NO
CAN BE TRANSPORTED AND EXCHANGED	**EASE OF USE (FUNGIBILITY)**	CAN BE SENT DIGITALLY VIA PRIVATE KEY
CAN BE REMELTED IN BARS, OUNCES, GRAMS	**DIVISIBILITY**	INFINITELY DIVISIBLE
HAS OUTLASTED ALL FIAT CURRENCY	**TRACK RECORD**	UNTESTED

Sources: Reuters, US Geological Survey, World Gold Council, IMF (at 6 March, 2019).

'Personally, I'm actually supportive of technologies such as Bitcoin,' Naylor-Leyland said. 'I've been talking about the current monetary system and how we need to go back to more transparency. People intuitively understand trusted third parties, such as the state and the banking system, are becoming less required. That's positive.'

He added: 'There is an outlier possibility the current monetary environment has to reset in the relatively short-term. In that case, gold could very well re-emerge as formal payment. But using distributed ledger technology is an interesting development: you get sound money back and no friction in payment. The state probably gets to oversee all these transactions too, so I'm sure they'd be happy with that.'

Increasingly, this means advisers and wealth managers are having to explore the potential possibilities of bitcoin, gold, and the end of our current pure fiat system that's held sway since President Nixon closed the gold standard back in 1971.

'Bitcoin is completely different from regular cryptocurrency,' said Patrick Thomas, investment manager at Canaccord Genuity Wealth Management. 'Right now it's more of a pure equity theme for us, as it potentially offers that disruption. But it's incumbent on us to do the work on this – and gold – and come up with some good answers.'

What's the best avenue for investors to gold then? And are regular exchange-traded funds (ETFs) the way forward for cheap and easy access? Charlie Lloyd, investment manager of Skerritts Consultants, said a number of factors have led him to favour a passive approach to precious metals and miners versus an active manager.

'You've got lots of factors feeding into the decision between active and passive,' he said. 'Unfortunately, one of these is cost. The other is the ease of access. If you're using platforms, platform availability is another issue. And if it's a tactical allocation, you don't want to be allocating large sums of money to an active manager only to take it away months later. That's not really appropriate.'

ACCESS VERSUS RISKS

Such an easy-going approach still has its complications, however, and investors should be cognisant that not all passive products are built the same.

'The main issue is banking is a form of fractional reserve magic,' Naylor-Leyland said. 'That's true with regular banking as well as bullion banking, where gold and silver operate.'

He added: '99% of gold and silver trading are in derivative instruments. So, the important thing to ask is whether a product is physically backed, and who has access to the physical? Almost anything I can buy has a redemption clause in it. This means that someone can access the gold and remove it in certain circumstances, if there's a redemption process.'

In other words, investors own shares and units that track the spot price. But this gives them fractional entitlements, and means they can't convert their shares into physical gold if they need to. While most ETFs are physically backed ("allocated"), investors are likely to have their cash returned to them if there's a run on gold – a prospect that's becoming more likely given most gold trading is derivative based and gold exchanges, such as the London Bullion Market (LBMA), actually have very little physical gold.

More than $200 billion of unallocated gold is traded daily on the LBMA, however.

If, like in March 1968, buyers lose confidence in the market's structure and ability to deliver bullion, a run on the vaults could occur, and the price of physical gold could spike. Were this to happen, gold-backed ETFs could soon carry considerable counterparty risk given their complex structures, with these instruments never tested in a serious crisis or gold run before.

This is where active managers, who understand the complexities of the gold world and bullion banking, have a distinct advantage. 'One of the most interesting things is that you can actually turn this structural risk to your advantage, it can become a structural return,' Naylor-Leyland said.

He added: 'If there is a run, and you've got access to the physical, then 99 different credit instruments are going to want that 1% off you. That outcome is hugely in your favour, and so making sure your portfolio has some of that structure is paramount. Understanding this is probably the core of understanding gold, money and some of the risks in the financial system.' ●

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