Exchange traded funds track fortunes of platinum-group metals

Large volumes of palladium ETF sales point to yet-to-be defined industry development

PRECIOUS metal Exchange Traded Funds (ETFs) have evolved a long way from being the new kids on the metals investment scene. Today ETFs act as a market barometer for underlying investor demand and a potential window into the future metal demand and prices.

So while, historically, precious metals were considered a relatively opaque commodity sector, the advent of ETFs has provided a viewable indicator of the underlying price and volume demand.

"ETFs are used to track and predict broader industry changes and developments, especially in the gold, platinum, palladium and rhodium industries," Standard Bank head CIB Wealth Johann Erasmus.

Using ETFs as a barometer to better understand, for example, the platinum-group metals (PGM) sector has worked extremely well, "up till now," adds Erasmus.

Currently, the US dollar price of gold, platinum, palladium and rhodium are rising. As expected, trading volumes of gold, platinum and rhodium ETF's are slowly increasing in line with the price increase as investors become more active in executing their views for the underlying metals future price movements.

The demand for palladium is expected to increase

The volume movement of gold ETFs, mirror the yellow metals' traditional status as a safe haven. Unsurprisingly, current high pricings and strong growth of gold ETFs correctly reflect both the insecurity and unpredictability gripping developed markets in the wake of Trump's election and Brexit.

The outlier, however, is palladium.

Despite the USD palladium price being near two year highs, the mass sell-off of palladium ETFs by investors is bucking the trend. Initially South African institutional investors sold some holdings in the last quarter of 2016 – repeated, a couple of months later, by European institutional investors sell-off of palladium ETFs early in 2017 – which provides pause for thought.

Unanswered questions abound.

"While the high prices of palladium in ZAR, GBP and EUR could account for some of the sell-off, when one considers that the volume of ETFs sold by institutional investors accounted for almost half the total volume of palladium ounces held in ETFs, profit taking might not be the only explanation," says Erasmus.

An alternative explanation for the broad sell-off of palladium ETFs by South African institutional investors, arguably, could be attributed to institutional investors rotating some funds into general commodities stocks, currently perceived as good value in a rising market. This does not, however, explain why European institutional investors would do the same – three months later. "Dollar palladium values are increasing, and any adjustment in US interest rates, making US equities a more attractive bet, is only likely in March – if at all in 2017," says Erasmus.

Furthermore, the demand for palladium is expected to increase, should the United States economy enter a period of strong growth, now might not be the right time to be unloading palladium ETFs in such large volumes.

Finally, since the autocatalytic industry can substitute rhodium for some palladium, sustained higher palladium prices have, to some extent, seen a slight uptick in rhodium prices, and a small rotation into rhodium ETFs. Again, however, "this does not explain the huge sell-off of palladium ETFs," says Erasmus.

"The fact that this anomaly is so puzzling reflects the extent to which analysts view ETF pricing and volume movements as the bellwether of broader industry trends, especially amongst PGMs," says Erasmus, who expects to observe the explanation for palladium's outlier status over the short term.

The efficacy of PGM and gold ETFs in predicting and explaining broader industry and economic trends aside, "ETFs remain one of the best, and safest, vehicles for investors to participate in the PGM and gold market - without the risk, expense, time costs and legal hurdles of holding and trading physical metal," says Erasmus.

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