**How to Play Gold**

Gold can be played in three ways

* **investment in the short to medium term**, given the increased demand for gold as a safe haven by central banks and gold ETFs in recent times. While gold prices have risen sharply by 33% Y-o-Y, it is likely that this can continue given the geo-political and economic uncertainties.
* **portfolio hedge** provided allocation is significant and rebalancing is done periodically.
* **consumption** using sovereign gold bonds.

**I Gold as an investment**

***Gold returns depend on international gold prices and exchange rates:***

Gold return in local currency terms is dependent on international gold prices (eg London Metal Exchange gold prices or India Bullion & Jewellers Association) and rupee exchange rate.

Gold prices have risen sharply by ~ 21% in H12019, driven by 8 per cent rise in gold demand. The demand rise can be attributed to

* 77% growth in global Gold ETFs
* 57% growth in gold purchases by Central Banks in US and other major markets & monetary policies

**Global Gold Demand has risen by 8%**

|  |  |  |  |
| --- | --- | --- | --- |
|   | **H1 2018** | **H1 2019** | **Y-oY increase** |
| **Jewellery** |  1,048  |  1,062  | 1% |
| **Technology** |  165  |  161  | -2% |
| **Investment** |  570  |  584  | 2% |
| ETFs & similar products |  61  |  108  | 77% |
| **Central banks & other inst.** |  238  |  374  | 57% |
| **Gold demand** |  2,021  |  2,182  | 8% |

Source: [www.goldhub.com](http://www.goldhub.com)

Rupee is expected to depreciate further in 2019 given the geo political uncertainty and trade tensions, positively affecting gold returns.

*Gold returns have a low correlation to other asset classes and definitely preferred over negative yielding debt*

Please see the low correlation to other asset classes and ideal diversification/hedge during market uncertainties <https://www.gold.org/goldhub/data/gold-and-major-index-correlations>)

***India - Gold safe haven asset class during economic uncertainties***

***Where to invest - Gold Fund vs Gold ETFs – Gold ETFs is a winner due to better liquidity***

Gold ETFs are funds that invest in physical gold of 99.5 per cent purity. On the other hand, a gold fund is an open-ended fund that invests in a gold ETF. For an investor, buying a gold fund is easier as one doesn’t need a demat account, which is required to invest in a gold ETF.

Returns of gold ETFs are superior vs gold funds, with returns higher by about 4 per cent in the last one year. However, returns across gold ETFs do not vary much and hence tracking error vs physical gold returns is similar. The main selection criteria include the fund house and liquidity. Here, Reliance ETF Gold BeES and HDFC Gold ETF score higher, due to lower bid-ask spreads or better liquidity.

**Comparison across Gold ETFs**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Fund** | **Launch** | **1-Year Ret** | **3-Year Ret** | **5-Year Ret** | **Assets (Rs cr)** | **4th Sep 2019 ETF price** |
|  Reliance ETF Gold BeES | Mar-07 | 31.38 | 7.34 | 6.79 | 2,877 | 3549 |
| SBI Exchange Traded Fund Gold | Apr-09 | 32.03 | 7.25 | 6.67 | 799 | 3628 |
| HDFC Gold Exchange Traded Fund | Aug-10 | 31.83 | 7.65 | 6.83 | 615 | 3643 |
| Physical Gold  |   | 33.30 | 8.40 | 7.78 |   |   |

*Tracking error: Returns of ETFs are indicatively upto 2% lower than those of direct gold*

*Please note that Reliance ETF Gold BeES and HDFC Gold ETF are more liquid than other ETFs*

Source:AMFI

While sovereign gold bonds enjoy higher returns due to the inherent 2.5-2.75% interest they enjoy, liquidity levels for the ~ 30 sovereign bonds trading on the exchange is the least. Hence, not been assessed.

***Timing & monitoring of gold investment is critical; gold is classified as moderately high risk asset by mutual funds***

**Medium term track record:** Historically gold returns during uncertain market conditions have outperformed other asset classes.During the market crash of 2008, gold prices (INR/gm) rose at a 23% CAGR between Jan 1, 2008 to Jan 1, 2013 (ie upto to Rs 2,964/gm from Rs 1,056/gm respectively). Gold price returns in the subsequent years were negligible, hence, if the same investment of Jan, 1, 2008 was held till Jan 1, 2019, returns would have fallen to ~ 9%.

**Long term track record of returns in the Indian context:** A study done over ~ 40 year period (1979-2019H1), reveals that while Sensex grew by ~ 360 times or CAGR of ~ 15%, gold returns were ~ 60 times or a CAGR of ~ 10%, largely due to currency depreciation (> 9 times) and the rest was due to gold.

***RISKS in Gold Investing***

1. ***Volatile asset class:*** Gold while being considered as a safe haven investment when financial markets are turbulent and economic uncertainties prevail, is considered to be an extremely volatile asset class. A study conducted by Freefincal indicates volatility is significantly higher than equity or debt when rolling returns are assessed over 5, 10, 15 years period (<https://youtu.be/sHHBf7PZ1so>). This clearly indicates that gold as an investment needs to be carefully monitored.
2. ***Gold is not an income generating asset:***

Unlike bonds and equities which give interest and dividend payments, gold is not an income generating asset by and large. An exception is gold sovereign bond which gives 2.5% to 2.75% semi-annual interest on the bond. Warren Buffet does not invest in gold as it believes that besides making jewellery, it does not serve a ‘usefulness purpose’.

1. ***Tightening of the monetary policies by central banks:***

Monetary policy is an important driver of gold prices. Monetary policy affects the money supply growth which in turn determines the inflation rate (in the long run). And gold is, under certain conditions, an [inflation hedge](http://www.sunshineprofits.com/gold-silver/dictionary/gold-inflation-hedge/). When money supply tightens, usefulness of gold as a hedge is lost.

**II Gold as a portfolio hedge**

Allocation of upto 20% in gold can lower risk of a portfolio when markets are turbulent, and provide a cushion to the existing returns in equity and debt. However, gold allocation needs to be sizeable and the portfolio needs to be periodically balanced. Moreover, given gold returns are volatile, entry and exit of this investment is crucial.

*As seen in Example 1, in very turbulent times, as in the case of 2008, gold can cushion portfolio returns to the extent of 10% if the gold allocation is 20%.*

**Example 1 (No gold): Portfolio pre and post Market Crash - 2008**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Investment on Jan 1, 2008** | **%** | **Return in 2008** | **Investment on Dec 31, 2008** |
| Equity | 60 | 60% | -50% | 30 |
| Debt | 40 | 40% | 7% | 42.8 |
|   | **100** |   |   | **72.8** |

*Please note: Return assumptions across asset classes are indicative*

**Example 1 (With gold): Portfolio pre and post Market Crash – 2008 (Equity + Debt)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|   | **Investment on Jan 1, 2008** | **%** | **Return in 2008** | **Investment on Dec 31, 2008** |
| Equity | 48 | 48% | -50% | 24.0 |
| Debt | 32 | 32% | 7% | 34.2 |
| Gold | 20 | 20% | 20% | 24.0 |
|   | **100** |   |   | **82.2** |

*Please note: Return assumptions across asset classes are indicative*

*As seen in Example 2, under slowdown market conditions, with a gold allocation of 20%, the portfolio value is maintained.*

**Example 2 (No gold): Portfolio pre & post Market Slowdown - 2019**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|   | **Investment on Jan 1, 2019** | **%** | **Return in 2019** | **Investment on Dec 31, 2019** |
| Equity | 60 | 60% | -15% | 51 |
| Debt | 40 | 40% | 7% | 42.8 |
|   | **100** |   |   | **93.8** |

*Please note: Return assumptions across asset classes are indicative*

**Example 2 (With gold): Portfolio pre & post Market Slowdown - 2019**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|   | **Investment on Jan 1, 2019** | **%** | **Return in 2019** | **Investment on Dec 31, 2019** |
| Equity | 48 | 48% | -15% | 40.8 |
| Debt | 32 | 32% | 7% | 34.2 |
| Gold | 20 | 20% | 20% | 24.0 |
|   | **100** |   |   | **99.0** |

*Please note: Return assumptions across asset classes are indicative*

**III Gold as consumption**

If gold is considered by the user for consumption at a future date, then gold sovereign bonds are useful. For instance, if one wants to purchase gold for one’s child’ marriage 8 to 10 years down the line, then investing in gold sovereign bond (tax free with a lock-in period for 8 years earning 2.5% interest semi-annually), is attractive. This investment tracks gold price, for a later day consumption.

**GOLD AS AN ASSET CLASS – OPTIONS**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Parameters** | **Gold ETF** | **Gold Fund** | **Sovereign Gold Bond** | **Physical Gold** |
| Issuer | Mutual Funds | Mutual Funds; Gold Funds invests in Gold ETFs | RBI through fresh issuance or through secondary market  | Gold bars/jewels from jewellers |
| How to Buy | Demat Account | Mutual Fund Account | Directly from Banks/Post Office/Demat | Jeweller/Banks |
| Investment limit | Minimum 1 gm, No maximum limit, No SIP possible | SIP possible | Minimum 1 gram and maximum 4 KG for an individual (as per rules for SGB 2018-19). SIP not possible | No limit |
| Issue Price | - | -  | Issued in tranches during the year & priced at simple average of closing price of gold of 999 purity, published by IBJA for the last 3 working days of the week preceding the subscription period | - |
| Physical Delivery | Some ETFs give the option subject to a minimum quantity (say 500 gms/ 1 kg) | Not Applicable | Not Applicable | Yes |
| Total returns | Lower than actual return on gold, depends on tracking error, expenses and exit loads | Lower than actual return on gold, depends on tracking error, expenses and exit loads | Higher than actual return on gold (Due to the 2.5% or 2.75% semi annual interest paid on the bond)  | Lower than actual return on gold. Please note 3% GST charged on gold plus making charges |
| Financial transaction costs/Expenses | Expense ratio capped at 1%; Brokerage charges, but no STT | Expense ratio capped at 2%  | 1% commission is paid to the commercial banks/post offices | Making charges of upto 5-15% can be present |
| Exit Loads | No | Typically 1% before 1 year | 5 years lock in, but can be traded on the exchange within a fortnight of purchase | Not applicable |
| Taxation | Tax treatment is like debt: long-term capital gains is lower of 10% without indexation and 20% with indexation. Short-term capital gains will be added to income and taxed at the marginal income tax rate. | Capital gains taxed similar to debt; Interest is taxable (No capital gain tax if bonds are held till maturity ie 8 years)  | Long term capital gains tax applicable after 3 years *plus* wealth tax |
| Tradeability / Liquidity | Tradeable on Exchange, Liquidity is high | Tradeable on Exchange, Liquidity is high | Tradeable on Exchange, however liquidity is low. Can be redeemed by RBI from 5th year onwards | Realisable value by selling to jewellers/private gold buyers will be subject to purity level of gold and will be net of making charges, if any |
| Safety and Security | Safer in terms of reduced risk of theft  | Safer in terms of reduced risk of theft  | Safer in terms of reduced risk of theft  | Higher risk of theft than other forms  |
| Gold as a collateral for loan?  | No | No | Yes | Yes |
| Purity Check | High (as it is held in electronic form) | High (as it is held in electronic form) | High at 0.999(as it is held in electronic form) | A big concern |
| Storage Cost | Low (held in demat form). Demat account charges may be spread over several securities.  | Low | Very low (The bond is issued by RBI and is held in the books of central bank.)  | Can be high if kept in locker (locker cost)  |