GOLD EXCHANGE TRADED FUNDS – THE MOST TAX EFFICIENT WAY TO OWN GOLD

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Abstract

Gold should definitely form a part of investors' portfolio. Apparently Indian investors always had a fancy towards this class of asset. The switching over form physical assets to financial assets for potentially high returns Over the past few months, the popularity of Gold exchange traded funds have increased among investors, due to the surging interest for gold as an instrument for investment.

This paper intends to focus on the inherent advantages of investing in gold ETFs and the transition phase in the Indian financial market relating to Gold ETFs. These passively managed funds provide many advantages to the investor. They assure convenience, transparency in pricing, diversification at low cost and more liquidity. Gold exchange traded funds is an exchange traded fund that aims to track the price of gold. These are units representing physical gold. These units are traded on the exchange like a single stock. The fundamentals of a country are basically responsible for the performance of gold ETFs. Undoubtedly equities are considered as the best class of assets for long term growth but gold is no exclusion due to appreciation in value.

These are traded on the major stock exchanges including London, Paris, New York. It is not a new concept in India. There has been two ETFs launched in India. One is based on Index which is called spice and another launched with Nifty as an underlying asset, known as gold Nifty Bees. Since 2008, the gold ETFs are recording good returns.

Keywords: Portfolio, Asset Management Company, Capital gain, derivatives

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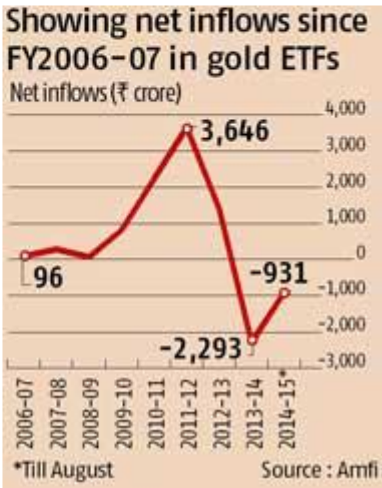
Introduction

In 2011-12 net inflows had peaked to Rs 3650 cr from Rs 96 cr in 2006-07, when the Indian mutual fund sector first launched gold ETFs for investors. Gold ETF's are intended to offer investors a means of participating in the gold bullion market without the necessity of taking the physical delivery of gold and to buy and sell that participation through the trading of a security.



Source: AMFI

Although, some funds charge an entry load and exit load. However, it does not have to bear up with the dividend distribution tax. GOLD ETFs also known as paper gold are open /close ended mutual fund schemes that will invest the money in standard gold bullion(0.995)purity. In general parlance, this degree of purity is called as 24 carat gold. The AMCs appoint a bank as the custodian of the gold bought on behalf of the investors. The gold held by the custodian would be fully insured will not be used for lending. These are designed to provide returns from physical gold in the spot market. The popularity of gold ETFs are gradually increasing in the Indian financial market with increase in the financial awareness. The volume of trade is likely to increase.

Why India is a price taker for gold

India accounts for nearly one third of the total world demand for gold thus India is a biggest consumer of gold. Indian consumers demand for gold is 37.6% more than that of China. Another major economy of the world USA does not even come close to the levels of being reported at 213.5 tonnes. India produces less than 2% gold consumed and rest 98% is imported.

Investment objective

The investment objective of the gold ETF scheme is to generate returns that are in alignment with the performance of gold. Falling interest rates have forced Indian households to look at other classes of assets. There has always been a fascination for gold in the Indian market and the launching of gold EFTS makes it tradeable and increases its liquidity. It can be bought like a stock in the stock exchange, storage to be done by the fund manager, no security risk, no impurity risk and no cost of making charges. Holding costs would be lower and the same channel of trading and delivery would be used. Time can only tell whether Indians would continue to buy gold from jewelers & banks or from the stock exchanges.

Investment strategy

The scheme would invest in gold in the domestic market and intends to track the spot price of gold in the domestic market. The scheme may also engage in gold lending or deposit gold with banks in return for fees as and when permitted by SEBI. There is an investment also in the debt and money market instruments in order to meet the liquidity requirements. However no guarantee of returns are promised in such schemes. Some of the popular Gold ETFs in India are as follows

SCHEME NAME	MANAGED BY
AXIS GOLD ETF	AXIS MUTUAL FUND
GOLDMAN SACHS GOLD EXCHANGETRADED SCHEME	GOLD MAN SACHS MUTUAL FUND
UTI GOLD EXCHANGE	UTI MUTUAL FUND
HDFC GOLD EXCHANGE TRADED FUND	HDFC MUTUAL FUND
ICICI PRUDENTIAL GOLD EXCHANGE TRADED FUND	ICICI PRUDENTIAL MUTUAL FUND
KOTAK GOLD EXCHANGE TRADED FUND	KOTAK MUTUAL FUND
QUANTUM GOLD FUND	QUANTUM MUTUAL FUND
RELAINCE GOLD EXCHANGE TRADED FUND	RELAINCE MUTUAL FUND
RELIGARE GOLD EXCHANGE TRADED FUND	RELIGARE MUTUAL FUND
SBI GOLD EXCHANGE TRADED SCHEME	SBI MUTUAL FUND
BIRLA SUNLIFE GOLD ETF	BIRLA SUNLIFE MUTUAL FUND
IDBI GOLD EXCHANGE	IDBI MUTUAL FUND

TRADED FUND	
CANARA ROBECO GOLD EXCHANGE TRADED FUND	CANARA ROBECO MUTUAL FUND

Source: nseindia.com

Comparison of benefits

The following table provides an analysis on the various modes of investment in gold.

BENEFITS	PHYSICAL GOLD	COMMODITY EXCHANGE	GOLD ETF
Control of quality of gold	Low	High	High
Cost of holding	High	High brokerage cost	Low
Risk of theft	High	Low	Low
Available denominations	Small	Small	Small
Wealth Tax	Yes	No	No
Long term capital gains tax	After 3 years	No	After 1 year
Liquidity	Moderate	High	High

Source : Kotak Mutual fund

Risk control

The investments made in the Gold ETFs will be in accordance with the guidelines of the Asset Management companies. The AMC will strive to achieve the investment objective by way of a judicious portfolio mix comprising of gold bullion and instruments related to gold. (including derivatives as and when permitted by SEBI). Debt securities and money market instruments would be assessed with regard to credit risk, interest rate risk and liquidity risk.

Credit risk

Investment in debt securities and money market instruments that have been assigned high investment grade ratings by a recognized rating agency. A detailed credit evaluation of each investment opportunity will be undertaken. The AMC board and the trustee shall approve the detailed parameters for such investments. In case, any security does not fall under the parameters, the prior approval of the board of AMC and trustee be sought.

Interest rate risk

The analysis of this risk depends on the macro-economic front and the demand and supply of funds. Based on this analysis an AMC would manage the investments of the scheme on a dynamic basis to exploit emerging opportunities in the arena of investment and manage risks at all points of time. Every economy of the world is exposed due this risk due to fluctuability in the interest rates, which at times leads to the cheap or dearer funds availability in the market.

Liquidity risk

The liquidity risk of the scheme can be controlled by investing in securities that provide easy liquidity. It all depends on the maturity profile of the portfolio and the daily performance of these stocks. If at all there arises an urgent need to liquidate these securities, at times there may be a loss in the valuation of the stock or the Net Assets Value.

Tracking error

Tracking error means the variance between daily returns of the underlying benchmark (gold) and the NAV of the scheme for any given period. NAV of the scheme is dependant on valuation of gold. Gold is valued based on the formula prescribed by SEBI.NAV so computed may vary from the price of Gold in the domestic market. This error could be the result of several reasons like execution of large sell order, delay in the purchase of gold, transaction cost. However, this error can be avoided by rebalancing the portfolio and use of gold related derivative instruments.

In this financial year, there have been net outflows of Rs 931 cr. Since June 2013there has been a continuous outflow. After touching a high of 32000/10gm in Oct2013, gold prices fell to a low of Rs 26,900/10 gm in June2013.A decline of 16%.currently it is being traded at Rs 27,450/10 gm. As of August, the mutual fund sector had 14 gold ETFs with assets under management of Rs 7661cr.With the betterment in valuation, the yellow metal is expected to do good business in future.

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