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A Study on Gold Exchange Traded Funds (ETF'S) In India

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ABSTRACT

Historically Gold has a very high co-relation with inflation & oil prices and has a very low co-relation with equities & US dollar. Also Gold provides "insurance" against unforeseen events or financial catastrophe. In times of national crisis, people fear that their assets may be seized and the currency may become worthless and therefore they prefer gold as an alternate form of investment. The shiny yellow metal has been regarded as an effective hedge against inflation, and is known to preserve the purchasing power over a long period of time. Rising inflation rates typically appreciate gold prices and vice versa. It has an inverse relationship with interest rates.Gold does have an important role to play in an investor's portfolio. Gold ETF's (exchange traded funds) offer a fairly cost-efficient way to invest in gold. Gold ETF's have delivered a 34 % return in the last three years. This study is undertaken to analyze the performance of ETF gold schemes traded in the Indian capital market. The study will provide valuable insights to investors to relook on their investment strategies

Keywords : Exchange traded fund , Net Asset Value & Investment

INTRODUCTION

Investment is the commitment of funds in an asset or financial instruments with the aim of generating future returns in the form of interest, dividend or appreciation in the value of the instrument. Investment is involved in many areas of the economy, such as, business management and finance no matter from households, firms, or Governments. An investor has numerous investment options to choose from, depending on his risk profile and expectation of returns. Different investment options represent a different risk-reward trade off. Low risk investments are those that offer assured, but lower returns, while high risk investments provide the potential to earn greater returns. Hence, an investor's risk tolerance plays a key role in choosing the most suitable investment. Various investment options available are Bank Deposits, Commodities like Gold, Silver, Post Office Savings Schemes, Public Provident Fund, Company Fixed Deposits and Stock Market options like Bonds and Debentures, Mutual Funds, Equity Shares etc., Of the various types of investment options in the Stock Market, Gold Exchange Traded Funds (Gold ETFs) happens to be one of the best options to be included in the portfolio for diversification of risk. The idea of Gold ETF was first conceptualized by Benchmark Asset Management Company Private Ltd. in India, when they filed a proposal with the SEBI in May 2002. However, there was no regulatory approval then and later it was launched in March 2007. The first Gold Exchange-Traded Fund was actually launched in March 2003 on the Australian Stock Exchange under Gold Bullion Securities (ticker symbol "GOLD"). Graham Tuckwell, the founder and major shareholder of ETF Securities, was behind the launch of this fund. In this context, the study is undertaken to assess the importance of Gold ETFs and it's performance in India.

NEED FOR INVESTMENT IN GOLD :

Gold is a foundation asset within any long term savings or investment portfolio. For centuries, particularly during times of financial stress and the resulting 'flight to quality', investors have sought to protect their capital in assets that offer safer stores of value. A potent wealth preserver, gold's stability remains as compelling as ever for today's investor. As one of the few financial assets that do not rely on an issuer's promise to pay, gold offers refuge from widespread default risk. It offers investors insurance against extreme movements in the value of other asset classes.

A number of compelling reasons underpin the widespread renewal of interest in gold as an asset class:

Portfolio diversification :Most investment portfolios primarily hold traditional financial assets such as stocks and bonds. Diversifying your portfolio can offer added protection against fluctuations in the value of any single asset or group of assets. Risk factors that may affect the gold price are quite different in nature from those that affect other assets. Statistically, portfolios containing gold are generally more robust and less volatile than those that do not.

Inflation hedge :Market cycles come and go, but over the long term, gold retains its purchasing power. Gold's value, in terms of the real goods and services that it can buy, has remained remarkably stable for centuries. In contrast, the purchasing power of many currencies has generally declined, due for the most part to the rising price of goods and services. Hence investors often rely on gold to counter the effects of inflation and currency fluctuations.

Currency hedge :Gold is employed as a hedge against fluctuations in currencies, particularly the US dollar. If the world's main trading currency appreciates, the dollar gold price generally falls. On the other hand, a fall in the dollar relative to the other main currencies produces a rise in the gold price. For this reason, gold has consistently proved to be one of the most effective assets in protecting against dollar weakness.

Risk management :Gold is significantly less volatile than most commodities and many equity indices. It tends to behave more like a currency. Assets with low volatility will help to reduce overall risk in your portfolio, adding a beneficial effect on expected returns. Gold also helps to manage risk more effectively by protecting against infrequent or unlikely but consequential negative events, often referred to as "tail risks".

Demand and supply :The price of gold tracks the shifting balance of supply and demand. Long lead times in gold mining mean production of gold is relatively inelastic, regardless of increases in demand. That's why the rally in the gold price since 2001 has not engendered a meaningful increase in gold production levels

CONCEPT OF GOLD ETF :

Gold ETFs are open-ended mutual fund schemes which work on the principal of mutual fund but will invest the money collected from investors in standard gold bullion (0.995 purity) instead of various securities as in standard Mutual fund. The investor's holding will be denoted in units, which will be listed on a stock exchange. Each unit carries a NAV which is specified as the value of 1 gram of gold or as the asset Management Company fixes. The fund doesn't involve active management as in case of other varieties of mutual funds. The NAV goes with the prices of physical gold and so the return also varies in some way directly to that of physical gold. So we can say that return of the ETF goes hand in hand with Gold returns. The most flexibility involves in Gold ETF is that an investor can buy and redeem the units either directly from the mutual fund, subject to certain stipulations, or from the stock exchange. The below chart depicts how GOLD ETF works.

PARAMETER	JEWELLER	BANK (bars / coins)	Gold ETF
Purchase & sale	Physical form	Physical form	Demat
Trading timing	Shop hours	Bank hours	10 am-3 pm
Buyer's premium	High	Very high	Low
Making charges	Involved	involved	None
Impurity risk	May exist	May exist	Cannot exist
Recurring expenses	High	High	Low
Delivery centre	Single	Single	Single

DIFFERENCES WITH PHYSICAL GOLD

Investment in Gold ETF have all advantages as that of gold. But it also eliminates some drawbacks which gold have like Cost of Storage, Liquidity & purity, Wealth tax after a certain limit. Since the working of Gold ETF is same as that of Mutual fund, so transparency is maintained due to strict regulation of regulatory body. Also standard of gold is Fixed, so no question of getting less pure Gold. The NAV figures are also displayed daily wise, so the buyer /seller can determine his position. We need to invest in huge amount for physical gold considering the present price of gold. Whereas in Gold ETFs we can invest in small denomination, which makes it easier for the retail investor to participate. On the secondary market, the minimum lot is one unit. This enables the investor to accumulate units over time and reap the benefits of rupee cost averaging. The units can be redeemed either from the fund directly or from the market

Parameter	Physical Gold	Gold ETF's
How gold is held	Physical (Bars / Coins)	Dematerialized (electronic form)
Pricing	Based on physical demand & supply and differs from bank to bank. Not Transparent	Linked to international gold prices and very transparent. Will be traded at NSE/BSE, so, transparent
Making charges	Charges are incurred	No charges are incurred
Storage	Locker / safe	Demat account
Resale	Conditional and uneconomical	At secondary market prices
Theft	Possible	Not possible
Wealth tax	Levied	Not levied
Long term capital gain tax	Only after three years	After one year
Short term capital gain tax	If sold before three years	If sold before one year
Impurity risk	High	Nil

COMPARISON OF ETF Vs STOCKS AND MUTUAL FUNDS :

The below chart represents the superior features of investment in ETF's as compared with stocks and mutual funds .

S. No	Functionality	ETF's	Stocks	Mutual Fund unit
1.	Real-time trading and pricing throughout market hours	Yes	Yes	No
2	Ability to put limit orders	Yes	Yes	No
3	Can be purchased through Broker or online trading account	Yes	Yes	No
4	Returns at par with index or market	Yes	No	No
5	Intra day trading	Yes	Yes	No
6	Paper less investing	Yes	Yes	No
7	Exit load	No	No	Yes

Source : National stock exchange

LIST SHOWING THE PERFRORMANCE OF GOLD ETF's IN INDIA :

Scheme Name	Latest NAV	30 days	6 Months	1 year
Axis	2858.82	2983.66	2699.60	2304.12
Birla Sun life	2928.37	3052.73	2757.66	2353.73
GS Gold BeES	2795.93	2916.79	2637.15	2254.17
HDFC	2863.17	2987.27	2701.42	2301.19
ICICI Pru	2880.90	3005.05	2715.35	2317.70
Kotak	2805.89	2928.03	2647.25	2252.67
Quantum	1396.24	1457.00	1317.78	1120.81
Reliance	2732.71	2851.39	2577.95	2192.50
Religare	2886.81	3012.15	2721.36	2316.33
SBI	2862.83	2987.15	2699.30	2296.58
UTI	2807.74	2929.80	2648.51	2253.74

From the above analysis of NAV as on July 21st 2012, it can be infered that Birla Sunlife holds the highest NAV followed by Religare, HDFC, ICICI Pru, SBI, Axis, UTI, Kotak, GS Gold BeES , Reliance and Quantum. The spot gold price on the multi commodity exchange closed on July 20th at Rs 2914. The performance of the Gold ETF is above the Gold spot market price. This indicates that the returns from the Gold ETF market seem to be promising for investors in the long run.

CONCLUSION

Investor demand for gold has been increasing amid global economic and political uncertainty. There are several options for investors interested in using gold as part of a short- or long-term investment strategy. Exchange traded products backed by physical gold offer investors an innovative way to access the price of physical gold. As gold prices can be quite volatile investment in gold can be carried out through ETF's in installments. If you cannot do this, buy a few units every month through systematic investment plan. Gold ETF's allows you to faithfully track gold prices, irrespective of whether they move up or down. As an investor after few years down the line, if you want to splurge on jewellery, one can simply cash out all ETF gold units and not worry about missed opportunities. Overall the global annual production of gold has decreased by nearly by 8% since 2001. Hence 2011, will prove that gold and gold ETF's are the best investment options. The gold ETF schemes returns need to analyzed periodically to achieve the investment objective.

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