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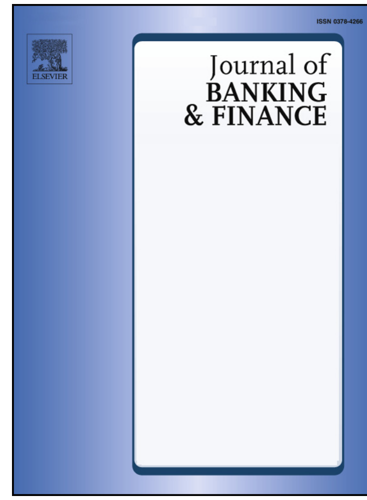

The Securitization of Gold and Its Potential Impact on Gold Stocks

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The Securitization of Gold and Its Potential Impact on Gold Stocks

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Abstract

We study the market impact of a very successful financial innovation – the SPDR Gold Trust exchange-traded fund (GLD). GLD holds physical gold, and provides traders with a convenient and cost-effective way to gain exposure to gold. We find that after the introduction of GLD, the liquidity of gold company stocks declined, and their adverse-selection risk increased. Over the two-month period after GLD's introduction, the stocks' relative effective bid-ask spreads increased by over 15%, while their adverse-selection cost, as measured by the price impact of trades, went up by more than 30%. Gold stocks also experienced significant negative abnormal returns (–12% on average) in the month after GLD started trading. Our findings suggest that GLD attracted traders, especially uninformed traders, away from gold company stocks, and that the resulting negative demand shocks and decrease in the stocks' liquidity caused their prices to decline. Our results show that existing securities can be seriously adversely affected when a new security enters the market.

JEL classification: G10; G12; G14

Keywords: Financial innovation; Securitization; Market impact; Gold; Exchange-traded funds