All that glitters is certainly Gold

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WITH GOLD prices close to historical highs, hovering around Rs 18,000 per 10 grams in India, there are two clearly divided views. Gold bulls, who believe that gold has only just begun its upward journey and has a long way to go, and the bears, who believe that with gold prices up three times in the last five years, there are excesses in gold already that need to be corrected.

It is therefore all the more important to focus on the fundamentals for gold:

■ Gold has traditionally been a safe haven wherein gold prices have moved up whenever there is heightened uncertainty in the economy. With heightened concerns around the US, China, Japan and western Europe over the last few weeks, the uncertainty continues.

■ Gold has classically been a good inflation hedge. With significant amount of money supply having been added globally in the last couple of years to fight the global slowdown, the effects are already starting to show on inflation in certain parts of the world, including India.

■ There has been a decrease in the supply, with annual gold mining output having fallen by 15 per cent in the last eight years.

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Countries like South Africa, which have been very large gold producers, seeing significant declines and there has been very few substantial discoveries of new gold.

■ Central banks are looking at gold to diversify their overall holdings from foreign currencies, notably the US dollar. Gold reserves still make up a very small percentage of countries with high foreign reserves like China, India and Russia. Thus, the demand from central banks are likely to be strong.

■ Investment demand globally has been very high but jewellery demand has been falling — Over the last 5 years, traditionally 60 per cent of gold demand has been led by end users so the slowdown in demand for jewellery on the back of higher prices is a concern.

Considering that the fundamentals for gold still continue to look strong, gold is recommended as a part of the portfolio provided:

■ With hidden gold reserves in most Indian households in the forms of coins and jewellery, there could be a tendency to go overweight on gold by not adjusting the overall portfolio for this gold that is already owned. Even though jewellery is not an ideal vehicle for gold investments, it can be discounted to 20-25 per cent of its current value and added to the overall holding.

■ Jewellery, which is the preferred vehicle, is the most inappropriate due to purity concerns and inability to realise true value at the point of sale. Buying certified gold biscuits from jewelers may be an option to be considered, though it should be avoided through banks as they tend to be much more expensive on an average. Gold ETFs that are backed by physical gold in India may be the most cost and tax efficient option to take gold exposure in your portfolio.

■ Whilst systematic investing has been very popular in equities over the last few years, it is important that a SIP model is used for buying gold as well as to get the benefits of rupee cost averaging.

■ It is bought as an insurance on the rest of the portfolio. Whilst investors would like all their investments to go up significantly at the same time, gold investments are to be viewed as an insurance on the rest of the portfolio, which will protect returns on a part of the portfolio during adverse times.

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