INVESTMENT IN GOLD: An Overview

Why choose Gold?

Gold protects your portfolio from volatility because the factors, both at the macro-economic and micro-economic fronts that affect the returns from most asset classes do not significantly influence the price of gold. Just after 9/11 and during the 2008 recession, while stock markets and bonds crashed across the world, gold held steady and, in fact, rose on that day by 6%.

- **Gold as a diversifying investment:** Gold acts as a diversifying component to your portfolio. It is not correlated to stocks, bonds and real estate.
- **Gold acts as a safe haven during uncertainty:** Gold is a safe haven during times of political and economic uncertainty. During uncertain times, investors who held onto gold were able to successfully protect their wealth. Consequently, whenever there is news and events that hint at some type of uncertainty, investors often buy gold as a safe haven making it an attractive investment avenue.
- **Gold has historically proven to be a good hedge against inflation:** The factors that affect the price of gold are rather different from factors that affect other assets like say domestic fixed deposits. And therefore, if inflation in India were to dent the value of the Rupee, and consequently your wealth, it will have no impact on the price of gold (other factors remaining the same) thereby lending support to your wealth. In fact, in times of inflation, the smart money tends to move to gold, thereby driving up its price.
- **Worldwide gold production is not matching consumption**: Due to the rising demand, the price of gold is expected to go up with demand. Most gold consumption is done in India and China and their demand is increasing with their increase in national wealth.

How can you invest in Gold?

Today, an individual or corporate has the option of buying gold through different routes, based on their needs.

- **Physical Gold/Jewelry –** through bank or jeweler
- **Commodity Exchange –** open an account in commodity segment and buy in demat or physical form
- **Exchange Traded Funds (ETFs) –** through your stock trading account

The mode of buying or investing in gold would depend on your need. If you want to speculate or trade in gold, and gain from price volatility, then buying gold through commodity exchange would be best suited for you. If you goal is to make jewelry, then buying gold through a jeweler or a bank in physical form would be more suited for your need. However, if you are looking to buy gold for investment purpose or maybe investment now but use it later for your child's marriage, then buying gold through an ETF makes more sense.

Given below is a comparison of buying gold through different channels.

A comparison of different modes of Buying Gold:

Parameters	Jeweler	Banks	Commodity Exchange	Gold ETF
Purchase Price	At a premium	At a premium	Close to market price (but brokerage cost involved)	Close to market price
Risk of impurity	High – comes in varied carats	Very Low	Nil	Nil
Resale	Buy-back at a discount	Banks do not buyback, hence uneconomical	On the exchange, close to current market price (demat). If delivery is taken then uneconomical	On the exchange, close to current market price
Liquidity	Moderate	Moderate	High	High
Transparency in pricing and quality	Low	High	Very High	Very High
Mode of holding	Physical	Physical	Dematerialized/Physical	Dematerialized
Risk of theft	High	High	None	None
Denomination	Standardised. Lower denominations uneconomical due to high making charges	Standardised. Lower denominations uneconomical due to high making charges	Different lot size, minimum 10 grams	Minimum of 1 unit (1 gram of gold) and in multiple thereof. No making charges
Wealth Tax	Applicable	Applicable	Applicable	None

What are gold ETFs?

Gold ETFs are open-ended mutual fund schemes that will invest the money collected from investors in standard gold bullion. Being ETFs, these funds are listed and traded on the stock exchange i.e. investors can buy and sell them like any other stock on the stock exchange, on a real- time basis. These are passively managed funds and are designed to provide returns that would closely track the returns from physical gold in the spot market.

Gold ETFs are **listed and traded on NSE and/or BSE.** They are held in demat form just like the stocks. To invest in Gold ETF, you need to have a trading and demat account with a stock broker.

What are the charges involved in buying gold through ETF mode?

An investor has to pay brokerage, demat and trading account charges and expenses to the fund house for buying and investing in gold ETF.

Why Gold ETF's?

- **Investment even with small amounts is possible:** Gold ETFs allow investment in gold even in small denominations, which makes it easier for the retail investor to participate.
- **Convenient and hassle-free:** Investing in gold ETFs will give the investor all the advantages of investing in gold while eliminating drawbacks of physical gold -- cost of storage, liquidity and purity of gold.

- **More Tax Efficient:** Investing in paper gold gives investor's tax advantages over investing in physical gold. Firstly, gold ETFs are not liable for wealth tax, unlike physical gold. Secondly, gold ETF units held for more than one year qualify for long-term capital gains at 20%, whereas the holding period in physical form has to be three years to qualify for long-term capital gains. For less than three years, the gains are taxed at 30%.

Taxation – Gold: Physical vs. Commodity Exchange vs. ETF

	Physical Gold	Commodity Exchange	ETF
Wealth tax	Applicable	Applicable	Not applicable
Long term investment	Yes	Speculation or Trading	Yes
Short term capital gain tax	Applicable if sold within 3 years from purchase	Gains are not categorized as short term. Purchase/sale without delivery is treated as speculative gain/loss. If delivery is taken, it is categorized as income/loss from business and taxed accordingly	Applicable if sold within 1 year from purchase
Long term capital gain tax	After 3 years	No	After 1 year

How are Gold ETFs better than Gold Funds?

Gold ETFs are better than Gold Funds because in comparison to gold funds, **gold ETFs are less volatile**. While gold ETFs invest in physical gold, gold funds invest in equities of gold mining companies; and gold stocks are more leveraged to the gold prices than the gold itself. If you are looking for returns that match to gold returns, then you should invest in Gold ETF. However, if you want to invest in equities of gold mining companies, gold funds would be the right choice, but remember they are more risky as their returns are correlated to performance of equity markets.

Who should invest?

- Investors looking to diversify:
  - from other asset classes (equity, debt, real estate, etc.)
  - from physical gold holding - A small quality of gold can be held in the form of ETF, hassle-free
- Investors who want to buy gold as an investment and gain from its ability to create wealth
- Individuals looking at gifting gold to their child in future, can start accumulating gold through ETF
- Investors who want to get the full value of their gold investment and believe in transparency

What should investors do?

Gold ETFs offer investors a convenient means to invest in gold without the hassles of storage; also it spares investors of the concerns regarding the quality of gold. Gold ETFs would probably be appropriate for investors who wish to invest in gold in bulk and are likely to be faced with a storage problem. Stability, reduced volatility in a well-diversified portfolio, hedge against inflation, convenient investment vehicle to get tax-efficient exposure due to the absence of wealth tax and long-term capital gains tax, are all good reasons to invest in gold ETFs.

Gold will also help you to diversify your portfolio – remember 'Do not put all your eggs in one basket'.

Which are the currently available Gold ETFs in India?

As of now, there are nine gold ETFs available in India, their details are given below. Our **recommended Gold ETFs are marked in blue**.

Name of the Scheme	NSE Code	Inception
Gold Benchmark Exchange Traded Fund	**GOLDBEES**	**March 2008**
UTI Gold Exchange Traded Fund	GOLDSHARE	January 2007
Kotak Gold Exchange Traded Fund	**KOTAKGOLD**	**June 2007**
Reliance Gold Exchange Traded Fund	RELGOLD	November 2007
Quantum Gold Exchange Traded Fund	QGOLDHALF	February 2008
SBI Gold Exchange Traded Fund	SBIGETS	March 2009
Religare Gold Exchange Traded Fund	RELIGAREGO	January 2010
ICICI Prudential Gold Exchange Traded Fund*	-	July 2010
HDFC Gold Exchange Traded Fund*	-	June 2010

* Yet to be listed on exchange, their NFO closed recently.

Our view

As an investment option in gold, gold ETFs are more convenient and hassle-free than physical gold or commodity. Besides, investors are freed from the headache of worrying about the quality, safety, transparency in price and resale value. Moreover, investors looking to put in small amount in gold will also find gold ETF better, as one can buy as low as 1 gram of gold through the ETF way. From tax perspective too, Gold ETFs are attractive.

Have a query?

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