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THE OVERVIEW OF GOLD ETFS AND ITS VARIOUS POSITIVE FEATURES

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ABSTRACT

The main objectives of this paper are to trace the emergence & history of Gold ETFs in India and also to explain proper working mechanism of this fund along with portfolio risk diversification and tax implementation of Gold ETFs fund in India. This paper also tries to explain comparative study of Gold ETFs v/s Physical Gold and it also give focus on Gold ETFs as a strong and attractiveinvestment option for investor.

Qualitative Research Methodology is used in this paper, on the basis of reading various research papers and personal experience of Gold ETFs.

While reading this paper you will easily understand Gold ETFs and its working mechanism and also will know that Gold ETFs give extra leverage to its users in terms of profit.

KEYWORDS: Gold ETFs, Portfolio Risk Diversification, Tax Implementation and Working Mechanism,

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Introduction

Every society and country like India is required to have a high rate of growth of economy and infrastructure. Apart from this it should be independent in respect of all financial matters, so that every constructive and progressive move must be taken. For being independent in terms of financial matters, there is a need of hours to make fund mobilized to contribute in constructive purposes. This mobilized fundshould be invested properly. Now the question was arises where to invest and how to invest? There may be different-different perception and theories regarding the investment. These theories and perceptions differ person to person. Every investor has a different module regarding the return and risk. There is a general rule of return and risk and that is “higher the risk, higher the return and lower the risk, lower the return”. The return and risk combination depends upon the investors choices and his or her actions. There are so many destinations for investment such as equity shares, bond, debentures, bank deposits, gold, silver and many more, and their “risk & return” relation always differ from each other. But investment should be of such type that may produce high return with minimum risk and that is convenient to do. At these criteria gold is much attractive and most productive in terms of return in current scenario.

Due to these attributes the demand of the gold is increasing day by day in India. India is one of the largest consumers of gold. Nearly 8,00 tons of gold is imported every year. Indian accounts for 23 percent of the world's total annual demand for gold. There are so many other reasons behind the surge in the demand of gold such as the traditional importance in our society, industrial consumption, uses in jewelry and most famous now a days is investment in it. It can be said that the investment in gold is the main factor behind the surge in the demand of gold. Now everyone wants to invest in gold just because of good amount of return at lesser risk and its high liquidity feature. For these reasons it is more and most attractive destination of investments. But there are some problems and drawbacks while making investment in gold. These may be the fear of loss by theft, loss by damages. The most important is that everyone is not able to invest in or purchased the gold. The investors who have small amount of savings or funds to invest will not be able to do this because of the prices and scarcity nature of gold. Gold investment requires a big amount to get adequate growth and return on investments. To make investment in gold possible for such investor, there is a most popular type of investment called "Gold exchange traded Funds (ETFs)".Gold ETFs are another effective way to invest in yellow metal. To understand the Gold ETFs, it is required to have a basic idea about the exchange traded funds.

An Exchange Traded Funds (ETFs) is an investment fund traded on stock exchange much like a stock. Exchange Traded Funds (ETFs) hold the assets such as stock, commodities or bonds and trades close to its Net Asset Value over the course of trading day.In other words, it can be said that its prices and value depends upon the market value or prices of the underlying asset. Most of ETFs have an index such as stock index or bond index. ETFs have so many features (like low cost, tax efficiency, easy conversion in to cash, and stock like attributes) which make it most attractive. Because of this, Exchange Traded Funds (ETFs) are the most popular type of investment destination.

Gold Exchange Traded Funds or **Gold ETFs** are the exchange traded funds based upon the net asset value of the underlying asset gold. The Gold ETFs are divided into units representing physical gold. These units may be in paper form or dematerialized form. These units are traded on the exchange like a single stock of a company. Gold ETFs provide the opportunity to the investors to participate in the gold bullion markets without the necessity of taking physical delivery of gold and to buy and sell that participation through the trading of a security on a stock exchange.

The history of Gold ETFs is started from Canada. The first Gold ETFs product was "Central Fund of Canada", a closed-end fund founded in 1961. It later amended its articles of incorporation in 1983 to provide investors with an exchange tradable product for ownership of gold and silver bullion. It has been listed on Toronto Stock Exchange since 1966 and the AMEX since 1986. In India, the idea of Gold ETFs was first conceptualized by Benchmark Asset Management Company Private Limited when they filed a proposal with the Securities Board of India (SEBI) in May 2002.However it did not get approval at first and later in 2007, it was launched.

Review of Literature

Gold ETFs are defined in numerous ways. According to Bang (2009) gold ETF is fundamentally an open-ended mutualfund that invests in standard gold bullion as its underlying asset. It is also known as paper gold. These Instruments are listed on the stock exchanges and, hence, can be bought and sold just like buying and selling of shares.

As per Bloomenthal (2008) the first gold exchange-traded fund was launched in March 2003 on the Australian Stock Exchange. In U.S. the Gold ETF trading began on the New York Stock Exchange (NYSE) in 2004.These ETFs are traded under the symbol “GLD”. Different people define and perceive GLDs differently. Somepeople perceive that they will own physical gold by investing in the shares of Gold ETFs. However, it’s not theright observation. The objective of GLDs is not to provide investors with the opportunity to own gold bullion byinvesting in the shares of gold ETF. Rather, gold ETFs are designed to track the price of gold.

Kostovetsky (2003) studied relative performance of the ETFs and Index mutual funds from the investor’s point of view. He reported key areas of differences between the two to lie inmanagement fees, shareholders operation fees, taxation competence, and the qualitative factors transaction suitability, short selling, and ability to margin. His core finding was that Index mutual funds are better suited for small investors and ETFs are preferable by large investors.

Johnson, W.L. (2008) studied 20 foreign country ETFs and the underlying index returns from1997 to 2006 for the presence and sources of daily and monthly tracking errors. He found exceptfor one case, market subdivision or incorporation of the foreign country was a substantial source oftracking error. He also concluded “variables such as foreign index positive returns relative to theUS index and whether the foreign exchange trades 12 simultaneously with the US markets weresignificant explanatory variables in the correlation coefficients between ETFs and theirunderlying home index”.

BakulChugani(May 2010)in his article has pointed that the Gold ETFs have clocked in about 8.7% gains, strengthening its role as a hedge against inflation as well as equity markets as Sensex has declined by about -5.6% during the same period. He also pointed out that, since the launch of gold ETFs in early 2007, they have emerged as a strong asset class, generating more than 27% returns (CAGR) in the past three years against the Sensex returns of just about 4% CAGR during this period.He further corroborated that the increasing demand for gold is evident from the growth in theAssetsunder Management (AUM) of gold ETFs. During the period Apr 2010May 2010, the AUM of gold ETFs has surged by nearly 10% from Rs 1,650 crore to Rs 1,815 crore. In fact, the AUM has risen by more than 100% in the past one year the highest annual growth witnessed by gold ETFs since their launch three years ago.

DipakMondal (2010)suggested that investors should take exposure in gold by buying either physical gold, Gold Exchange-Traded Funds or even units of mutual funds, whichinvest in the stocks of gold mining companies. He also added that due to the crisis in the European Union, most currencies are witnessing high volatility and unless world currencies reach some kind of equilibrium, prices of gold would continue to go up. In the very short-term, there are possibilities of a correction but gold, either in physical form or in mutual fund units, continues to be a very good investment tool.

Fisher lists five reasons why the yellow metal remains the most universally accepted and time-tested asset class. The reasons are Effective Portfolio Diversifier, Thrives under worst conditions, Hedge against inflation, Linkage with oil and US Dollar and Widening demand and

supply Gap.He suggested that gold must be made a part of the asset allocation because it is a great risk diversifier and considered as a safe haven during times of economic uncertainty, Political strife, high inflation and wars.Fisher in his article mentioned that Gold Exchange-Traded Funds (ETFs) have made investing in the yellow metal very convenient and inexpensive. He expressed that they offer a way of participating in the gold bullion market without the necessity of physical delivery of gold. He listed out six reasons why gold ETFs are considered as the best way to invest in the gold. The reasons mentioned are Wealth tax exemption, Income tax benefit, Investment in small denominations, Hedging, Convenience and better holding of ETFs as compared to physical gold holdings.
Tim Pullen et al.(2011)observed by examining employing daily data over the mention period that the diversifying, hedging and safe haven properties of gold bullion, gold stocks, gold mutual funds and gold exchange traded funds (ETFs). First, with regard to gold bullion, we document a clear and strong hedging role over a mere diversifying capability. Second, our results highlight that gold stocks, gold mutual funds and gold ETFs tend to be diversifiers. Third, both gold bullion and gold ETFs show support for the safehaven property. However, gold stocks and gold mutual funds display very little evidence of the safe haven characteristic. Consequently, investors who are keen on securing safe haven features of gold investment cannot generally rely on gold stocks or mutual funds. Instead, they need to take positions directly in bullion or gold ETFs.

Objectives of the Study

- Emergence of Gold ETFs in India;
- Introduction to Gold ETFs and its mechanism;
- Comparative study of Gold ETFs v/s Physical Gold;
- Focus the Gold ETF as a strong and attractive investment option;
- Stress upon the inclusion of Gold ETF in a portfolio for risk diversification; and
- Analyze the tax implications of Gold ETF

Research Methodology

Research methodology used in this paper is based on '*Qualitative Research*'. In which, we studied various research papers and experience of various Gold ETFs and so many other parallelGold ETFs were analyzed so as to get a deep understanding of Gold ETFs markets. This paper is developed while keeping in mind that it will be useful to all mankind, who keep an interest in knowing about Gold ETFs and its working mechanism so as to start investment in Gold ETFsin India and abroad. This is basically a common approach paper, which provide over all inside and outside structure of Gold ETFs in India.

Emergence of Gold ETFs in India

First Gold ETF fund was launched by Benchmark Asset Management Company on February 15, 2007with a unit equal to 1 gram and it was also listed NSE with a symbol GOLDBEES. Then after government mutual fund Company UTI also lunched Gold ETF with NSE symbol GOLDSHARE on March 1, 2007 and size was same as previous launched company. Then after various public and private sector companies came in this sector of Gold ETFs funds list are given blow in Table 1.1.

Table 1.1

S.N	AMC	Launch Date	Size (1 unit equals)	Symbol at NSE
1	Benchmark Asset Management Company Pvt. Ltd.	15 Feb 2007	Approx. 1 gram	GOLDBEES
2	UTI Mutual Fund	1 Mar 2007	Approx. 1 gram	GOLDSHARE
3	Kotak Mutual Fund	20 Jun 2007	Approx. 1 gram	KOTAKGC
4	Reliance Mutual Fund	15 Oct 2007	Approx. 1 gram	RELGOLD
5	Quantum Mutual Fund	24 Jan 2008	Approx. 1/2gram	QGOLDHALF
6	SBI Mutual Fund	30 Mar 2009	Approx. 1 gram	SBIGETS
7	Religare Mutual Fund	28 Jan 2010	Approx. 1 gram	RELIGAREGO
8	HDFC Mutual Fund	25-Jun-2010	Approx. 1 gram	Not Yet Listed
9	ICICI Prudential Mutual Fund	28-Jun-2010	Approx. 1 gram	Not Yet Listed

Source: Computed from the data given in www.onemiint.com, www.moneycontrol.com, www.nse-india.com,

How are GoldETFs traded?

General question in mind of common investor is that how to trade in ETFs? It is as simple as trading in any other equity. For trading in Gold ETFs, one has to do similar work as to do in equity trading. You are required to

- Register with a broker having membership of NSE
- Fill up KYC form
- Open a de-mat account
- Post margins and
- Commence trading

For more understanding see figure 1.1 and 1.2;

Figure 1.1
Process Diagram for creation of ETF units.

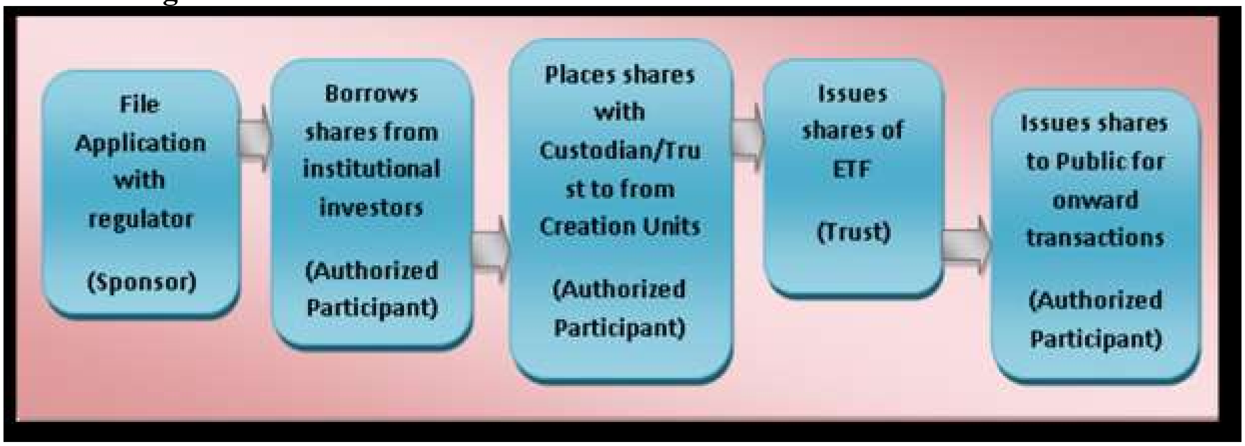
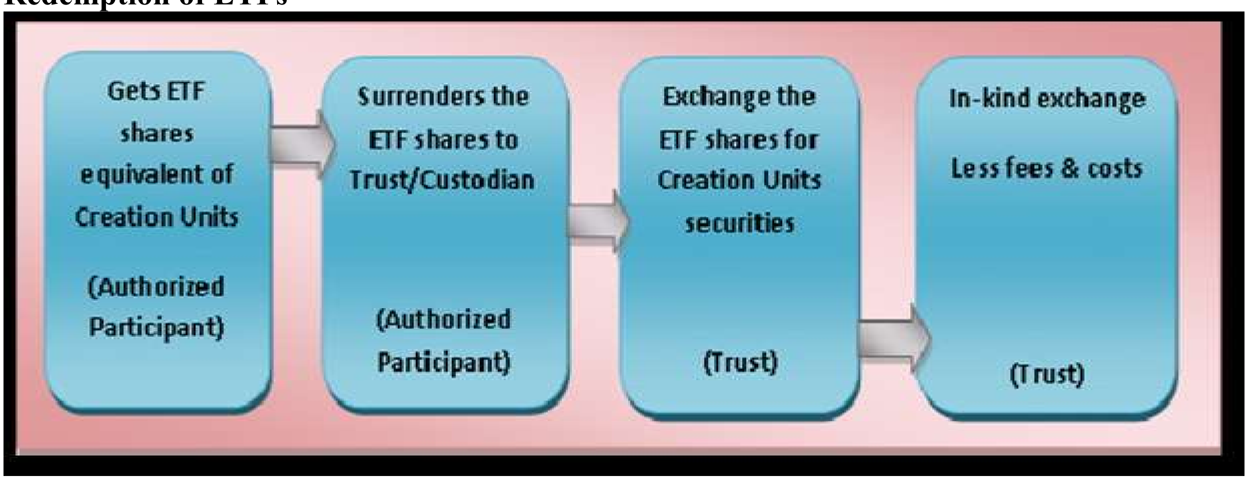


Figure 1.2
Redemption of ETFs



Gold ETFs v/s Physical Gold

A good comparison should always focus on different-different aspects of the elements which are to be compared. There is a comparison between Gold ETFs and Physical Gold. The Gold ETFs have so many such points which make it most favorable and attractive. Firstly, one of the most attractive features of Gold ETFs is that it can be easily purchased and sold in secondary market on a real time basis i.e. at the prevailing market price, while selling of physical gold is a costly affair because it attracts some charges which are deducted by jeweler at the time of sale. The second advantage is storage. Investors have not to worry about the storage and security aspects that are always associated with physical gold. Thirdly, it is very ideal for retail investors as minimum lot size to trade is one unit on secondary market. Fourthly, ETFs have a transparent pricing mechanism. And the last but not least Gold ETFs assure purity of gold. As per SEBI regulations, the purity of underlying asset i.e. gold in Gold ETFs should be 0.995 fineness and above. (See table 1.2 for more understanding);

Table 1.2
Comparative Chart for Gold ETFs and Physical Gold

Criteria	Gold ETFs	Physical Gold	
		Jewelers	Banks
Sale & Purchase	Demate Form	Bar/Coins/Jewelry	Bar/Coins
Selling Back	Sell back on Exchange	Conditional or Unconditional	Markup, 10-15% ideally restricted
Security of Asset	Responsibility of Fund	Investor's concern	Investor's concern
Transparency	Very high	Very low	High
Impurity Risk	Nil	High	Nil
Pricing	Transparent	Neither standard nor Transparent	Not Standard
Denomination	1 gram and in multiples of 1 grams	Standard Denomination	Standard Denomination
Wealth Tax	No	Yes	Yes
LTCG Tax	Applicable after 1 year	Applicable after 3 year	Applicable after 3 year

Gold ETFs as a strong and attractive investment option

Rising gold prices and continuing investment flow in gold has pushed the size of assets hold through Gold ETFs to an all-time high of Rs 11,198 crore. This is a clear indication that the demand for and attraction in Gold ETFs is increasing day by day. There are as many as 25 different Gold ETFs schemes across 14 different fund houses at present.

According to data compiled by mutual fund industry body AMFI, there are some interesting facts which shows the changing situation in Gold ETFs market-

- The assets under management of Gold ETFs crossed the Rs 11,000 croremarks in September 2012 from Rs 10,701 crore in August.
- In June 2012, investor wealth in Gold ETFs surpassed the psychological mark of Rs 10,000 crore; it was just above Rs 5000 crore level till a few months ago in May 2011.
- Gold prices have also drastic increase as it has become tripled from Rs 10,000 level to Rs 31,000 in last few years.
- In last few months, inflows worth Rs 500 crore have come into Gold ETFs.
- In 2011-2012, over Rs 3,600 crore was infused while inflows of Rs 2,250crore came in 2010-11.

These factors show the passion of the investors for Gold ETFs and represent contribution to the rush for Gold ETFs.

Gold ETFs as risk diversifier

Risk diversification is very crucial for any investment. There is a need to find and locate such securities or investments which may reduce and diversify the risk. Investment in gold is considered as a best way to mitigate the risk and hedge the portfolio. A small allocation (10-15%) in gold improves the performance of portfolio and makes consistency in the performance of portfolio. The purpose of diversification is not to increase the returns, but to reduce the risk. The aim is to protect the value of portfolio against the fluctuations in any class of asset and this purpose is achieved when the different asset classes in a portfolio have either low or negative correlation with each other. Gold serves this purpose well by diversifying and stabilizing the portfolio and protecting it against the stock market fluctuations.

Gold ETFs: Tax Implication

- The first step in understanding the tax implication or tax process, one should know the nature of the gains on investment which depends on the investment's holding period.
- The gains on investment are of two type- a) Short term capital gain and, b) Long term capital gain.
- A unit of a Gold ETFs that is held for less than twelve months is treated as a short term capital gain.Short-term capital gains will be added to income and taxed at the marginal income tax rate.
- In case of physical gold, if it is held for less than 36 months the gain is considered short term capital gain otherwise long term capital gain.
- If a unit of a Gold ETFs has been hold for more than twelve months, it is assumed as long term capital gain.Long-term capital gains are taxed at 20% (after allowing for indexation benefit) or 10% (without indexation benefit), whichever is less, thus, benefitting the investor in terms of lower incidence of tax.
- There is no implicationof sale tax or VAT on Gold ETF.
- No applicability of Security Transaction Tax (STT) because it applies to sell and purchase of equity. Gold ETF is a non-equity scheme.

Findings

The findings of the study are:-

- Gold ETF is a very attractive investment destination and provides easy access to make investment in gold.
- The volatility in gold prices is very less as compare to equity. Thus it is safer and protect against the risk associated with price fluctuation.
- Because it is available in smaller denomination so it allows easy asset allocation and diversification.
- Investment in Gold ETF attracts less tax implication in comparison of physical gold.
- Gold ETFs carry less risk in comparison of other investment in terms of storage (Physical gold) and market price fluctuation (Equity).

- Gold ETF may provide a better and strong platform for organized investment mobilizing the fund lying ideal in the hands of such people/investor who cannot make investment with huge amount of money.

Suggestions

These are the suggestion based on this study

- General people as investors do not have the adequate information about the Gold ETFs. There is a need of hour that investors should be well aware and informed about the scheme of Gold ETFs.
- The government bodies such as SEBI and AMFI should take initiative to make awareness among the general people or investors.
- Mutual Fund regulatory body and Member of Stock Exchanges should encourage the people to take participate in Gold ETFs to mobilize the savings of the people.
- Initiative should be taken to make Gold ETF more attractive and less risky.

Discussion

Every investor has a different perception about the risk and return. Some wants to make higher profit and for it they are ready to take risk of any degree and there are such people also who does not want to make aggressive investment but they prefer to make sensible decisions regarding investments. There are numerous investment options with different "risk & return" combination, depending upon the investor's willingness and his/her risk profile and expectation of return. Gold ETFs is emerging as one the most attractive and preferable investment option for the investors.
Gold ETFs is an exchange traded fund whose value depends upon the market value of underlying asset (gold). Gold ETFs are fund divided into units which are traded on the exchange. The market value of physical gold decides the value of the unit of Gold ETFs. This study of Gold ETFs is mainly focuses the light on the issues such as Gold ETFs v/s Physical Gold, Gold ETFs as strong and attractive asset, tax implication of Gold ETFs.
The business and investment in Gold ETFs is in an initial phase with rapid growth. It can be said that it a dawn for Gold ETFs with shining day. There is a need to make public aware about the emergence of Gold ETFs and make them convinced to take part in the growth of Gold ETFs. There is a sentimental attachment of the people to the holding of physical gold (Coins, bar, ornaments).
Among the best available investment options, Gold ETFs are one of them which are most attractive and very emerging. The price variations in gold is very low and because of this it is most secure against the price variation or price risk. In other words, it can be said that the low volatility of gold prices as compared to other investment options (such as equity market), is the prime factor responsible to its growth and better future prospects. There are so many reasons behind the growth and emergence of Gold ETFs such as fluctuation equity market, weakening of Indian Rupee against US Dollar and growing uncertainty about global economy. All these factors make Gold ETFs as a strong asset. On the other hand, Gold ETFs provide the opportunities to institutional investors as well as to small investors, to make investment in gold through ETF scheme.

Apart from this Gold ETFs help its holder while making tax planning as it attract less amount of tax as compared to physical gold.If the uncertainties over the global economies and fluctuation in the equity market persist for some more time, Gold ETFs will become more attractive and it will bind more investors to participate in this scheme. The market size of ETFs will grow and move upwardly because it will induce more Mutual Fund players to exploit that opportunity.

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