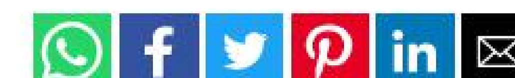
Gold rush! Is investing in yellow metal a better option?



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We have seen a consistent demand for gold over thousands of years due to reasons like easily portable, durability and liquidity. But what about gold as an investment? What kind of returns has it generated over a period of time?

If we consider returns over a 35-year period for gold, fixed deposit rates and equity market returns, you will see that the story is quite different and perhaps a bit surprising! If you had invested Rs 100 around 35 years ago in fixed deposit, gold and equities, respectively, your money would have grown 39 times with fixed deposits, 20 times with gold and a whopping 224 times in equities!

The physical metal

Buying the physical metal in the form of coins or bars seems a simple way of investing in gold but storing this precious metal safely becomes an issue. Also, banks do not buy back the coins at the same rate since there is a 'minting' cost added which is around 5– 10%. And, you would need to spend on a bank locker or a safe to ensure safety of the gold coins or bars.

And the most popular form of investing in gold for generations is in the form of gold jewellery. This should be done more as an ornament to wear. But is it really worth as an investment? Unfortunately, the answer is no. When we consider the additional charges, this adds up to additional costs of 10% to sometimes as high as 35% which would surely not make it a viable investment.

Gold ETFs

Exchange Traded Funds (ETF) are one of the globally accepted instruments to invest in commodities. Gold ETFs will have gold as the underlying asset, and according to the price movement of the underlying asset, the value of ETF also changes. Most of the time one unit of gold ETF is equal to one gram of gold. This is the simplest, most cost effective and easiest way to buy and sell gold without the hassles of storage, and other costs. It is similar to investing in a mutual fund and can be held in electronic form.

Sovereign Gold Bonds

Sovereign Gold Bonds (SGBs) are government securities issued by the RBI for which the price of the bond is equal to gold in grams. This is as good as investing in physical gold and is a substitute for holding physical gold. The investors can buy the bonds by paying cash and the bonds can be redeemed in cash on maturity.

The bonds bear an interest rate of 2.75 % (fixed rate) per annum on the amount of initial investment. Interest will be paid semi-annually to the bank account of the investor. Maturity value is equivalent to the prevailing market value of gold initially invested in Indian rupees.

Gold Monetisation Scheme

This scheme provides an opportunity to the investor to deposit gold in the bank and earn an interest on it.

The interest rate for the medium term is 2.25% per annum, (for five to seven years term) and 2.5% per annum (for seven to 12 years term). On maturity, the investor has the option to redeem the proceeds as gold or cash equivalent to the value of gold. Interest is not calculated on the investment amount, instead it is calculated as gold itself, i.e. if you have invested 100 gm of gold into the gold scheme, on the completion of fifth year, the maturity value will be 111.77 gm of gold or the cash equivalent.

What should you do to invest?

Studies show that gold has given more or less similar returns to fixed deposit instruments. Globally, the yellow metal has given a return of 1% above inflation, which makes the value of gold rather steady. Therefore, gold is always considered as a safe haven investment instrument during times of a global economic panic, currency devaluation, unpredictable or uncertain micro and macro economic situations.

In fact, during times of inflation more money tends to move to gold thereby increasing its price. Therefore, during global panic situations, such as China recession, Brexit, etc., we see investors invest more in gold but this needs to be done with the clear expectation of modest returns over the long-term and purely as a portfolio hedge.

As a concluding note, gold can always be considered as a hedge in your portfolio. In recent times, people have began expecting gold to give better returns than equity and this has not happened. Gold should be seen as an insurance for your portfolio, protecting it from adverse price movements. One can expect a modest return of 7-8% per annum from gold investments . It will be unfair to expect gold to outperform risk-related asset classes like equity over longer periods of time.

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