

Title: Why Platinum should do better than Gold.

Region: GLOBAL Date: 06th April 2010 No of Pages: 4

Traditionally we all are used to Gold as an alternative currency or as portfolio insurance or as a store of value during inflationary times or a safe haven during financial crisis. And Gold has its own place in the precious metals segment. What has made Gold and may be Silver to a certain extent, popular as active investment vehicles is that they have attributes which are not common for all precious metals. And they are : Liquidity, Standardization, Fungibility and Transparent Price Discovery mechanism. And Gold more than Silver possesses all of them.

But what Gold lacks is its lower leverage to a rising global industrial and economic cycle due to its limited industrial use. Only about 8-10% of the global demand for gold comes from industrial, dentistry and electronics. Platinum, which was the “black sheep “in the precious metals domain, is now slowly emerging as a stable investment vehicle.

Platinum is a dense, malleable, corrosion-resistant metal, which unlike Gold, is used in a wide variety of consumer and industrial products, including jewelry, laboratory equipment, dentistry equipment, and electrodes. But the majority of platinum is used in catalytic converters for automobiles. Without getting into the technical aspects, it’s enough to know that”Catalytic converters “are critical for controlling emissions from automobiles. So platinum has a higher beta to the global economic recovery, especially when the automobile production in Developed and Emerging markets are converging.

The path of Platinum is expected to be on similar lines of Gold, when an ETF (Exchange Traded Fund) backed by physical Gold was launched and started trading on NYSE in January 2005. Since then the gold held by all the ETFs have crossed 1,100 tones, bigger than some of the official gold reserves held by many countries. The success of Gold ETFs lied in ease of trading, lowering transaction costs and having all the aspects of an efficient investment vehicle, which we had discussed earlier in our note. Again in 2010, first ETF in US, backed by physical platinum was launched (PPLT) in January. Though Europe already had one. And so far PPLT has outperformed Gold ETF (GLD).

Chart I: Gold (GLD) and Platinum (PPLT) ETFs performance in 2010



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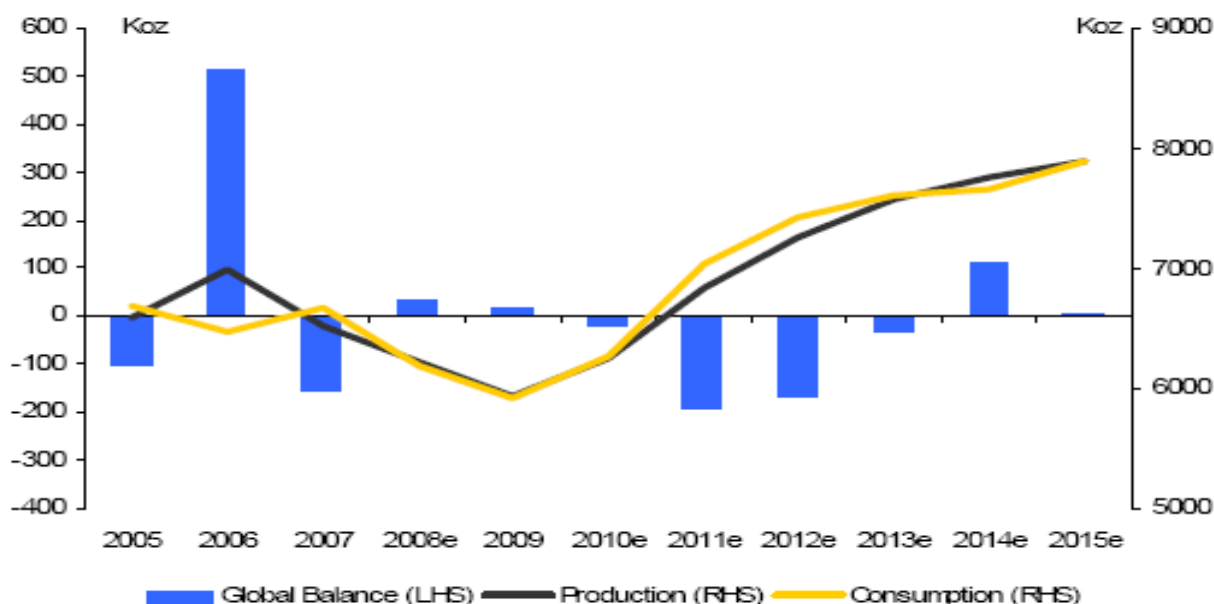
Region: GLOBAL Date: 06th April 2010 No of Pages: 4

Prior to the launch of the platinum ETF in US, investors had to be content with buying Exchange Traded Notes (ETNs) which assured returns similar to the underlying platinum prices, by rolling over futures contracts. A contango in futures contract can easily take away the some of the returns from ETNs. Thus it's an expensive way to track the platinum prices and the tracking error is higher too. The ETNs carry credit risk, since they were not backed by physical platinum holdings. They are senior, unsubordinated debt instruments backed by issuing banks or financial institutions.

About 50% of the global demand for platinum comes from the auto catalyst sector. And the balance comes from industries such as chemical, electrical, glass, and petroleum as well as from jewellery. The demand base is more diversified. The largest known reserves (supply source) of platinum are found in South Africa, Russia and Canada which together account for more than 80% of the world's platinum supply. The supply gets restrictive sometimes due to high power costs, safety issues and a strengthening domestic currency of the producers. This high concentration of supply and speculative activities sometimes makes the price of platinum more volatile than Gold. The supply also comes from recovery of platinum from scrapped cars, just like Gold supply rises with recycled Gold.

And platinum's supply demand balance remains tight as the extraction and mining process is extremely complex and labor intensive. Scarcity and restricted supply makes platinum a preferred investment and more expensive than Gold or Silver. Moreover platinum is a rare metal too.

Chart II: Global Supply & Demand of Platinum



Source: Johnson Matthey, MS Commodity Research estimates

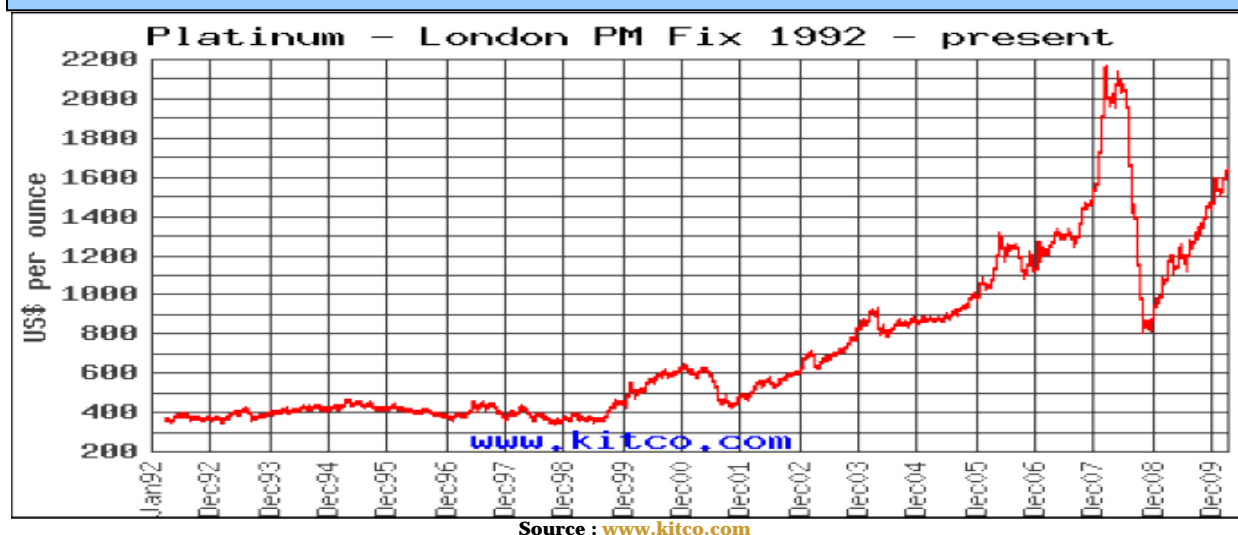
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Unlike the above the ground stocks of Gold which can last for more than 20 years of consumption, platinum ones may last only for over a year. Annual production of platinum is just around 5-7% of the annual gold production.

So how will platinum perform vis a vis Gold, since the advent of the new ETF in US. Let's look at the long term price chart of Platinum (Chart III).

Chart III: Platinum Long Term Price Chart



The stage at which the current global economic and industrial cycle is, Platinum has some distinct advantages over Gold in coming times though both are safe havens and inflation hedges of different degrees. These are:

- Platinum's leverage to global industrial (especially China demand) and economic recovery is very high, due to its use in various industries. This was clearly manifested in the financial crisis of 2008 and ensuing economic slowdown, when the price of Platinum collapsed by more than 50% (Chart III). Gold has very limited leverage on global recovery; in fact a global recovery to a certain extent would be negative for Gold safe haven status. Gold will do better in event of a more severe sovereign crisis. As a safe haven, Gold has an upper hand over Platinum.
- Platinum's supply demand balance is tighter than gold and moreover the supply is highly concentrated as referred earlier in the note.
- The Automobile sector is recovering in US (Cash for Clunkers pushed old cars replacement demand) and elsewhere in the western world. The markets for automobile production and sales are booming in emerging markets like China and India with rising income and consumption, under penetrated cars markets, ease in availability of financing, and improving

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jobs and business outlook. This will boost demand for catalytic converters and thus for platinum. Gold does not have that “auto” support.

- The newer regulations will prove a boon for platinum. Newer stringent regulations requiring manufacturers to cut carbon emissions are more beneficial to Platinum than for Gold.

But Platinum as an asset class is not likely to be a cakewalk for investors. If the global economy falters again and with it auto industry goes down, platinum demand and prices will be hit. Technological advancements in auto emissions or new reserve discoveries will be negative for the platinum price. And in event that US Dollar depreciates substantially, Platinum will underperform Gold.

As a strategy, it would make sense to partially switch to Platinum from Gold as the global economy recovers from a low point, industrial activity further gathers steam and risk appetite increases. This is the time when Gold will underperform Platinum especially if US Dollar is rising either on its own merits or on a weaker Euro. And Gold will outperform Platinum in an exactly reverse scenario, viz a faltering global economy, rising risk aversion and uncertain times like financial crisis.

As of now, the global economy looks to be on the path of a slow but an uneven recovery. And the double dip chances appear to be reducing after each economic data point that’s released. The new Platinum ETF in US might prove the game changer for Platinum demand as an efficient investment vehicle.

Though both Gold and Platinum carry the safe haven, inflation hedge and portfolio diversifier status, Platinum does carry an edge over Gold (for relative outperformance) in a scenario of an impending recovery in global economy and risk appetite.

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