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HOW TO TRADE

GOLD

AUGUST 2016

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Founded in 2010, we now have global presence in over 90 countries, with main offices in the separately regulated markets of Australia, Cyprus, New Zealand and the United Kingdom.

We believe that sound investment and trading decisions begin with a strong grounding in financial education. Our goal is to make this available to everyone - and this free eBook is part of that commitment.

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TRADING GOLD EFFECTIVELY

FOREWORD

There are few constants in life particularly in today's fast paced technologically driven, fashion conscious world. But one thing that has stood the test of time is our fascination for Gold.

Whether we admire its lustrous beauty or its ability to resist all but the harshest of chemical agents. Or perhaps the sheer heft and solidity of a gold coin in our hands.

Gold is also becoming ever more integrated into modern investment portfolios and Gold trading has never been more accessible to retail traders.

In this eBook we look at both our historical and modern relationships with Gold alongside some of the forces that can and do drive price changes in the Yellow metal.

These are exciting times for traders and if you haven't looked closely at trading Gold before now may be the perfect opportunity to do so.

Patrick Latchford
CEO, Blackwell Global Investments (UK) Limited

GETTING TO KNOW GOLD

Gold

No other element has excited mankind as much as Gold. If we look back through our written history we find a myriad of references to the yellow metal and there are even more mentions in our folklore, fables and fairy tales. Wars were fought over it and empires fell and rose as result. Gold has become an intrinsic part of human existence, whether it's as a decorative item of jewellery or a store of value. In most cultures around the globe Gold has its role to play. We are attracted to its dense lustrous colour and though soft and malleable when compared to many other metals, it does not rust or otherwise corrode.

A relatively scarce resource here on earth its very weight suggests solidity and stability in times of turmoil. Whilst new discoveries in the 19th century in California, Canada, South Africa and Australia helped to drive mass migration and global travel, at a time when crossing an ocean was no mean feat.

Today Gold is one of the world's most actively traded commodities and we don't need to pan for it in the shallows of a river or dig deep into the earth to find it,although plenty still do. How did we arrive at this point ? Why does Gold hold such an allure for us and how can we trade that affinity?

Ever wondered why Croesus was so rich?

I am sure you have heard the phrase "rich as Croesus" and you have probably wondered who Croesus was and how he became so wealthy that his name is still a metaphor for opulence and excess today.

Croesus was the ruler of the kingdom of Lydia which was located in the eastern Mediterranean, on the shores of what is now modern day Turkey. Lydia grew rich because it effectively invented money, some two and half thousand years ago. Precious metals had been used as a method of payment between trading nations in the Mediterranean and elsewhere before the Lydian innovation. But there was often an issue with purity, value and establishing whether proper payment had been made.

The Lydians master stroke was to create a standardised coinage that was of known purity and worth. Most importantly it was guaranteed by the rulers of Lydia. The medium they chose for this new coinage was Gold. Money in the modern sense had arrived. It was portable and accepted as payment across the Mediterranean and beyond. Lydians become incredibly rich as they produced and controlled this new proto currency. When

Croesus became King, Lydia was the height of its pomp and Croesus paid for the construction of one the seven wonders of the ancient world, the temple of Artemis at Ephesus. A legend that endures to this day, was born.

The Lydian blueprint was so successful that it was adopted by the Gold rich Spanish in 1598, when they minted the first “pieces of eight” or as they become known Spanish dollars. These coins were used as global method of payment for more than 150 years and in some cases the coinage was even adopted by other sovereign states. Pieces of eight remained legal tender in the USA until 1857 and they were the inspiration for what would become the modern day US dollar.

Gold in the modern world

Given the long history of association that humans have had with Gold it is perhaps surprising to note that it still remains a relatively scarce commodity. For example the World Gold Council estimates that only 175,000 tonnes of Gold have ever been mined since the beginning of civilisation. That Gold would all actually fit into a 21 metre cubed crate. Ninety percent of this Gold has been mined since the Californian Gold rush of 1849. Furthermore a one ounce nugget of Gold is rarer to find today than a five carat diamond.

In the 21st Century Gold has four principal uses or sources of demand if you prefer.

Most obvious of these is as jewellery or gifts. Perhaps less well known and often overlooked is Gold’s use in technology. Where its unique properties make it an invaluable component in high end electronics and engineering. As well as new uses in the delivery of medicines and environmental management. Gold is also used as an investment and as an alternative "reserve currency" by many of the world's central banks.

Given the above it's not surprising to find that over the longer term the price of Gold has appreciated sharply. The chart below shows the price of London spot Gold over the last fifteen years as an example of this trait.

Gold is produced, valued and traded in Troy ounces. A troy ounce equates to a weight that is a fraction over 31 grams. When we see a market price for Gold the price is expressed in US Dollars per troy ounce. As I write the Gold price is trading at $1347.89 per troy ounce for example.

Modern drivers for Gold demand

As we noted above one of the principal sources of demand for Gold is as personal jewellery or gifts. Whilst there is jewellery demand from western consumers, it is the highly populous economies of Asia. Specifically India and China that are real powerhouses in this trade. With a combined population of over 2.6 bln people, equivalent to five times that of western Europe, it's not hard to see how demand for Gold from Asia could have a dramatic effect on the price.

In the chart below which plots Chinese consumer spending (the dotted line) against the price of Gold. We can see that as the Chinese economy grew and consumers became more affluent from mid 2007, their spending rose and so did the price of Gold (blue line). That direct relationship was broken in 2013. But I believe the chart serves to show us what a powerful force the Asian love affair with Gold can be.

Chinese private demand for Gold has been forecast to rise to as much as 1350 tonnes per annum, by 2017. Though clearly

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that will depend on the performance of the underlying Chinese economy. But as we will discover even an economic downturn may not be entirely negative for Gold prices.

Historical relationships

Gold's intrinsic relationship with money and banking means that it has built up a series of long standing relationships to economic and market forces. In this section we will look at two of the most well known of these namely Gold's historical relationship to inflation and secondly to the US dollar. Gold has historically been seen as a store of value indeed it was that utility that made it ideal as medium for Lydian and Spanish coins we discussed earlier. But as Human history and in particular financial markets and their practices advanced. So Gold took on extra level of security in the minds of investors. Paper currencies are a relatively new innovation, at least in the west. These paper bank notes were, initially at least, guaranteed or redeemable into an issuer's holdings of Gold and they carried a promise to that effect. That promise is still visible on bank notes to this day. As we can see highlighted in the image of modern UK £50.00 note below.

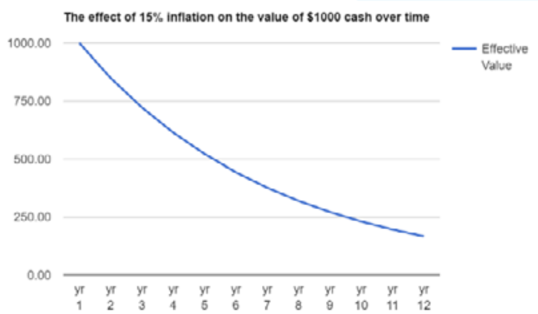
However the temptation to print more money and reduce or even remove the guarantee of backing in Gold proved to be too much for expanding economies. For some this would prove to be a good thing as it removed what could be seen a barrier to growth and the expansion of credit. But for others it would unleash the financial curse of the twentieth century namely inflation.

Inflation can best be described as an excess of demand, or if you prefer too much money, chasing too few good and services within an economy. As that demand increases prices rise, society clamours for more money to keep up with the rising cost of living. Central banks create more money, which in turn fuels further demand and price rises once more. This is particularly true if it is not possible to raise the level of the supply of goods and services in an economy, or import the shortfall from abroad.

At the same time as inflation rises and the banks print more money, the worth of a local currency may be devalued in the eyes of foreign suppliers and the markets. Making any imported goods and services that much dearer to come by.

In the worst case scenario this vicious circle can become entrenched and create what is known as hyperinflation, in which a currency effectively becomes worthless and prices rise by the hour. As happened in Weimar Germany and Hungary in the 1920s and more recently in Zimbabwe in 2008 and 2009. In all three of the cases Inflation rose to almost incalculable levels and the central banks were forced to print ever higher denominations of notes to allow day to day commerce to take place. The Zimbabwean notes in the image below are a clear example of this.

In such circumstances an unadulterated, widely accepted and portable store of value such as Gold can come into its own. Hyperinflations are thankfully rare events. But in my lifetime inflation in the USA has touched 15% per annum. At that rate any cash that was not receiving interest would effectively be devalued by approximately two thirds within 7 years see below.



This is why Gold bugs (as Gold investors are known) are so keen on the yellow metal, as a hedge against the "corrosive power" of inflation on cash values.

Gold and the US Dollar

For much of the last twenty years the US dollar has had an inverse relationship to Gold that is to say as the Dollar weakened so the price of Gold appreciated and vice versa. In truth we could say the same for many commodities. But unlike Gold, commodities such as Oil and Iron ore, though widely traded, are almost completely reliant on industrial demand and don't have that much attraction to investors apart from that. We can clearly see the relationship between Gold and the Dollar at work in the chart below. Which plots USD JPY or Dollar Yen against the spot price of Gold. As the US currency weakened against the Yen, in the period between 2006 and 2012, so the price of Gold rose. But as the Dollar strengthened against the Yen from early in 2013 the Gold price retreated.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What's interesting to note is that in recent times and particularly over the most recent quarter of 2016 this relationship looks to have been modified, with the trade weighted Dollar rallying at the same time as Gold.

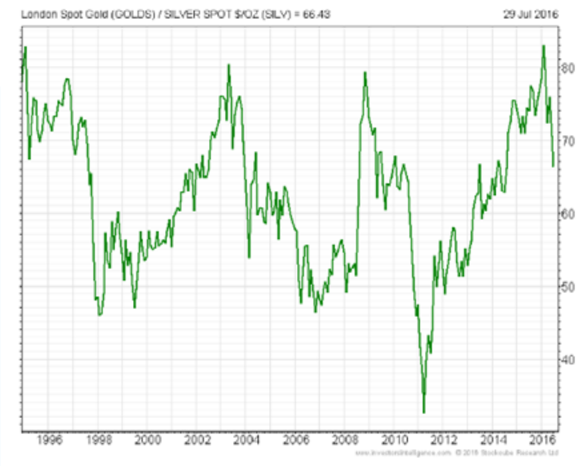
As we noted in our recent eBook on Brexit, the political and economic uncertainty created by the Brexit vote pushed investors towards safe havens, such as US Treasury Bonds and Gold. Both of which are of course priced in and have to be paid for in US dollars.

Most recently we have seen the US dollar give ground once again and the price of Gold rally. Following weaker than anticipated GDP data and a non committal statement from the Federal Reserve, at its July meeting. Political risk remains on the horizon however with a constitutional referendum to come in Italy in October and one of the most divisive US Presidential elections of all time taking place in November. As such safe haven assets could re assert themselves once more.

Gold and other precious metals

Gold forms part of the group of precious metals of course and its relationship to the other group members is closely studied. None more so than with its with its more commonly found cousin Silver.

The chart below plots the price of Spot Gold divided by that of Spot Silver over the past twenty years. As we can clearly see the ratio rarely extends above a reading of 80.00. Whilst to the downside the ratio historically finds support at or around the mid 40s. The exception in recent times being at the height of the Greek sovereign debt crisis, in the spring of 2011. When the ratio reached the low 30s.



At the current level of 66.4, the Gold Silver ratio remains elevated above its long term historical averages. Suggesting that Silver is undervalued, on this metric, when compared to Gold. The performance of Silver year to date could be said to be trying to close that gap.

At the time of writing spot Silver is up by 47% whilst spot Gold has appreciated by a more pedestrian 27% since January (Platinum and Palladium, the other two members of the precious metals group, have performed more or less in line with Gold over this period). Looking at the chart it's tempting to think that the Gold Silver ratio could retest back towards 60, a level that has provided support in the past.

Breaking down barriers

Not everyone is a fan of Gold as an investment. Its detractors point to a lack of income arising from a Gold investment and they question the idea that Gold would actually represent a store of value in times of extreme financial crisis in the modern world. The latter argument is as much a question of philosophy as it is economics. But objections over a lack income or dividend from investments in Gold, are looking increasingly moot. Largely because in the current climate, negative interest rates and quantitative easing from Japan and the Eurozone, has pushed trillions of dollars worth of bonds into negative yields ($12.9 trillion according to recent data from Bank of America). In a world where bondholders effectively pay the borrowers for the privilege of lending money to them, the lack of dividends from an investment in Gold no longer seems such a big deal.

For many years trading commodities involved the need to be able to undertake physical delivery and storage of the underlying items. In the case of Gold this necessitated access to a high security bank vault, in which to place your ingots or coins. There would of course usually be a charge for this service alongside associated layers of administration.

However in today's modern trading environment this is no longer the case. Brokers such as Blackwell Global offer their clients instantaneous electronic access to the world's markets. Allowing them to seamlessly trade important global commodities such as Gold, Silver and Oil from their desktop or mobile device. With no need to worry about delivery or storage of the same. Clients effectively trade the underlying prices of

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these commodities profiting or otherwise from their rise and fall. Without ever having to take ownership or delivery of those underlying assets.

Summary

To summarise then Gold is one of a select group of precious metals. It has been used as a form of money and a store of value since ancient times. Gold originally formed the backbone of the modern banking system and though it would be replaced after world war two, central banks still hold significant amounts of Gold as a part of their strategic reserves.

Gold is seen as a safe haven asset and has historically been used as a hedge against inflation and the dilution of paper currencies. More recently industrial uses for Gold have started to emerge within high end electronics and medicine to name but two. This trend may well continue. Jewellery demand from Asia remains one of the largest uses of Gold, as standards of living improve for the populations of both China and India so that demand is likely to pick up.

Political risk and economic uncertainty have been recent drivers for Gold prices. There is potential for more of both over the balance of 2016 and beyond. Central banks are continuing to pursue low or negative interest rate policies, which are helping to remove objections to Gold trading. Electronic access to cash settled contracts on Gold and other instruments has greatly simplified commodity trading for retail clients.

WHY BLACKWELL GLOBAL?

We can't pretend that is easy to become a successful trader. But we are here to help and support you as you make your trading journey, providing dedicated resources such as our demo trading accounts and regularly published research materials.

Founded in 2010, Blackwell Global was established to offer brokerage solutions for private and institutional clients. Blackwell Global is a Straight Through Processing or STP broker who provide their clients with superior liquidity and price feeds from top international banks. These are offered alongside 24-hour technical support, market research tools, educational materials, professional partnership programmes and fully integrated trading platforms.

We offer access to multiple asset classes including more than 60 currency pairs, precious metals and other contracts for differences. As a global broker, we are always striving to achieve excellence in our customer service, as well as developing innovative technology to support our customers needs.

Today, the Blackwell Global group of companies has a presence in over 90 countries, with its main offices situated in the individually regulated markets of Australia, Cyprus, New Zealand and the United Kingdom.

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