

# EXCHANGE TRADED FUNDS

2007 saw the launch of two separate sets of exchange traded funds backed by physical platinum group metals. In Switzerland, funds based on platinum and palladium were launched by the Zuercher Kantonalbank (ZKB). In London, two similar funds were launched by ETF Securities, as well as one based on a basket of precious metals. None of these has any exposure to the minor platinum group metals.

The first exchange traded funds, or ETFs, focused on replicating stock market indices using equities as the underlying investment. Instead of buying a range of stocks and shares, the fund purchased these on a customer's behalf. The investor instead bought shares in the fund which were backed by these assets. These shares in the fund were then traded just like shares in a conventional listed company.

Soon, however, commodity ETFs were launched, allowing a simple way to invest in a commodity, such as gold, without the need to physically hold and store it. Gold ETFs were amongst the first to be launched and have been relatively successful. The launch of platinum group metal exchange traded funds

in April and May of last year therefore did not surprise the market greatly.

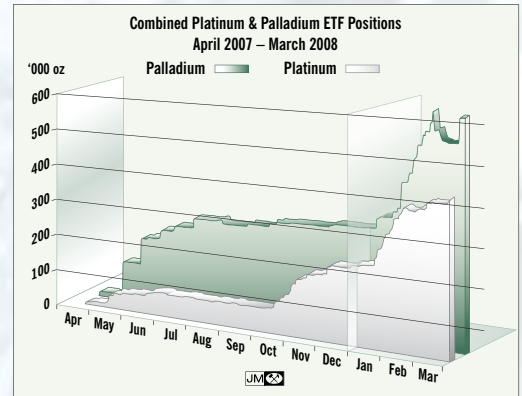
Both of these sets of pgm funds work in a similar way, being 100 per cent backed by the physical metal, with the funds unable to lend or sell metal themselves. At launch, the two fund managers anticipated total combined investments of 150,000 oz of platinum and 400,000 oz of palladium after the first year of trading. By late-September 2007, the total amount of metal held was 60,000 oz of platinum and 255,000 oz of palladium.

However, as the platinum price rose in November and December 2007, and, more especially, in January 2008, investors charged into the London platinum fund in particular. Over 40,000 oz of platinum were purchased for this fund in the last week of January alone – just as the South African power supply problems were coming to light.

It seems likely, therefore, that, in a scenario of rising metal prices, ETF investment – whether from funds or from retail investors – can cause positive feedback, increasing short-term volatility and reinforcing price rises by removing metal from the open market.

What is not yet known is whether the same positive feedback can be expected should prices drop, with net sales of metal expected to accentuate any fall in the price. However, experience from gold ETFs suggests that a falling price does encourage sales, again intensifying price movements.

Nonetheless, the growth in stocks of metal held has been impressive. Almost 195,000 oz of platinum were accounted for by the ETFs at the end of 2007. A further net



165,000 oz was bought by investors in January and February of 2008 alone. At the end of March 2008, 390,000 oz of platinum bars were held in the full set of ETFs.

With the palladium price less volatile, growth in the palladium funds was much less spectacular. However, investment flows still grew strongly and stocks reached a combined total of 280,000 oz by the end of 2007, and 580,000 oz by the end of the first quarter of 2008.

In terms of future developments, there is still no evidence of the launch of platinum or palladium ETFs either in Japan or in North America, markets where significant investor interest might be expected. We do not anticipate the launch of any such fund in the near future. A rhodium fund is equally unlikely.

March 2008 did, however, see a new short platinum fund created in London. This allows investors to gamble on prices falling and may attract attention whenever precious metal prices start to soften.

However, this fund and the new leveraged and classic funds launched on the same date are backed by futures contracts rather than physical metal and should therefore have no immediate impact on the physical market.

*The combined holdings of all pgm exchange traded funds grew sharply at the end of 2007 and in the first quarter of 2008.*

*Platinum bars owned by exchange traded funds are stored separately to other metal and are not available for sale or leasing to the market.*

