

A Golden Opportunity

by Mr. Ubed Shipra

Gold has traditionally been the standard by which the value of anything is assessed; it has also been a universally accepted medium of exchange.

Gold prices are closely linked with two important factors, the US Dollar and Crude Oil prices. While gold has an inverse relationship & strong negative correlation with the USD (the prices of gold rallies as the dollar falls and vice versa), it has direct link with the oil prices.

In general, higher oil prices tend to push up the inflation numbers and gold is considered as the best hedge against inflation. Thus, when oil prices shoot up, so does the price of gold.

In the current financial turmoil – when the stock markets were down, property and commodity prices were weakening – gold was the only asset class that saw a sharp rise in prices. It is the only asset that stands on its own during turbulent times. In the last few months, as the financial markets stabilized, gold price has been a lot more tempered.

There are also 'emotional' reasons why people hold gold in their portfolio. For Indians, gold is an essential for marriages. Here, obviously, the 'return' is really not that important.

In our view, gold is a "must" in every portfolio as it brings in an element of diversification. The price of gold is driven by factors which are broadly speaking different from those that drive the price of other assets such as stocks. This results in what is generally seen as a contrarian trend. This was seen, not only in the recent financial market turmoil, but also soon after the 9/11 terror attacks.

For a long time, buying physical gold was the only option for investing in gold. Then public sector banks in India started offering Gold Bonds. These bonds allowed people to exchange their physical gold with certificates that gave them exposure to gold. In the last few years, Indians have also got the opportunity of investing in Gold futures, a derivative with gold as the underlying. Gold Exchange Traded Funds (ETF) are increasingly become popular among investors.

Gold ETF

Gold ETFs are open-ended funds which are passively managed. Since the fund takes gold exposure, net asset value of the units of the scheme track prices of gold. The units of the scheme are listed and traded on a stock exchange; hence, they can be bought and sold like stocks on a real-time basis. By enabling investors to invest in gold without holding it in physical form, Gold ETFs offer a rather unique investment opportunity to investors.

The World's first Gold ETF (exchange-traded fund) was launched in Australia in March 2003. But the idea was originated in India way back in 2002, when one of the AMCs filed a proposal with SEBI in May 2002. However, regulations were not friendly towards the launch of such schemes then. Finally, in Feb 2007 India's first gold ETF was launched.

Gold Sector Funds

Investors need to be clear about the difference between Gold ETF and Gold Sector Funds. The latter are not passively managed funds that take gold exposure. Instead, they invest in the shares of gold mining companies that are listed on the stock exchanges across the world. Therefore, Units of Gold Sector Funds fluctuate based on profitability and prospects of the gold mining companies. As such, they do not closely track the prices of gold.

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Let us compare some of the gold exposure alternatives

Comparison of Gold ETF with Physical Gold

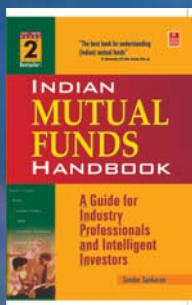
Sr. No.	Parameter	Physical Gold	Gold ETF
1	Form of holding of gold by investor	Physical (Bars / Coins / Jewellery)	Dematerialized (Electronic Form)
2	Pricing	Low on transparency.	Linked to International Gold Prices and very transparent.
3	Buying Premium above gold price	Likely to be more	Likely to be less
4	Making Charges	Charges are incurred for jewellery	No Charges are incurred
5	Impurity Risk	High, especially with jewellery	Nil
6	Security of Asset	Investor is responsible	Fund House takes the responsibility
7	Resale	Possible, but not standard	At transparent Secondary Market Prices
8	Quantity to Buy / Sell	Available in standard denomination	Minimum is ½ or 1 gram according to the fund
9	Bid Ask Spread	Very High	Very Low
10	Wealth Tax	Yes	No
11	Long Term Capital Gains Tax	Only after 3 years	After 1 year

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Comparison of Gold ETF with Gold Sector Funds

Sr. No.	Parameter	Gold ETF	Gold Sector Fund
1	Investment of Scheme	Physical Gold	Equities of Gold Mining Companies
2	Scheme	Exchange Traded Fund	Equity Oriented Scheme
3	Return	Based on Actual Gold Price	Based on movement of gold companies' shares in stock exchange
4	Market Risk	Less Market Risk	Market Risk is Greater
5	Volatile	Less Volatile	More Volatile
6	Relation with Gold Price	Direct Relation	Indirect Relation
7	Performance of Scheme	Little difference between various Gold ETFs in the market	Significant difference between performance of various Gold Sector Funds

Performance

Category Wise return as on December 24, 2009

Over 1 year, the share market has done better. But a 2-year perspective shows gold as a better performer.

Sr. No.	Fund Category / Benchmarks	1 Year Return	2 Years Return
1	Gold ETF	25.31%	25.65%
2	Sensex	81.43%	-6.49%
3	S & P Nifty	79.38%	-5.95%

Source: www.valueresearchonline.com

Fund wise Gold ETFs return as on December 24, 2009

There is little to choose between the ETF schemes

Sr. No.	Scheme Name	1 Year Return	2 Years Return
1	Gold Benchmark ETF	25.73%	26.14%
2	UTI Gold ETF	25.34%	25.98%
3	Kotak Gold ETF	25.31%	25.90%
4	Quantum Gold ETF	25.19%	NA
5	Reliance Gold ETF	24.97%	24.58%


Source: www.valueresearchonline.com

The gold sector funds have performed much better than the Gold ETF. Inter-scheme differences in performance too are seen.


Sr. No.	Scheme Name	1 Year Return
1	AIG World Gold Fund	61.70%
2	DSP Black Rock World Gold Fund	46.26%

Source: www.valueresearchonline.com


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