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Analytical study of Paper Gold vs. Physical Gold

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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 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 attractive investment option for investor. The major outcome of this study is 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.

INTRODUCTION TO GOLD:

Financial system consists of financial institutions, market, services and instruments that are closely related with each other. The role financial institutions, services and markets have tremendous increase in nowadays compared to the past decade; the only reason for this was customers are aware about this. There are so many institutions that are conducting coaching classes for the financial system, for example Tata Institute in Bombay is a leading institute conducting coaching classes for actuarial course in the field of insurance

India has always been known as elephant of the investment world. It moves slowly but surely. Investment is a planned method of safely putting ones savings into different outlets to get a good return. The essential quality of an investment is that it involves waiting for a reward. Investment involves long term commitment Investment is a commitment of a person's fund to derive future income in the form of dividend, rent, interest...etc. There is a positive relationship between investments and risk. The success of every investment activity depends upon the ability and knowledge of an investor to investment in right scheme at a right time without any loss.

Gold as an asset plays a very important role in an investor's portfolio as it not only provides stability for returns but also gives an opportunity to maximize the wealth of the investor .Investors generally buy gold as a way of diversifying risk. Price of gold is determined by the market force of demand and supply. Central bank keeps some portions of their securities in the form of gold. Some studies pointed out that US central bank is the largest holder of gold they own 8133 tons of gold it represents 76% of American foreign reserves. Gold is a hedging tool against inflation.

INTRODUCTION TO GOLD AS AN INVESTMENT:

Gold is considered by many, to be the best investment you can make to protect yourself during stock market declines and inflation. In fact, history shows that the performance of gold goes up in times of high inflation. However, the price of gold also has its highs and lows and you could just as easily lose money investing in gold as with any other investment.

INVESTMENT OPTION IN GOLD:

Today, gold as an investment is just not limited to buying ornaments or jewellery, it has expanded into many different options. One can invest in gold through various other means with each holding unique benefits. There are ways to invest in gold such as:

1) PHYSICAL GOLD:

You can invest in gold coins and bars, by buying them from your jeweller or from the bank. Gold coins are mass produced; they are available at very competitive prices compared with similar size bars. Gold coins are almost universally recognized, they are also easy to resell.

LAST FIVE YEAR RATE OF RETURN OF GOLD IN INDIA

(TABLE 1)

YEAR	RETURN
2015	-6.2%
2016	11.5%
2017	5.2%
2018	7.5%
2019	24.1%

2) PAPER GOLD:

An asset that reflects the price of gold while not actually being gold itself; it's not backed by real metal, so it's considered to be only on paper. Holding paper gold enables one to get exposure to the price of gold without having to possess physical bullion and is considered more useful for trading purposes than for long-term investments. Examples of paper gold include: gold certificates, pool accounts, gold futures accounts, and most exchange traded funds (ETFs).

TYPES OF PAPER GOLD:

(i) GOLD ETFs:

Traditionally, Indians have always had an affinity towards gold. Investors looking to invest in gold can do so via ETFs or more specifically Gold ETFs. A Gold ETF **(Exchange Traded Fund)**is an instrument that is based on gold price or invests in gold bullion. It is traded on major stock exchanges and Gold ETFs track the gold bullion performance. When the gold price moves up, the value of the exchange-traded fund also rises and when the gold price goes down, the ETF loses its value.

Investors can buy the gold ETFs online and keep it in their Demat account. An investor can purchase and sell gold ETFs on the stock exchange. Gold ETFs are units in lieu of physical gold, which may be in dematerialised form or paper form. One gold ETF unit is equal to one gram of gold and is backed by physical gold of very high purity.

Gold ETFs allow investors to participate in the gold market at ease and also offer transparency, cost-efficiency and a secure way to access the gold market. They also provide the benefit of liquidity as it can be traded at any time during the trading period. The first gold ETF in India was launched in 2007, and since then, their popularity amongst Indian investors has grown immensely.

(ii) Gold Mutual Fund:

A Gold saving fund is a mutual fund that invests in the units of Gold ETF. So it will provide returns that closely correspond to the returns of its underlying Gold ETFs. The benefits are you can:

- Invest in the precious metal without having a Demat Account
- Through Systematic Investment Plan (SIP) of gold mutual funds, one can affordably have disciplined investment in gold. One can invest as little as Rupees 100 every month in gold funds.

You should note that the expense ratio is higher than in gold ETFs and returns are slightly lower than that of gold ETFs.

Reasons for Paper Gold Instead of Physical Gold

1. **To avoid storage costs:** If you invest a sizeable part of your capital in physical bullion, you might not want to keep your metal at home (you'll need a safe and perhaps other additional equipment). In this case, you might prefer to choose a custodian – an institution that stores your metal for you. This storage service is not free of charge (neither is transportation to the storage facility, nor its insurance), so you need to take this cost into account, and it diminishes your returns on gold. By buying paper gold, you get a paper that more or less reflects the price of gold and allows you to avoid the cost and headache of storage.
2. **Don't have enough capital:** Paper gold enables you to invest in gold even if you don't have enough capital to buy an ounce of gold. This is because ETF shares, or similar investment vehicles, usually reflect less than one ounce of gold – most commonly they follow the price of 1/10 of an ounce. If you do not have enough money to buy a full ounce, ETFs might be a solution. This is another reason for the popularity of ETF vehicle with individual investors.

The Golden Rule

If you invest in gold ETFs it is crucial to choose either the funds that allow redemptions in gold (there are only a few such ETFs) or those that have their shares **fully backed by gold**. Apart from that, you should always remember about diversification – in this case it would mean holding both **physical gold** for long-term investments and non-physical (futures, options, ETFs, pool accounts, certificates) for small, quick trades. If the derivatives market collapsed, then the rocketing price of your physical holdings would more than compensate for the losses on the speculative paper gold. This is why diversification is important in this case.

LITURATURE REVIEW:

1. **Shobha C.V (2017):**This study also analyses various demographical factors that influence on the decision to invest in gold and as well as in selecting a particular kind of gold investment. The chi-square test was applied and the results showed that all the variables under study except education qualification ('p' value 0.8308) dictated investors decision in selecting gold as an investment opportunity.
2. **Dr.Jyoti H. Lahoti (2017):** This study tries to focus about different gold investment schemes available in the market and also the investor's attitude towards the investment. This study aims at collecting investor's response towards investment in gold. Pros and cons of investing gold have been elicited. We in our study have tried to throw light on the different avenues of gold investment available in the market. This will ensure that gold becomes tradable and generates revenue rather than lying idle as a dead investment.
3. **Dr. J K Raju, Mr.Manjunath B R, Mr.Rehaman M (2018):** The research paper was to study of the Performance evaluation of gold ETFs in India. GoldETFs were launched mainly with an objective to increase the liquidity for the better market efficiency. Mutual Fund is a trust that pools money from a group of investors sharing common financial goals and invest the money. This aims at discovering and analysing risk in the emerging security in the stock market i.e. Gold ETFs. This paper will give focus on Gold ETFs as a strong and attractive investment option for investor.
4. **Mr. Ram Raj G (2019):** - This research article was intended to estimate the volatility and connection between real Gold and Gold Exchange Traded Fund (ETF) in India by using various statistical models. The data for the study period for three years period 2015-2018 acquired from the National Stock Exchange of India's historical statistics and others. The outcome of this study was found that there are a strong positive short-run relationship and long-run equilibrium relation between gold and Gold ETFs. It is unidirectional, and few bidirectional causes and relationship existed in this study. This Study is fit to be analysed GARCH model to estimate volatility in the Gold price returns; it shows there persist the volatility effect. This study will be helpful to investors in the selection of better investment options.

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 favourable 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 jeweller at the time of sale.
- The second advantage is storage. Risk of theft when investing in Gold ETFs is very little as compared to physical gold.
- Thirdly,Minimum investment can be made for as low as 1 gram of gold. You can also invest via the SIP route rather than making investments in a lump sum and trying to time the market.

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Comparative Chart for Gold ETFs and Physical Gold

	Gold (physical gold)	Gold ETFs
Meaning	An individual buys gold in the physical form. The purity of the gold may or may not be of minimum 99.5% purity.	Gold ETFs are open-ended exchange traded funds that will invest the money in standard gold bullion (gold with 99.5% purity). An investor holds units of an ETF whose value depends on the price of the physical gold in the market.
Pricing	Pricing of the physical gold is not uniform. It varies from jeweller to jeweller.	Gold ETFs are priced as per international standards and are always transparent.
Investment	Physical gold biscuits are available in the standard denomination of 10 grams that requires a huge investment.	Gold ETFs are available in small quantities i.e. even in 1 gram. Hence, are more affordable.
Charges	When an investor buys gold jewellery, he has to pay 20%-30% of the total buying value of the gold as making charges.	Buying a gold ETF includes expense ratio of only 1% every year and brokerage charges of ~0.5% or less of the purchase price with every transaction.
Wealth tax	1% wealth tax is applicable if the value of the gold possessed by an individual is more than Rs 30 lakhs.	There is no wealth tax applicable on Gold ETFs.
Short-term capital gain tax	If physical gold is held for less than 3 years then the investor has to pay a short-term capital gain tax as per his income tax slab.	The short-term capital gain tax applicable for gold ETFs is same as physical gold.
Long-term capital gain tax	If gold is sold on profit after three years then the investor has to pay a capital gain tax of 20% with indexation.	The long-term capital gain tax is the same as physical gold.
Liquidity	Physical gold can be purchased from banks and jewellers but can be only exchanged through jewellers.	Buying/selling of gold ETF is much easier than physical gold as it is traded on the stock exchanges - NSE and BSE.
Returns	Actual return = Current price of a gold/coin minus buying price and making charges of an ornament.	Actual return = Current price of a gold unit trading on stock exchange minus buying price and brokerage charges.

Demat account	Demat account is not required.	An investor compulsorily needs a Demat account.

Conclusion

An investor should invest in gold ETFs than physical gold because it carries no wealth tax and making charges. In addition, liquidity and convenience in transacting in gold ETFs is better than physical gold. The fear of buying physical gold at a higher price is eliminated in the case of buying gold ETFs as it is priced as per international standards. Therefore, one should prefer investing in gold through ETFs over buying physical gold.

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