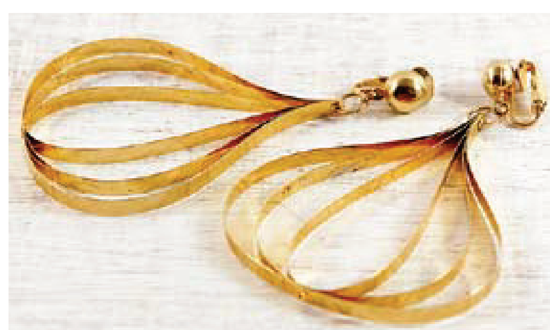
Is It Wise to Invest in Gold Now?

Gold has been a lot in the news recently. We have had the union finance minister asking investors to shy away from gold investments, the import duty on gold being raised to 10 per cent, the Reserve Bank of India (RBI) curbing gold imports and, above all, gold prices soaring in the country on account of a weak rupee. This has not been good news for investors seeking to add gold to their investment portfolio. The report that follows explores if investing in gold in the current market is a wise decision, what factors one must consider before making this decision, and if one needs to buy gold, then what are the best options available.

Isha Goel, Consumer VOICE FSRG Group

Gold is the world's oldest international currency and an important element of global monetary reserves. Having gold in your investment portfolio is a smart choice. Returns from gold can help beat inflation and even during periods of crisis, when equity markets have not performed well, gold has given stable returns. Add to that the Indian attraction towards it, and gold emerges as an impressive investment option.



VOICE Recommendation

This analysis of various methods of buying gold – as in September 2013 – reveals that from a purely investment perspective, gold ETF is the best option available. It's easy to buy and hassle-free, and it mirrors the returns of physical gold without having to worry about storage costs, insurance, etc.

Should you then invest in gold ETF in the current market scenario? Since it is impossible to accurately predict future gold price movement, it's best not to second-guess and to buy during price dips in small quantities.

If the objective of investment in gold is twofold – that is, you want to gain from the price appreciation as well as accumulate gold for future consumption – gold ETFs are not the best way forward. That's because, except for Motilal Oswal MOSt Shares Gold ETF, all other gold ETFs offer physical delivery on accumulation of one kilogram of gold with limited delivery centres. Motilal Oswal MOSt Shares Gold ETF offers the minimum delivery size at 10 gm; however, delivery charges are payable.

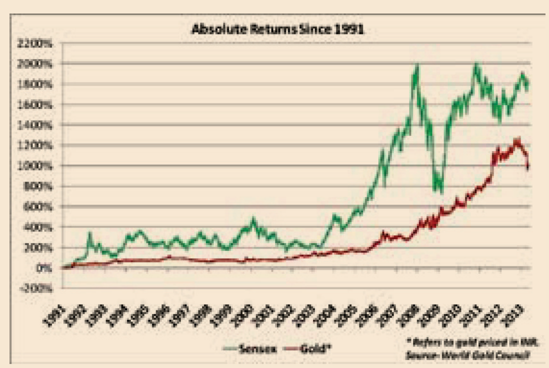
From a future consumption point of view, e-gold seems, at first glance, to be very impressive. However, with it not being a viable option currently (see 'E-Gold Troubles'), it is best to buy physical gold in form of coins or biscuits.

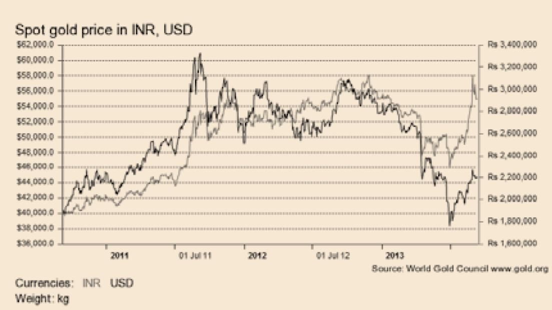
BEST BUYS

For Investment	For Consumption
Gold ETFS like Goldman Sachs Gold BEES , Reliance Mutual Fund's R Shares Gold Fund, Kotak Mahindra Gold ETF, SBI Gold ETF, UTI Gold ETF	Physical gold – buying e-gold currently is neither possible nor advisable.

Factors to consider before investing in gold

- **International price and domestic price comparison:** The chart here shows how price of gold in India has risen in comparison to price of gold in US dollars. This is mostly due to the rupee slide and the increased import duty on gold in India.
- **Demand and supply comparison:** Demand for gold arises from jewellery demand, investment demand, central bank reserves and demand for applications in industries. India is the largest market for gold jewellery in the world, with investment demand mainly arising due to ability of gold to act as a hedge against inflation. Though demand for gold continues to rise, supply for gold is not rising as much.
- **Past returns:** While evaluating past returns given by gold, long-term data should be evaluated. It is not wise to only look at short-period returns, say, from 2006 to 2012, when CAGR has been over 20 per cent. There have been times when gold prices have not shown much movement for over 20 years. Also, a comparison with returns from Sensex shows that over the long run returns from both have moved in the same direction, while some negative relationship exists in the short run. Thus, gold can give good returns in the long term, but in the short run it can be quite volatile.





Check the following five marks of Hallmark before buying

BSI Standard Mark	Purity/Fineness Grade	Assaying & Hallmarking Centre's Mark	Year of Marking	Jeweller's Identification Mark
	e.g. 958 23 carat 916 22 carat 875 21 carat 750 18 carat		e.g. A for 2000 P for 2012 Q for 2013	

Methods of Buying Gold in India

There are a number of ways in which you can gain exposure to gold. You may buy gold in form of jewellery, coins and biscuits; or invest in it through mutual funds, gold ETFs, e-gold and gold futures. These methods are discussed here.

Jewellery: Gold in the form of ornaments is the preferred form of gold investment for a majority of people in India. While it serves the dual purpose of being a consumption article as well as an investment for future, its biggest disadvantage as a form of investment is that about 10 per cent to 15 per cent of the total cost is lost as designing and making charges. Many jewellers are also providing gold savings schemes through which it is possible to pay in instalments and accumulate gold. While buying jewellery, look for the BIS Hallmark logo on the jewellery piece (see the accompanying box) as it provides an assurance about the purity of gold and can also help you take gold loans against the jewellery if the need so arises.

Gold bars, biscuits and coins: Gold in bulk form is called bullion and while bullion bars are a good mode of investment, the minimum investment to be made is quite high and often out of reach for an average consumer. Bullion can be cast into bars or minted into coins, but additional costs like small lot fees and processing fees have to be incurred. While gold coins sold by banks are a popular choice, they offer lesser liquidity as they are not bought back by the banks. Buying physical gold also comes with worries about its safety, insurance and storage.

Gold ETFs: Gold exchange traded funds, or paper gold, are financial products that invest your money in physical gold and are listed on a stock exchange. They are highly liquid and make it easy for buyers and sellers to trade. A typical gold ETF invests 90 per cent to 100 per cent of its funds in 99.5 per cent pure physical gold sourced from RBI-approved banks and agencies, while the remaining 0 per cent–10 per cent is invested in debt instruments. Hence, returns from gold ETFs are similar to returns from physical gold.

E-gold: Gold can be purchased in demat form through National Spot Exchange Limited (NSEL), with investors being able to take physical delivery on accumulation of a minimum eight grams of gold. One trading unit is equivalent to one gram of physical gold. Though the concept of e-gold is very attractive on paper, it has run into problems due to certain regulatory oversight and NSEL having to suspend trading in its e-series contracts. (See 'E-Gold Troubles')

Gold mutual funds: A gold fund is an open-ended fund that has gold ETFs and shares of gold mining companies as its majority holdings. It is simpler to invest in gold funds since you do not need a demat account and it is also possible to invest through a systematic investment plan (SIP). However, expenses tend to be

E-Gold Troubles

The National Spot Exchange, an electronic spot market, provides an opportunity to buy lower-denominated demat contracts on precious metals (including gold and silver) and industrial metals called e-series contracts. E-gold can also be bought on the exchange, with one trading unit being equal to one gram of gold. However, with NSEL running into a crisis due to certain norms on commodity trades being violated, trading on e-series was suspended in August 2013 until further notice. Currently, existing investors are experiencing delays in physical delivery due to a huge settlement demand facing the exchange. Though concept of e-gold on paper is very attractive and it bridges the gap between traditional consumption demand for gold and demand for investment purposes, its future for now is unclear and, hence, is not recommended by us until the NSEL is able to overcome its current problems.

Comparative Analysis of Methods for Investing in Gold

Method	Advantages	Disadvantages
Physical gold in form of jewellery, gold coins, bars, etc.	• Physical possession • Jewellery serves a dual purpose – as a consumption article as well as an investment • Gold loans can be availed of if need arises	• Risk of theft, storage charges • In case of sale within three years, short-term capital gains tax is payable • VAT has to be paid at the time of purchase
Gold mutual fund	• No need to open demat account • Diversification is done by combining gold holdings with equity/debt	• Higher expense ratio as compared to gold ETFs • Only about 60 per cent of holdings are invested in gold • No option of getting units held converted to physical gold
Gold ETFs	• One unit of gold ETF = one gram of gold for most schemes • Easy to buy and sell, no storage costs • Gold ETFs are taxed under long-term capital gains after one year only	• Demat account is required • Conversion option is available if the investor holds 1,000 units (1 kg) gold in most schemes
E-gold	• Extended trading hours from 10:00 am to 11:30 pm on weekdays. • Conversion to physical form for minimum eight grams	• Separate Demat Account is required • Currently not possible to invest in e-gold (See E-gold Troubles)

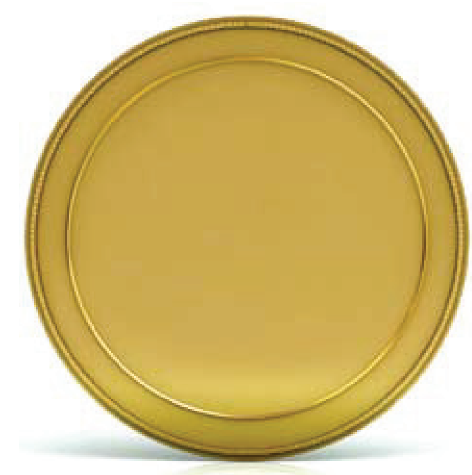
higher in gold mutual funds, and in periods where gold is doing well, returns may not be as good since fund exposure to gold is lesser as compared to gold ETFs.

Gold futures: Gold can also be bought in futures market like other commodities. In India, MCX and NCDEX offer future contracts in gold. However, they are not recommended as a mode of gold investment for an average customer due to their increased risk.

Investing in Gold ETFs

Gold ETFs provide investors a way to participate in the gold bullion market without having to take physical delivery of gold and to enjoy returns that, before expenses, correspond to returns provided by physical gold in the domestic market. They offer the following advantages:

- It is possible to buy in small lots as for most gold ETFs one unit represents one gram of gold. (In Quantum Gold ETF Fund 1 unit = ½ gm of gold.)
- They are easy to buy and sell and are quite liquid.
- There is no risk of theft.
- No making charges have to be paid—unlike in physical jewellery.



How to Invest in Gold ETF?

Gold ETFs can be bought and sold through a stock exchange (such as NSE, BSE) just like regular stocks. You need a demat account to be able to invest in gold ETFs. In case you already have one for share trading, there is no need to open a new one. You can buy gold ETFs from a stock exchange either through your online trading account or through your broker.

Open a trading and demat account with a broker affiliated with NSE

If you already have one for share trading, there is no need to open a new one

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Decide which ETF to buy and the quantum of investment

Administrative charges for different ETFs may be different

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Place order through broker or through online trading account

Brokerage has to be paid

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GETF units are credited to your demat account on T+2 basis (trading day + 2 days

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Track performance of GETFs

Buy more or book profits according to gold prices

Long-term capital gains tax payable on sale after one year of holding

Selecting a Gold ETF from Various Options

- Compare expenses of the various gold ETFs. The expense ratios of asset management companies (AMCs) are available on their websites. The lesser the expenses, the better it is.
- Compare net asset value (NAV) of the fund to its price. A good bargain is a fund available at a discount – that is, where NAV is higher than price.
- Compare gold exposure in holdings. Gold ETFs also invest 0%–10% of their total holdings in debt and liquid funds. This can lead to difference between returns from physical gold and from gold ETF. This is called tracking error.
- Compare size of assets under management (AUM). ETFs with higher AUM should be preferred.
- Compare volumes traded. Funds with high volumes traded offer greater liquidity to the investors.

Based on the above criteria and the accompanying table, the gold ETFs that are marginally better than the rest are:

- Goldman Sachs Gold BEES
- R Shares Gold Fund (Reliance Mutual Fund)
- Kotak Mahindra Gold ETF

The following two ETFs are also good buys due to the brand value of the companies:

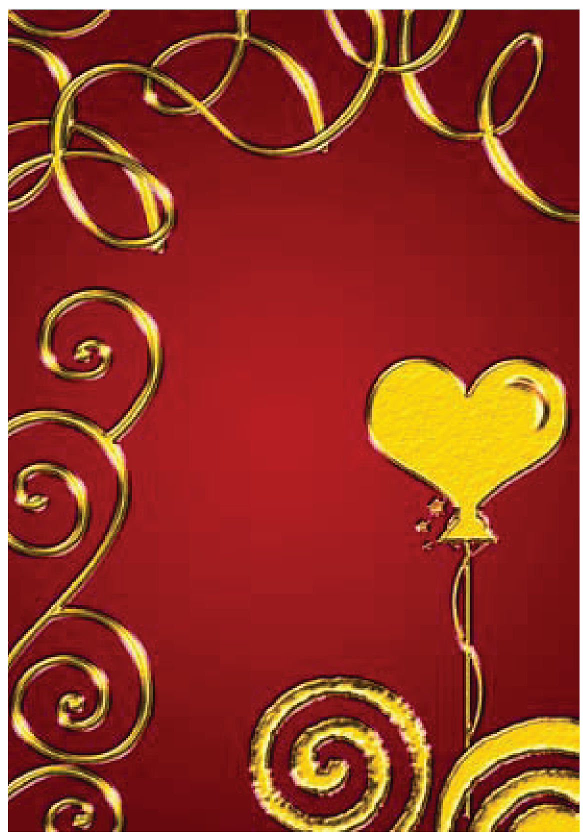
- SBI Gold ETF
- UTI Gold ETF

Taxation of Gold ETF

Unlike shares that are exempt from tax after one year, capital gains tax is levied on gold ETFs and physical jewellery when they are sold. Gold ETFs are taxed under long-term capital gains after one year of holding and benefit of indexation (adjustment for inflation) is available.

For individuals, the long-term capital gains tax payable on gold ETF is 10 per cent without indexation or 20 per cent with indexation, whichever is lower, plus 3 per cent education cess.

Gold ETFs score on physical gold here since if physical gold is sold within three years of holding, short-term capital gains tax is payable. Long-term capital gains tax is levied on physical jewellery only after three years of holding period. The short-term capital gains will be taxed according to the applicable tax slab of the individual.



Comparison of Gold ETFs

Sl No.	Fund Name	Assets (Rs Cr in June '13)	Expense Ratio	1-Y Return (%)	3-Y Return (%)	5-Y Return (%)	Tenure (Years)
1	Goldman Sachs Gold ETF	2,934.74	1.00	-2.72	16.82	21.41	6
2	R*Shares Gold ETF	2,550.39	1.09	-2.56	17.12	21.19	5
3	SBI Gold ETS	1,290.51	0.99	-2.58	17.11	--	2
4	Kotak Gold ETF	1,143.02	1.04	-2.71	17.01	21.45	5
5	HDFC Gold ETF	765.70	1.07	-2.75	16.88	--	3
6	UTI Gold ETF	648.86	1.00	-2.67	17.05	21.49	2
7	Axis Gold ETF	439.98	1.06	-2.73	--	--	1
8	ICICI Prudential Gold ETF	186.00	1.00	-2.18	16.93	--	1
9	IDBI Gold ETF	160.00	1.17	-2.77	--	--	2
10	Canara Robeco Gold ETF	132.23	1.06	-2.42	--	--	1
11	Birla Sun Life Gold ETF	118.16	1.00	-2.82	--	--	1
12	Religare Invesco Gold ETF	69.23	1.00	-2.46	17.13	--	3
13	Motilal Oswal MOSt Shares Gold ETF	63.51	1.42	-3.09	--	--	0
14	Quantum Gold	59.25	1.00	-2.60	17.06	21.49	4

Data given is as on 6 September 2013. Funds have been arranged in decreasing order of assets under management. (*Source: www.valueresearchonline.com*)

Investing in Gold ETFs

Do's	Don'ts
Ask yourself: Why am I investing in gold? Your answer should guide your decisions relating to gold investment.	Don't follow the herd mentality – that is, don't buy gold just because everyone is buying.
Consistently invest in small quantities to gain rupee cost advantages.	Avoid any tendency to overinvest since gold is not a productive asset.
Build up your gold holdings slowly rather than investing all at once. One unit of most ETFs represents one gram of gold.	Don't be tempted by returns that others have earned. Their entry level might be different and it might not be possible for you to replicate the returns that they have earned.
Invest 10%–15% of your total portfolio in gold. Book profits partially, periodically.	Don't sell the entire portfolio at same level. Sell in a staggered manner.
Check administrative expenses applicable to the gold ETF before buying.	Don't compare NAV of different gold ETFs. Instead, compare NAV of the funds with their respective prices.
Gold ETFs with higher assets under management (AUM) should be chosen as they offer greater liquidity	

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