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Gold rallies over 8% in 2018 so far; is it time to buy a gold ETF?

Moneycontrol News

Investors have avoided investments in gold in the past 5-6 years due to rising equity markets and opportunities in debt funds. But gold prices have been quietly inching up.Â The price has risen to Rs 31,850 per 10 gram, up 8.33 percent from the end of last year. Experts saidÂ gold has begun to glitter once again in the back of global uncertainties and trade wars. The moot question is should you buy gold?

Hyderabad-based Ajit Parameshwaran, a senior management professional with a pharmaceutical MNC, certainly thinks so. He started buying units of gold exchange traded funds (ETF) recently. He has been an investors in stocks and equity mutual funds for more than a decade. â€œGold ETF prices have been moving in a band over some time with strong support around Rs 2,800-3,000 per gram. It has the potential to rise from here,â€ Parameshwaran said, adding thatÂ gold reduces volatility in his portfolio.

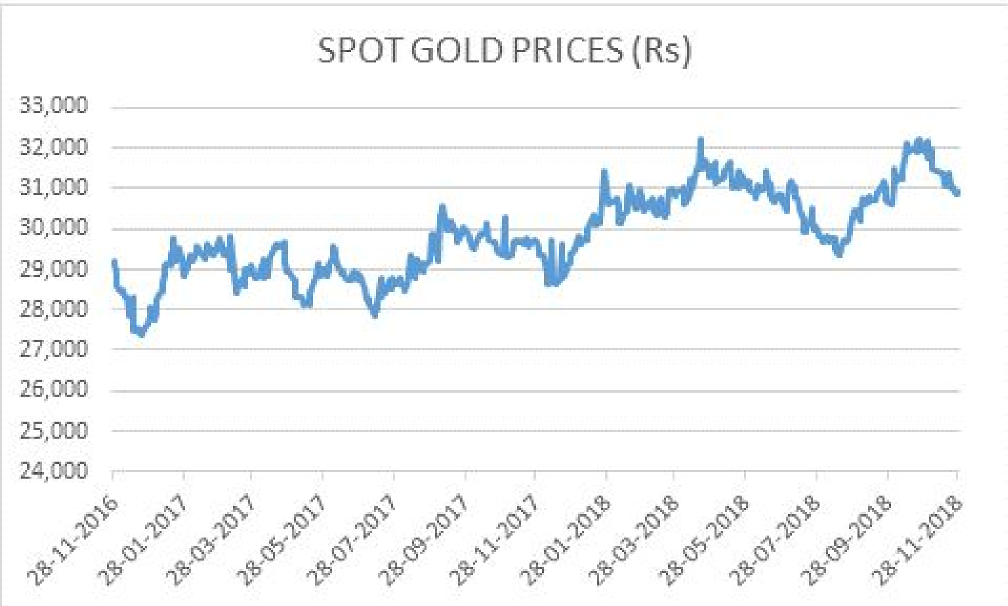
Is gold shining again?

Expert attribute three broad factors behind the rise in gold prices in the past year. First, the geo-political risks associated with conflicts in Syria. The proximity of US and Russia in such conflicts have a positive impact on gold prices, experts said. There are many local issues in oil producing Middle-East nations, such as tension between Saudi Arabia and IranÂ and Saudi Arabia and Turkey which can add to global uncertainty.

Second, the trade wars have increased uncertainty between the US and China. Although there has been a temporary ceasefire in the past weekend where both nations have moved a step forward to a truce, itâ€™s a temporary truce and nobody really know the future. Trade wars are strategies initiated by countries to boost oneâ€™s exports to other countries and reducing imports from other countries by resorting to tariffs and non-quantitative restrictions.

Ritesh Patel, Commodity Analyst, IIFL Securities, explained, â€œTrade wars have never turned out to be good for any economy, and hence, the International Monetary Fund (IMF), earlier this month, cut its global growth forecast to 3.7Â percent (0.2 percentage point less from its earlier forecast) for the coming year. However, gold has always outperformed during turbulent global economic conditions.â€

Lastly, a weak rupee leads to a hike in gold prices. Other things remaining the same, when the rupee weakens, gold prices go up because much of Indiaâ€™s gold is imported. The rupee fell to Rs 74.39 a dollar on October 11, down from Rs 63.67 a dollar at the start of 2018.



Potential US slowdown

The US economy has done well over the past decade after the Lehman crisis, registering growth fuelled by pumping in money. But interest rates in the US are expected to rise. â€œWhen the supply of money is reduced, there is an expectation of growth slowing down. In anticipation of that, money may move away from the dollar,â€ Shyam Shekar, Founder of Chennai-based iThought, said. If the US enters into recession, the world economy will find it difficult to grow and investors may try to hide behind gold.

â€œThe current set of fundamental factors revolving around the yellow metal ranges from whether the rate hike cycle in the US will go as planned, the trade and tariff war between US and China and geo-political tensions between US and Iran, Italy budget crisis and the negotiations surrounding Brexit. Gold prices will be influenced by these over the next six months,â€

said Prathamesh Mallya, Chief Analyst - Non-Agri Commodities and Currencies, Angel Broking. In nutshell, global uncertainties gives a push to gold prices.

To further support gold prices, according to the data released by World Gold Council (WGC) for Q3 CY18, central bank purchases across the world has risen 22 percent year-on-yearÂ to 148.4 tonne. This is the highest quarterly purchases since the last quarter of 2015.

Why investors have shunned gold

According to the Association of Mutual Funds in India (AMFI), total assets under management has shrunk to Rs 4,621 crore as October 31, down from Rs 5,017 crore a year ago. Gold ETFs have lost 0.39Â percent in the past five-years.

â€œWhen an asset class gives low returns, investors tend to shun it altogether. There is a tendency to invest in an asset class that has given high returns in recent past,â€ said Vishal Dhawan, founder of Plan Ahead Wealth Managers. In India, investors moved away from physical assets like gold and real estate to equity mutual funds in search of high returns. Between October 2014 and October 2018, the assets under management of equity funds went up by Rs 3.97 lakh crore.

Should you go against the tide?

Things may be changing for the precious metal. â€œWhenever stocks remain over-valued, there is a fair chance that the gold makes a strong come back. Though gold has not given good returns in the recent past, it offers a good investment opportunity for someone who has a three-year time frame,â€ Sekhar said, advocating investing around 10Â percent of your money in gold.

â€œAfter the September dip, gold resumed its upward journey and finally broke out of itsÂ two years price range on weekly charts. If the breakout unfolds the way it should, then we expect a minimum upside potential of over 3,000 points for MCX gold, which suggests that the prices would at least attempt to touch the Rs 38,120-mark in the next 18-20 months,â€ Patel said.

What should you do?

Moneycontrol doesnâ€™t recommend buying physical gold or jewellery if you wish to invest in gold. You can either buy a gold ETF, a gold mutual fund scheme (a fund-of-fund scheme through which you can buy gold ETF units if you donâ€™t have a demat account) or a sovereign gold bond.

All these options passively track the price of gold and their net asset values move in line with gold prices.

Opt for sovereign gold bonds (SGB):Â These are issued by government of India and are denominated in grams. But unlike gold ETFs, you earn a small interest over and above the price movement. Gold ETFs, on the other hand, deduct their expense ratios from the returns they make from the movement in gold prices. SGB comes with a tenure of eight years, but there is a lock in of five years. You can buy and sell them on the stock exchange. You can even buy them at a steep discount on the exchange given its low liquidity. â€œTo make it a relatively more attractive investment option, SGB offers interest at the rate of 2.5Â percent per year,â€ Dhawan said.