Editorial

Closing the Gap between Physical and Electronic Trading

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In the late 1970s, the term "electronic trading" was almost exclusively associated with stock exchanges since they were the first to implement such trading platforms. Off course, at the time, these platforms offered rarely more than a glimpse of what they would evolve to in the decades to follow. Today, buying or selling stocks and other securities is hardly imaginable without the aid of fully automated trading platforms: Cutting-edge electronic trading systems connect market participants worldwide, facilitating transparent price discovery within nanoseconds. One asset class, however, needed significantly more time to adopt electronic trading, and still does in some respects: commodities. The New York Mercantile Exchange, for example, abandoned floor trading of commodities no earlier than 2017, and while electronic trading witnessed a notable upturn in the commodities sector lately, only few products are traded fully electronically, as it is the case with stocks or bonds. Most commodities transactions are completed via a hybrid model, using both electronic trading systems and the traditional voice broker space. Moreover, many commodity markets are still so-called inter-dealer markets, neither offering equal access for all market participants, nor access for private investors at all, but relatively high transaction cost. The reason that commodity trading has taken so much longer to get fully automated than securities lies in the issue of physical delivery and the physical hedging following the transactions, respectively. Think crude oil, wheat, coffee beans, or steel.

However, there is one commodity that always has stood out: gold. This precious metal plays a dual role: one as an essential industrial commodity and another as the hardest currency in the history of mankind. It is no coincidence that in times of financial market turmoil and geopolitical uncertainties, gold has been a proven safe haven time and again. Therefore, gold has always been a special case when it comes to trading, and has served as a forerunner in electronic commodity trading.

With the introduction of Exchange-Traded Funds (ETFs) some 25 years ago, the ground for a more flexible and cost-efficient way to trade gold was laid. While ETFs initially were designed as investment funds passively tracking the price movements of a given stock index, soon new indexes were created to allow investors to pursue more refined trading strategies. In early 2003, the worldwide first gold ETF was listed on the Australian Securities Exchange, enabling market participants to track the spot price of gold without having to purchase a single ounce of the precious metal. To ensure holders of the gold ETF that their investments were safe, the fund was hedged with physical gold. Gold-backed ETFs have proven very popular right from the start with instructional and private investors alike, facilitating highly liquid trading with spreads tighter than ever deemed possible in gold trading. As a consequence, gold – traditionally a long-term investment – has become of interest for a total different class of investors, from hedge fund managers to day traders.

In Germany, neither private nor institutional investors are allowed to invest in gold ETFs due to the German adaptation of the EU-wide UCITS (Undertakings for Collective Investments in Transferable Securities) directive. To solve this problem, the Exchange-Traded Commodity (ETC) Xetra-Gold was introduced in 2007 – a fully gold-backed bearer bond that certifies every buyer the right to demand delivery of one gram of physical gold for every Xetra-Gold bearer note they own. Thus, the gap between electronic and physical gold trading – from automated price discovery to physical delivery – has been closed for good. Today, Xetra-Gold is the most popular ETC in Europe.