Grow Beyond Gold

The rally in gold prices could allure investors, but staying diversified to create a well-balanced portfolio is the way to long-term growth

Gold has become red hot again. Globally, the yellow metal has hit a six-year-high and gold stocks are soaring. In India, there has been a splendid recovery and a price surge of more than 23 per cent since January, the only bright spot in an otherwise gloomy state of affairs. Consider this: Equity benchmark BSE Sensex has corrected 3.4 per cent over the past one year (as on August 30). The highest interest rate offered by State Bank of India on fixed deposits is 6.5 per cent. And systematic investment plan (SIP), the safest route to invest in equities, is no longer immune to market mayhem. On an average, SIPs in large-cap funds have given a negative return of 1.56 per cent over the past one year, while mid-cap and small-cap funds have returned minus 11.16 per cent and 15.63 per cent, respectively. Understandably, people betting on debt and equity are getting hurt. Gold, on the other hand, has always been considered a safe investment during economic uncertainties. The current rally is encouraging people to invest more in this metal. Still, some are hesitating, given the high volatility in gold prices over the years. Should you go for portfolio reallocation, focussing more on gold and ditching investments in debt and equity markets? There is no easy way to optimise a portfolio, but a well-balanced investment strategy often helps.

Start with Review and Rebalance

Asset allocation is all about selecting a mix of investments for your portfolio to achieve financial goals, at a risk level you can tolerate. It is not a one-time undertaking, though, as asset classes frequently experience sharp upturns and downturns and percentage of portfolio allocated to that class is thrown off-kilter. That is why you need to review performance of assets from time to time and rebalance the portfolio to stay on course. "When a portfolio is created using the asset allocation strategy, the targeted proportioning of assets such as debt, equity and gold depends on a variety of factors, including investment objectives and financial goals, timeframe, investor's age and risk profile, among others. By allocating assets, one is essentially adopting an investment strategy which can balance the portfolio's risks and rewards, keeping in mind these factors," says Saurav Basu, Head of Wealth Management at Tata Capital.

If a portfolio has well-balanced allocations to various asset classes, people generally stick to it until they reach significant milestones. But in case of any major movement in one or more asset classes, the entire portfolio composition becomes skewed, and it requires a review and rebalancing. "Rebalancing means readjusting the portfolio to stick to the decided asset allocation that has gone awry due to changes in values of the various asset classes," says Basu.

Given the current debt, equity and gold returns, it is more than likely that your investment portfolio needs rebalancing. "Investors should review their asset allocations as per their risk profile and see if they want to make any change. If the equity or debt allocation has gone below the stipulated level, they can consider increasing it to the level advised in the asset allocation plan," says Renu Pothen, iFAST Financial's India Research Head. However, any rebalancing should be done keeping the holistic picture in mind. She is not swayed by the current spike in gold prices and says that the company's "allocation to gold across all risk profiles is 5 per cent. If a 30-year-old investor has an aggressive risk profile, she can put 25 per cent of the corpus in debt, 70 per cent in equities and just 5 per cent in gold."

Satyen Kothari, Founder and CEO of Mumbai-based financial planning start-up Cube Wealth, also urges investors not to be hasty. "Any rebalancing should be thoughtfully done as there will be tax consequences when trading occurs."

A Deep Dive into Gold

Why gold has risen: The MCX spot price for gold rose from Rs 31,220 per 10g on May 3 to Rs 39,011 on September 4 - a 25 per cent spike within four months. But before we analyse the surge, we must understand what drives the price of gold. Whenever the markets are in a bear hug and economic growth, both local and global, faces significant hurdles, the demand for gold rises as it is considered a safe asset. "A period of economic and geopolitical uncertainty augurs well for gold prices. Weak macro data from major economies, downward revision of growth numbers and central banks adopting a significantly dovish stand indicate all is not well, and hence, the rise," says Pritam Kumar Patnaik, Head of Commodities at Reliance Commodities. Ankur Maheshwari, CEO of Equirus Wealth Management, concurs, saying that the growing signs of a slowdown are fuelling investors' preference for the yellow metal. "The US-China trade war escalation, inverted yield curves in many economies and concerns over a possible recession have led to increased attention towards this safe-haven asset class," he adds.

Interestingly, retail investors alone are not dominating this space. Substantial wholesale buying has put further pressure on the demand-supply equation and pushed gold prices upwards. "Recent data released by the World Gold Council shows that central banks of China, Russia and India bought huge volumes in the first six months of 2019. Additionally, a survey of central banks reveals that the majority expects their global holdings to climb in the next 12 months. The universal robustness in gold demand is pushing up the price," says Narinder Wadhwa, President of the Commodity Participants Association of India (CPAI).
Gold prices in rupee have soared even higher compared to the global spike due to certain India-specific factors. "We are mostly price-takers (LBMA gold price), and our domestic supply and demand have little or no impact on global prices," says Patnaik. "The key reason gold prices in the domestic market have rallied close to 25.34 per cent in this calendar year - nearly 4 per cent higher than the international benchmark - is rupee depreciation. The currency has depreciated close to 4 per cent against the US dollar in CY2019, and hence, the difference in domestic and international prices."

Why Gold Prices Have Surged

- Global slowdown has become more visible.
- No end of US-China trade war in sight.
- Equity markets have been subdued.
- Fixed-income returns have been poor.
- Preference for safe haven has risen due to economic slowdown.
- Central banks across the world have gone for record buying.
- Gold ETFs are buying as more investors come in.

A couple of regulatory actions have partially fuelled the rise. "For instance, the government raised the import duty on gold in this year's Budget, and it is now 15 per cent, including GST," says Anuj Gupta, Deputy Vice President, Commodities and Currencies Research, at Angel Broking. "Moreover, the rupee has depreciated by 3.27 per cent since January 2019, making gold costlier in India. Gold imports rose 28 per cent to 274 tonnes, but demand in the April-June quarter rose 13 per cent to 213 tonnes as against 189 tonnes in the year-ago period, and so prices have gone up."
Should you buy?: "Historically, gold has been an excellent hedge against inflation and has significant resilience when it comes to preservation of purchasing parity. That is why people generally adopt a very long-term approach while investing in gold," says Patnaik of Reliance Commodities. This is also the reason why most investors still have gold in

their portfolios. "It is a good, uncorrelated asset class, and hence, works as a good hedge or protection in one's portfolio. One could consider 5-10 per allocation to this asset class from a diversification point of view," says Maheshwari of Equirus.

Should you add gold to your portfolio now? As equity returns are subdued and interest rates are touching new lows every day, it may appear to be a good move. "In terms of performance, MCX Gold has generated 24.96 per cent return between January and August 2019, compared to the Nifty return of 1.12 per cent. Hence, an investor should add gold to the portfolio," says Gupta of Angel Broking. Investing in gold also depends on price trends - whether prices are likely to rise further or a course correction is impending. "After six years of range-bound movement in gold, it broke up the range and now it is in a bull run. Spot gold prices are around $1,544 per (troy) ounce (31.1g). We think the rally would continue and gold would reach $1,600-1,650 by year-end. It rose to $1,920.95 per (troy) ounce in September 2011, and there is a chance it will touch that range again," says Gupta. As international gold prices are nowhere close to its previous peak, many think that gold will continue to deliver decent returns in the long run. "The current situation (slowdown and volatility) will take some time to be brought under control as markets are assessing whether we have seen the worst or more is to come. Given this fact, the attraction for gold is expected to continue well into the next calendar year, with prices close to Rs 40,500 per 10g," says Patnaik of Reliance Commodities.

What You Should Do with Gold

- Use the metal only for asset diversification.
- Exposure of more than 10 per cent of the portfolio is not advised.
- After the surge is over, you can bring down your exposure below 10 per cent by selling.
- If you are near your life objectives, you may sell at least half your holdings now to lock in gains.
- Buy gold only if you have a long-term horizon like 10 years.
- Even if you have surplus funds, avoid bulk buying; it is always advisable to buy after some gaps.
- If you do not need liquidity, go for sovereign gold bonds for additional return.
- Invest through Gold EFT to avoid safekeeping costs and making charges.

Experts, however, advise against overexposure, stressing that gold allocation should not exceed 10 per cent of the portfolio. In case you are raising your gold exposure, be cautious and do not buy it at one go. "Just like other volatile assets, gold should be ideally bought in tranches so that investors get the benefit of averaging instead of trying to time the market," says Vishal Dhawan, Founder and CEO of Mumbai-based Plan Ahead Wealth Advisors. If an investor is underweight in gold and has a long-term horizon, she can buy it gradually and systematically."

In case you are buying physical gold, there will always be a cost attached to it for keeping it safe. So, you should look at other substitutes which will help you benefit from the price surge minus those costs. "Sovereign gold bonds pay a coupon and allow investors to benefit from the change in gold's capital value. For those who want the discipline of regular buying without any lock-in period, gold exchange-traded funds, or ETFs, will work well," says Dhawan.

Should you sell now?: If you are sitting on a substantial chunk of gold, its proportion in the portfolio may have gone up significantly compared to other assets. Should you sell a part of it to lock in the gains and bring the allocation down to the desired level? "Investors holding gold for more than five years have clocked in an absolute return of almost 50 per cent. In fact, gold has provided better returns than its previous peak in 2012. So, those looking to exit can do so at the current levels," says Wadhwa of CPAI. If you are not looking to exit and are working on a long-term strategy, you need to rebalance your portfolio.

"Gold prices, which fell 1.58 per cent in 2018, have risen 19.06 per cent so far this year. In contrast, the benchmark Sensex is up 1.75 per cent in rupee terms but down 0.94 per cent in dollar terms so far. As gold's uptick in 2019 has been the highest in the last nine years, one's portfolio must have seen a huge spike due to this rally. So, it is time to liquidate some part of the gold portfolio and rebalance it as per the preferred allocation," says Basu of Tata Capital. According to Dhawan of Plan Ahead, "One should look at what percentage of the overall wealth is already allocated to gold. If it is less than 10 per cent, you can continue to hold. Otherwise, rebalance it to 10 per cent of the overall mix."

Equities Matter

If you are a long-term investor, your investment focus should not be swayed by the current gloom in the equity market. Even the best gold rallies cannot match the superior returns generated by equities. For instance, equities have outperformed gold over the last 15 years with an annualised return of 15.7 per cent compared to gold's 12.41 per cent. Markets are in a slowdown cycle and will take time to recover, but in the long run, equities are expected to rebound and outperform all other asset classes. "It is difficult to ascertain the length of any slowdown. But demand boosters (like the ones the announced for NBFCs and the auto segment), coupled with the RBI's 'accommodative' stance and the upcoming festive season, should lead to revival of sentiment and a pick-up in consumption in the short-to-medium term. Over the long term, equity investments will be very rewarding as India's long-term growth outlook is intact, and security markets will reflect that sooner than later," says Arun Thukral, MD and CEO of Axis Securities.

Stick to SIPs: On an average, SIPs in small-cap funds have given a negative return of 15.63 per cent over the past one year, while large-cap funds, the safest bet, have fallen 1.56 per cent. Investors with direct exposure to equity may have a higher risk appetite to deal with any correction. But retail investors, who prefer mutual fund SIPs to play it safe, may find it challenging to deal with the turmoil. Should the disheartened SIP investors get out of equities and reallocate their funds to debt, an all-time safe haven? Thukral does not agree. "One benefit of SIP investment is that investors can enjoy better entry price in good quality stocks due to volatility in stock prices. This slowdown is cyclical and natural price corrections are taking place - it means investors have a good opportunity right now. If they stop SIPs now, they will not be able to reap the benefits when this cycle turns."

Should You Continue SIPs?

- Even after the correction, long-term returns from SIPs are impressive.
- Large-cap and mid-cap funds have given over 10 per cent returns.
- Equity market is known to witness volatility, which is often cyclical.
- During corrections, SIPs help you accumulate equity at low price.
- If you remain invested, you will gain more from future market rallies.
- If you are near your goal, you may start withdrawing funds gradually.
- This is the correct period to review funds with benchmarks.
- Get out of a fund if it has consistently given lesser return than the benchmark.
- Sell funds which have been consistently outperforming their benchmarks.

According to Dhawan of Plan Ahead, the market correction presents a unique opportunity to keep buying equities at lower prices. When the market rebounds, investors' gains will be higher. "As long as SIP investors are saving towards their goals which are 7-10 years away, they need to continue. They are in a position to add exposure at more reasonable pricing. They can even consider increasing their SIP exposure gradually and add more units at lower prices," he says. "If investors have a short horizon, they should avoid equities altogether."

When you realign: Except for a few large-cap stocks, most other stocks have faced price corrections. "The broader market has been in a slowdown for a longer time than the Nifty 50 stocks, but with the government's demand stimulus in place, they should start recovering. There are early signs of a pullback in select auto ancillary, EV-focussed auto OEM and mid-cap PSU banking stocks after the government announced measures to boost demand for these sectors. A couple of announcements are yet to come and that should see the broader markets picking up," says Thukral.

If you want to rejig your equity portfolio, where should you direct your funds? It will depend on your risk appetite and the quality of stocks rather than a cap-driven approach. "All companies which have corrected during this slowdown but have good fundamentals and quality managements will rebound faster, whether they are mid-caps or the left-out large-caps. Those who have been investing in quality stocks throughout this period will enjoy superior returns when there is an economic revival," says Thukral. The current situation does not necessarily require you to change your long-term investment strategy.

Shrinking Debt Returns

Conservative investors prefer debt investments. But of late, they seem to have been trapped in a situation where interest rates are continually falling. "Rate cuts matter, but the transmission of interest rates on bank deposits has only been partial in case of bank and corporate fixed deposits (FDs). Besides, small savings rates have undergone only a small change. Thus far, fixed-income investors have largely been insulated against rate cuts," says Dhawan. "But over time, the transmission of rate cuts is likely to be more meaningful. So, locking in your funds at a relatively higher current interest rate is a good idea."

Basu of Tata Capital underlines more options. "For conservative investors, bank FDs remain the first option. One can also park money in small finance banks which are offering up to 9 per cent interest. However, taxes eat a considerable portion of FD returns if you are in a higher tax bracket. A part of the portfolio can go to AAA-rated NCDs (non-convertible debentures) which are currently offering stable yields. You can also opt for short-term or medium-term mutual funds, with a mix of exposure to AAA, sovereign and AA papers. They are offering better yields to maturity in the range of 8-8.5 per cent," he says. But given the recent incidents of corporate debt defaults, you should be extremely cautious and only get into it if you have the risk appetite.