CHAPTER – III
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THE INFLUENCE OF FACTORS AND THE REASONS OF REPEATED INVESTMENT IN GOLD ETFs

3.1 INTRODUCTION

In the Middle East of Asia and the Indian subcontinent where gold is the best possible protection against upheaval for both political and economical conditions. In the developing world gold is still one of the most liquid and widely accepted forms of exchange and quite simply they possess the most efficient store value. As India’s domestic production of gold is very limited due to which the rising demand has to be sourced from outside the country. Moreover, Gold as a commodity on its own does not add much to the productive capacity of the economy. When one buys gold it is either stored in lockers or gets converted into Jewellery. In both the cases the money spent on purchasing gold gets blocked since gold is not a productive asset. The latest argument is that the craze for gold among Indian households is endangering our country's balance of payments.

The policymakers are busy in trying to find the ways of discouraging investments in gold but if households keep the common good in mind, they would be paying the market price for gas cylinders as they do for or say, their mobile phone bills. Gold is primarily acquired for its merit as a store value. Even if the worst crisis hits a family, the gold that it holds could be put to use anywhere in the world. In fact, this attribute and rationale encouraged the traditional wisdom of adding gold ornaments to a daughter's wedding. Every family needs this buffer, but one should desist from overdoing it. Gold is a safety net and this is the role it plays in one's investment portfolio too. This need could be met by a 10% allocation to gold in a family's portfolio.
There are two other drivers of investment in gold. The first is the need to hoard undisclosed cash earnings. The other is to use gold as collateral to borrow money. Both these uses have been entrenched in the system due to flaws that have persisted for a long time. The lack of law enforcement when it comes to income disclosure and tax collection has led to large-scale hoarding of illegal income in the form of gold. The purchase of gold to hoard wealth neither requires Know-Your-Customer (KYC) compliance, nor is it declared as wealth. Gold is also seen as a source of liquidity which is prompted by the lack of widespread banking, investing and insurance facilities and the non-inclusion of many households in the financial markets.

It is common for those with irregular and seasonal incomes whether it is an agricultural labour or urban casual labour as to save periodically in gold. This is pledged to generate cash during the lean times and recovered when incomes goes up. Unfortunately, this practice has also spread among those with access to banking facilities. The ease of transacting, ability to transact in cash and less stringent processes has led to a sharp growth in the market for loan against gold. There are two prime motivations that are fuelling the demand for gold.

The first attraction is a physical asset that creates a sense of well-being. Then there is the bias from the recent out performance of gold as an asset. It has beaten equity, property and bonds by a large margin in the past five years. Hoarding gold is a clear case of acquiring an asset for emotional rather than financial needs. Such investors should realize that gold generates no income while idling and it has to be sold to redeem the economic benefit. The householders must have a firm plan to sell the gold as and when needed, since that is the main purpose of building assets. From the point of view of the latter, pure gold bars and coins are superior to Jewellery. Those who have bought gold swayed by the sharp rise in prices in the recent past have made a tactical asset allocation decision.
In the market place, different assets do well at different points of time. As an alternative of blindly dumping on the bandwagon, investors need to focus on the reasons that might have caused gold to outperform equity and other assets and whether those conditions can be expected to prevail in the future. The period after 2008 global economic crisis was filled with uncertainty and a large investment banks failed, countries defaulted, currencies tumbled and businesses folded. Heightened uncertainty makes gold a safer investment and leads to it being given excess weight-age in a portfolio. This in turn pushes up its price.

The ultimate dollar hedge investment will always be gold. Investing in gold through ownership of the metal itself, mutual funds or gold mining stock provides the most direct counter to the dollar. As the dollar falls, gold will inevitably rise and vice versa. In a moment, brokers will provide investors with many ways for positioning their portfolio to a profit from a bull market in gold. But now it emphasize that the high probability of gold’s future. The real potential for profits in the coming years and decades is not going to be found in the traditional American blue chip industries. That is a financial dinosaur that can no longer compete in the world market. The future growth is going to be seen in gold. The world economy can remain off for the gold standard but ultimately the tangible value of gold as the basis for real value whether acknowledged by central banks or not. Historically, this has always been the case and it will be always.

3.2 PRE – LIBERALIZATION

A study on India’s gold demand would not be complete without a discussion on gold policy which forms an integral part of macroeconomic policy. Broadly, there is a shift in the approach of policy from a plethora of restrictions to a liberalized gold market during the period
of reform as compared with earlier periods. The policy approach no longer contends gold either productive or unproductive asset. The role of a liberalized and developed gold market in the interest of consumers is being increasingly realized and efforts are underway for integrating the gold market with financial markets.

During the British rule, gold inflows and outflows were unrestricted mainly due to the practice of metallic standards. Restrictions on gold imports were imposed only during the two world wars. After independence, Government of India adopted a fully restricted policy towards gold. Savings and investments in gold were viewed as a loss of precious foreign exchange resources with adverse consequences for economic development and technological progress. Therefore, the evolution of the gold policy until economic reforms in the early 1990s centered around the major objectives of weaning away people from gold by reducing domestic demand, regulating supply of gold, with domestic prices, curbing smuggling, black income and conserving foreign exchanges.

Accordingly, three major strategies encompassing legislative measures adopted to control over domestic production and gold mobilization schemes. The Foreign Exchange Regulation Act (FERA) of 1947, its successive legislation in 1973 and Gold Control Act 1968 empowered government to restrict exports and imports of gold. In 1956, the country's only gold mines in the southern region was nationalized to attain government control over gold production. In the same year the proportional reserve system (under which a minimum proportion of the currency liability was required to be covered by foreign assets including gold) was abolished and replaced by a minimum absolute level for foreign assets for the Reserve Bank of India (RBI) in the currency issue purposes thus it debased the monetary role of gold in India. Government of India attempted various gold bond schemes over the years in 1962, 1965, 1980, 1993, and 1999
respectively. However, these schemes achieved little success and an interesting feature of the
gold control regime was that it prohibited all transactions between residents and non-residents.
This coupled with administrative complexities that resulted in the failure of the gold control
order as smuggling of gold and unofficial transactions in foreign exchange flourished.

3.3 POST-LIBERALIZATION

In the wake of balance of payment crisis in 1990-91, external sector policies in general
and gold policy had witnessed a major review. The High-level committee on Balance of
Payments 1991, Government of India examined the issues which are related to the valuation of
gold held by the central bank, external commercial borrowing against gold and gold bond
schemes. The Committee felt that caution should be exercised in creating permanent institutions
or corporate bodies for mobilizing gold. Gold bonds may be launched immediately as an
experiment and a review to be made. The first major policy reversal occurred in 1990 with the
repeal of the Gold Control Act. Subsequently, in 1993, the provisions of the FERA 1973 relating
to gold were repealed. In order to augment supply through official channels, Non-Resident
Indians (NRI) were allowed to bring in 5 kg of gold as part of their baggage (subsequently raised
to 10 kg) every six month’s subject to payment of import duty which was increased in the early
1990s.

The other channel for importing gold was the way of issuance of Special Import Licenses
(SIL) for Jewellery export purposes only. By the mid of 1990s, there was growing realization
that the negative attitude towards gold on the presumption of productive or non-productive
savings was inconsistent with liberalized framework for economic progress. A positive approach,
on the other hand entails significant reduction in the transaction cost or the reduction difference
in price between world markets and Indian gold market after liberalization. In line with this changing perspective, the committee on Capital Account Convertibility 1997 recommended that free import of gold should be a pre-condition for further reforms in the external sector. For developing domestic gold markets the committee had made recommendations for allowing banks to freely engage in gold business in domestic and international markets.

Thus, gold banking followed by extending authorization to commercial banks to import gold for sale or loan to Jewellers and exporters. This policy has succeeded to a large extent in curbing illegal operations in gold and foreign exchange markets and reducing the disparity between international and domestic prices of gold from as high as 50 per cent during the 1980s to about 2 per cent in the recent years. In continuation of liberalized gold policy, Government of India lifted the forty-year-old restriction on gold derivatives in 2004, allowing gold futures to trade in the commodity exchanges. Following this initiative, in a span of two years gold surpassed all other commodities for futures trading in the Multi-Commodity Exchange, National Commodities and Derivative Exchanges.

3.4 A BRIEF ON GLOBAL ETF INDUSTRY

In 1993 they first came into existence in USA. It took several years for them to attract public interest but once they did the volumes took off with a vengeance. As of September 2010, there were 916 ETFs in the US with $882 billion in assets. About 60% of trading volumes on the American stock exchange are from ETFs. The most popular ETFs are QQQs (Cubes) based on the Nasdaq-100 index, SPDRs (Spiders) based on the S&P 500 index, Shares based on MSCI indices and TRAHK (Tracks) based on the Hang Seng Index. The average daily trading volume in QQQ is around 89 million shares. As of October 2011, in United States ETFs assets under
management have grown significantly since August 2007 from $400 billion to $1 trillion with total number of listed ETF are around 1300.

ETFs have revolutionized the investment industry in recent times due to their simplicity, low costs and ease of use. The US market has seen a massive growth in the usage of this financial instrument with a mind boggling variety of ETFs catering to almost every asset class ranging from equities, bonds, currencies, commodities and even derivatives. The low cost of the ETFs compared to the mutual funds and their passive form has attracted investors in huge droves. A similar surge is expected in the Indian market as well.

India’s journey started with Benchmark launching the first ETF called Nifty BeEs in 2002. Since then fund has come a long way with AUM rising to 587 crore from less than Rs 10 crore mobilized through NFO. Today there are 32 ETFs in mutual fund industry of which 11 are in Gold category and balance 21 are in other category. The total AUM managed under Indian ETF umbrella is close to Rs. 10.838 crore as of October 2011 of which 83% belongs to Gold ETFs. With the arrival of Gold ETFs the segment has acquired enhanced interest from investing community and today it has more than 5.54 lakhs investor in overall ETFs segment which comprises of 4.28 lakhs in Gold ETFs and 1.25 lakhs in other ETFs. The investors are spread across corporate, HNIs, retail and banks/ FIS.

ETFs can be tracked through various indices, e.g. Bank Nifty, Sharia Index, Infra index, liquid BeEs and the spot gold which are due to surge in the gold prices globally and the yields on the gold ETFs. It has generated a lot of interest amongst the investing community. As explained above, as a result, of AUM of the Gold ETF grew by leaps and bounds and is largest in the segment.
Goldman Sachs which took over benchmark AMC in July 2011 is most dominant player in the industry having a total of 6 schemes.

Due to the surge in the number of GOLD ETF, it was categorized into two

1. ETFs-Gold as such, there are three -

   i) ETFs (TOTAL)   ii) ETFs-OTH and iii) ETF’s -GOLD.

2. Others ETFs

Important observations are highlighted below:

◆ There is a consistent in overall growth of AUM in ETF. So this can be constructed that there is a demand of ETF in India and people have accepted ETFs as one of the most important investment destination.

◆ During the period 2008-09 there was a downfall in the AUM for the ETF-OTH. This is the time when the market faced the slump during the subprime crisis and Indian market saw an unprecedented fall. Since most of the ETFs were tracking the Nifty and other equity benchmark indices and the returns on ETFs were also plummeted. This leads to widespread redemption in ETF and hence considerable fall in the AUM of ETF.

◆ However, there is a fabulous growth in the GOLD ETFs. The first GOLD ETF was launched by benchmark in the year 2007 followed by UTI AMC.

◆ The returns on ETF track of the benchmark indices and there is a drop in the return amidst volatility on the various underlying like NIFTY, PSU BANK index, Bank NIFTY etc., at the same time the spot gold has been outperforming other indices. Due to firming
of the gold prices and this index has given phenomenal return during the period. It justifies the interest among the investor’s community for the GOLD ETF.

- The fall and rise in the AUM, normally tracks the return of a particular fund or scheme. It is quite understandable that the fund that performs better attracts more investors and the one which doesn’t perform well loses out. In case of ETF it is more prominent.

3.4.1 Global trends of ETF’s

- While ETF assets grew globally, the average AUM funds has been an exception from a rapid addition to global assets, even though it is line with Asia in terms of equity ETF’s. Increase in smaller sized funds outside the Top 10 ETF’s presents a concern and this impacts player’s profitability. Bigger the fund, the better it achieves the economies of scale and break even. As per recent research, a majority of the funds launched in USA in 2011 are struggling to reach even 30 million US dollar assets.

- Traditionally, ETF’s were held initially by institutions followed by advisor with retail acceptance building over a time. ETF’s has become popular with institutions due to lower cost, risk diversification, new beta exposure and short term liquidity management. Though slow to pick up in the retail space but it has started gaining the acceptance of late to the extent that retail now holds nearly half of the global ETF’s. However, many emerging markets like India where actually ETFs demanded more retail initially, though this is attributable to the proliferation of Gold ETF’s.

- ETF growth has been more due to net inflows rather than price appreciation which has given the recent volatility in the asset prices. Global ETFs have seen consistently high net inflows since last 4-5 years with clocking US $164 billion in 2011. In 2011 the new
money was at par with 2010 though the overall growth was 26% in 2010 Vs 3.2% in 2011, stressing the overall impact of net inflows and asset price declines.

- Increase in money had generated new ETF which launches product development. This industry has seen the higher launches in the year since 2009 which has been led by Asia. New ETF from China, South Korea and USA in 2012 rank amongst the largest fund launched. The industry maturing should intensify the move towards novel funds which also provides an entry for smaller and boutique AMC’s. ETF’s ability is to increase in investor’s access to multiple assets and many of which were not within reach, earlier has benefited the varieties available for new funds, later segments relatively successfully in USA during the crisis like Pan Asian bonds, US dollar and commodities are some such funds.

- Trends in evolved markets like USA show that as ETF volumes grew and its contribution towards cash volumes has shown more resilience even during a drop in overall cash volumes. During downturn, there is a shift in the investor’s preference towards passive products rather than active investing. Despite lower trading volumes, one has been significant asset addition in the ETF’s space and demonstrating the increased appetite for such products.

3.4.2 Market trends that aided the recent surge in ETF’s globally

- In Volatile times, diversity is a key for a volatile markets and inability to generate the alpha consistently. Since 2008, market volatility has risen globally, thus increasing the perceived risk and the inability to beat benchmarks consistently. This brought the focus of benefits of passive, uncorrelated and diversified investments. As investors seek to
balance the growth rate with risks or, they are increasingly looking at lower correlated assets and ETF products help in this matter.

- General move from commission model to free model the financial advisory is seeing a gradual shift from commission based to fee based advisory. This is largely due to the inability of investors to pick correct options by giving the correct proliferation, volatile markets and shifting focus to newer assets which may yet to understand, thus increasing the demand advice. Since advisory charges a fee for advice over and above other portfolio costs, as they seek low cost options and ETF’s fit this bill. This trend is a boon for ETF’s as a many distributors were otherwise reluctant due to low commission earned on ETF’s.

- Popularly with financial advisors work for their clients. ETF’s are changing the way of the advisors work for their clients. UK IFA’s and US fee based RIA’s are increasingly using ETF’s for their retail clients mostly in discretionary accounts in UK. This is due to its ability to take diversified, yet it has a focused exposure while keeping portfolios simple and at low cost. Few ETFs are addressing the asset allocations; advisors now get more time to develop client relationships. A recent survey by shares and Schwab shows that IAFs and investors are keen on ETFs, through lack of understanding a concern.

3.4.3 Investment strategies that investors can achieve through ETF’s

Core satellite investing the investors in present day expect and wish to trade through retail portfolio which has induced many investors for passive investing. Actively managed satellite seeks concentrated on the targeted exposure to certain sectors assets and markets to tap outstanding performances.
• Tactical or arbitrage investing of ETF’s can be a useful way to go overweight or underweight in markets which is based on short term views. Arbitrage is facilitated by the transparency and liquidity of investment portfolio.

• Dividend ETF portfolios for current income are appealing in the current scenario with each underlying paying a dividend monthly like the monthly dividend ETF portfolio.

• Exposure to undervalued segments for short term market movements that can render certain sectors relatively undervalue of assets. Assuming such sectors for typically coverage of their true values in the long run and such sector ETFs are often used.

• In pairs trading a deep understanding of markets can use ETF to capture stock vs. sector performance differential for buying the stock and shorting its sector ETF if the company is expected for better its peers and vice versa.

• In fixed income ETFs often optimize the index to comprise only part of the universe since many bonds trade in lower volumes. It lowers the risk of investing in single bonds offers a bond basket with single trade and replaces maturing bonds.

• Short term traders can often look at buying above 200 DMA that typically recover after a short term pullbacks and exciting ones market closes above 5 DMA.

• Portfolio completion access to alternative assets that gains the targeted exposure to certain sectors and makes assets like commodities, currencies which are typically uncorrelated to brand equities.
Leverage and shorting margins investing to be profitable, but interests can deteriorate returns. In USA shorting stocks on a downtick is prohibited while ETFs are exempt thus easing short selling with ETFs.

Investors with cash parked in their portfolios for some time can use ETFs like short duration bond ETFs instead of money market funds which can often pay better yields than money market funds.

3.5 Exchange Traded Funds

ETFs are open-ended funds that are traded in stock exchange just like the shares of an individual company. Unlike the share of a company, each unit of an ETF represents a portfolio of stocks. So it is similar to a unit of an open-ended mutual fund but with a big difference. The difference between an ETF and an open-ended mutual fund is that the units of an ETF trade on an exchange. So the investor can trade in the ETF during market hours and the units can be sold short or margined just like shares.

Another difference between ETFs and mutual funds is the type of management. Mutual funds employ an active management strategy wherein the fund manager actively chooses the portfolio of stocks and manages them in an endeavor to outperform the fund's benchmark. However, ETFs employ a passive management strategy because they are generally designed to closely track the performance of a specific index. So the fund manager creates the portfolio which is based on composition of the benchmark index. The ETFs are supposed to track and then passively manages the portfolio as to ensure that the composition of ETF mirrors the benchmark at all times. There could be slight deviations from this strategy at times if the fund manager feels
that it is necessary to overweight or underweight certain stocks with respect to the benchmark in order to achieve a better return.

### 3.5.1 Types of ETFs

ETFs are classified under three headings which were listed and traded in National Stock Exchange with a minimum of one unit as a size of lot. They are:

**Figure 3.1**

Types of ETF’s

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**Equity Index ETFs:** From the basket of capital market securities the values for such types of funds per units were derived. Depending upon the nature of ETF the baskets of securities differs. It is used for building a long term core holding and systematically investing in various funds. It can be brought when market is bullish. The main advantage is that it can be brought as a share, there are no hassles and real time NAV and prices were closed to 1/10 of the index value.
**Liquid ETFs:** These type of ETFs are derived from the money market securities which includes governments and treasury bonds, call money market etc. such type of ETFs has lower risk and higher liquidity through portfolio of debt and money market instruments. The main advantages of such ETFs are dividends were passed from daily returns and after dividend distribution tax the balance dividends were reinvested. In this NAV is maintained at Rs. 1,000.

**Gold ETFs:** Such type of unit’s represents physical gold which may be in demand form or paper gold and it is traded on the exchange. The main advantage is easy storage, purity, no wealth tax and no fear of theft.

**3.5.2 Creation or redemption process of ETF**

ETFs can either be purchased on the stock exchange or directly with the fund. The fund creates or redeems units only in predefined lot sizes in exchange for a predefined underlying portfolio basket. The investor’s are allocated with units and the portfolio basket is deposited with the funds. This is in kind creation or redemption of units. APs act as an intermediary between the capital markets and the ETF providers. As all trading transactions are done in kinds so it is not subject to a capital gains tax.
The figure demonstrates that how an investor obtains and sells ETFs in the market. An investor can purchase ETF shares on a stock exchange and cannot procure or put up for sale shares directly from the fund. Before trading, the funds carry out a process of creation in the primary market. Large blocks of shares were created by the ETFs, referred to as ‘creation units’, the investor should purchase units from the fund house by surrendering the underlying stocks of the index. In this process of buying and selling an AP does not generally use cash but, transfers a portfolio of securities to the ETF. Tracking of an equity index is necessary before the purchasing a creation unit in an ETF tracking an equity index.

The creation units are broken up and sold in the secondary market after transferring it to the APs. The process of reverse creation is process of redemption through which the ETFs can be
sold in the stock exchange. Those funds using derivatives to track their benchmark Cash may be used during the creation and redemption process.

3.5.3 Growth of ETF in the global context

ETF’s were traded as trading in like stocks that helps to achieve diversification, benchmark returns, access to multiple assets and real time allocation at a lower cost.

It has lead to a stronger path and growth. Since 1993, there was a tremendous growth in gold ETF’s. As of may 2012, there were 3,256 ETFs with an asset value of 1.4 ton globally. Over 80% of the ETFs today were launched in the last five years. ETF AUM has advanced with mutual fund assets and through the proportion is still quite small at 6%. The main reason for the development of ETF’s was due to the tough economic scenario, which has pressured to perform when the markets were volatile and the inability in attaining alpha consistently. The increased regulation of post 2008, tightened competition caused the recent popularity in passive investing through ETF’s.

3.5.4 Advantages of ETF

- ETFs are supposed to be tax efficient because there have a lower churn of the portfolio owing to the passive management strategy.

- It can be traded during market hours and can be sold short or margined.

- ETFs have a lower management cost than conventional mutual funds because ETFs do not have to bother about shareholder accounting. Mutual funds have to spend a considerable amount of time and effort in complying with shareholder accounting processes.
3.5.5 Disadvantages of ETF

- Even though ETFs are designed to track an underlying benchmark index and they cannot exactly mirror the performance of the index owing to certain management costs charged by the fund.

- Since ETFs are passively managed so they cannot provide an active return over the benchmark during up market moves unlike actively managed mutual funds where the fund managers is constantly trying to beat the benchmark.

- ETFs have a lower management cost than conventional mutual funds because ETFs do not have to bother about shareholder accounting. Mutual funds have to spend a considerable amount of time and effort in complying with shareholder accounting processes.

3.6 CHOICES OF GOLD INVESTMENT

Direct ownership: There are nothing like gold bullion which is ultimate expression of pure value. Historically, many civilizations have recognized the permanence of gold’s value. For example, Egyptian civilizations buried vast amounts of gold with deceased pharaohs in the belief that they would be able to use it after life. Great wars were fought among other reasons to pillage stores of gold. The Gold’s value will rise based on the pure forces of supply and demand. The big disadvantage of owning gold is that it tends to trade with a wide spread between bids and asks prices. So investors can’t expect to turn a fast profit. Investor can buy at retail and sell at wholesale, so investors will need a big price jump just to break even. However, investors should not view gold as a speculative asset but as a defensive asset for holding value. Since dollars are going to fall in value then gold is the best place to preserve value.
**Gold Exchange Traded Funds:** The recent explosion in ETFs presents an even more interesting way to invest in gold. An ETF is an open ended type of mutual fund that trades on a stock exchange like an ordinary stock. Its exact portfolio is fixed in advance and does not change. Thus, the two gold ETFs which are traded in the United States hold gold bullion as their one and only asset. These two ETFs are represented with the symbol “GLD” (for the street TRACKS Gold Trust) and “IAU” (for the iShares COMEX Gold Trust).

**Gold mutual funds:** For people who are hesitant to invest in physical gold but still desire some exposure to the precious metal for them gold mutual funds provide a helpful alternative. These funds hold portfolios of gold stocks of companies like Newmont Mining that mine for gold. Newmont is an example of a senior gold stock. A senior is a large, well-capitalized company that has been for several years and has a profitable track record. They tend to own established mines that produce known quantities of gold each year. For many investors, selection of such a company is a more moderate or conservative play (versus picking up cheap shares in fairly young companies).

**Junior gold stocks:** This level of stock is more speculative. Junior stocks are less likely to own productive mines and can be exploration with higher potential profits along with greater risk of loss. Capitalization is likely to be smaller than capitalization of the senior gold stocks. This range of investments is for investors whose risk tolerance is broader and who accept the possibility of gold-based losses in exchange for the potential for triple-digit gains.

**Gold options and futures:** For the more sophisticated and experienced investors options allow them to speculate in gold prices. But in the options market investors can speculate on price movements in either direction. When investor buy a call, hoping that the prices will rise. A call
fixes the purchase price so the higher that price goes, the greater the margin between the investors fixed option price and current market price. When the investors buys shares in a put option, expecting the price to fall. Buying options is risky and more people lose. In fact, about three-fourths of all options bought expire worthless. The options market is complex and requires experience and understanding. To generalize the options possess two key traits i.e. one bad and one good. The good trait is that they enable an investor to control a large investment with a small and limited amount of money. The bad trait is that options expire within a fixed period of time. Thus, for the buyer time is the enemy because as the expiration date gets closer, an option’s ‘time value’ disappears. An investor investing in options should understand all the risks before they spend money. The futures market is far too complex for the vast majority of investors. Even experienced options investors recognize the high risk nature of the futures market. Considering the range of ways to get into the gold market, futures trading are the most complex and while big fortunes could be made which they can also be lost in an instant.

There are certain qualities of gold that make it a desirable investment option. Some of these being:

- The ability of gold to insure against instability and protect against risk
- Has a universal acceptance.
- Provides liquidity.
- Deep cultural affinity with gold purchase
3.7 Awareness and perception of investors towards Gold ETFs

Consciousness about a certain aspect is known as awareness. Awareness is an ongoing process by which investors use to learn about various investment avenues. It also means that an individual should have knowledge for investing in capital markets depending upon its risk and return. There are many institutions which had taken steps for creating awareness among the public by ways of conducting programmes like financial literacy week, issuing of annual reports and bulletins and etc.

Many investors are interested in those schemes which can provide them easily liquidity, for which the investors should be educated about various investment avenues timely and it would help them to invest in the right area and at right time. They should be aware about the latest trends in the markets which led to the invention of new financial products in the capital market.

In certain situations the investors before going for investment has to collect all the information about various investment avenues which will have its effect on the level of awareness towards acceptance or rejection of it. When the investors become well versed of various investment avenues it makes them evaluate all other channel by comparing other alternatives. Later investor decides to make investment in more beneficial mode or modes. Thus awareness creates an attitude in investor’s towards investment channels.

By various external sources of information such as dailies, weekly, electronic media, friends, brokers and etc had created a sense of awareness for investors towards investments in various aspects. Awareness is an abstract concept and hence it is not possible to measure precisely and directly in quantitative terms but can be measured and assessed indirectly.
Perception is a dynamic process by which an investor organizes and assigns meaning to the information collected from external and internal sources. However different people perceive things differently according their needs and it is influenced by the social environment.

These study analyses the investment on Gold ETFs in relation to investor’s behavior and it includes their perception and awareness towards various issues like types of Gold ETFs, reasons for investing on it, source of information, factors that attract them for the repeated investments on gold ETFs and etc. The investors were very delighted to procure gold at minimal quantities and increase their security in the fluctuation of gold market. The major reasons and the perceived mind of the investor to invest in gold was only on two reasons viz., the gold ETF has given an opportunity to accumulate gold over a period of years and further the gold ETF had not forced the investor to purchase gold of a sovereign but gave freedom to purchase a gram gold. Hence forth the possibility of purchasing gold in small quantities had pushed the investor to purchase gold through ETF’s. Now a day’s investing in gold ETF have gained momentum in the recent days rather than investing in shares, real estate, etc.

Since Gold ETFs is product which provides the benefits such as purity, affordability, safety and liquidity. So the investor’s get more awareness about Gold ETFs as there is less risk and it is also helps them for the betterment of their life. It will be easy to understand from the analysis given in the successive chapter about the awareness and perceptions of investors towards Gold ETFs.

3.8. About Gold ETF

The idea of Gold Exchange Traded Funds was originated in India in 2002 by Benchmark and filed a proposal with Securities and Exchange Board of India but, due to some reason it has
not been approved. Later in February 2007 it was launched by Benchmark which was considered to be the first Gold ETF in India. Now more than 13 companies had entered in NSE under this product but the World first Gold ETF was launched in Australia in March 2003 and in United States in 2004.

Gold ETFs are considered as paper gold which is traded in NSE like other shares in demat form. It is regarded as open-ended funds and it can be traded in the ETF during market hours which can be sold short or margined like shares. It is meant to track the prices of physical gold and it can be owned through Demat Account. One unit of Gold ETF consists of one gram of gold but not physically owning it but investing on gold.

It provides the investors the facilities of easy liquidity and marketability in the market; it can be traded in the stock market during the working hours. It also includes short selling and buying on margin like normal stocks. Owning gold ETF also is cheaper than owning physical gold because it has no cost of carry or the cost of storing physical gold.

Mainly for the purpose of taxation its schemes are treated as non-equity mutual funds. If the Gold ETFs are held for more than one year then it will get Long Term Capital Gain Tax (LTCG) which comes around 20% and for short it will be Short Term Capital Gain Tax (STCG). If the companies declare dividend for Gold ETFs then the investors are liable for Dividend Distribution Tax (DDT) and the rates comes around 14%.

3.8.1 Types of gold ETFs

There are various types of gold ETFs, so investors can select any gold ETFs according to investor’s investment strategies.
◆ **Gold ETFs that contains gold products:** In this type the investors can invest in gold without actually buying gold and storing them in safely. Gold ETFs like IAU and GLD follow the performance of gold including gold products.

◆ **Gold ETFs that contains gold futures:** Some types of gold ETFs are constructed in a special way to track the performance of gold. Gold ETF alike to DGL which is consists of derivatives like futures, forwards and options in order to imitate a gold index. The construction strategy which is used not only for gold ETFs but also used for many commodity ETFs as well.

◆ **Gold industry ETFs:** In this type of gold ETF consists of companies in the gold industry. Like a sector ETF, this kind of gold ETF also tracks the performance of
companies which are greatly depended on gold as their key business. For example, GDX tracks the performance of the Amex Gold Miners Index which consists of companies in the gold mining industry.

**More than gold ETFs:** When an investor would like to invest in more than one precious metal then there is gold ETF which include multiple metal products. A precious metal ETF like DBP, the power shares DB precious metals for gold investors ETF can fit for their portfolio.

**Short Gold ETFs:** Acting like a reverse ETF, a short gold ETF is distinctively constructed to inversely follow the performance of a gold ETF index.

**Gold ETNs:** Gold ETF and Gold ETN are two different form of investing in gold. Gold ETN is DGP which tracks the Deutsche Bank Liquid Commodity index - Optimum Yield Gold Excess Return.

On the basis of the selection of gold ETFs an investor will be getting the benefits and detriments of gold ETFs.

### 3.8.2 Advantages of Investing in Gold ETF

- It is advantageous to invest in gold ETFs as the investors do not undergo any making charges. Whenever investor purchase gold coins, Jewels or bars and they tend to pay some premiums as making charges whereas there is no such charge when it comes to gold ETFs.
• Investors can breathe easy after investing in gold ETF as the returns are quite similar as compared to investing in physical gold and they need not worry about their gold being stolen.

• There are times when banks and jewelers refuse to buy back the gold coins and gold bars whereas the investor can easily sell off their gold ETF through broker at any point of time.

• If they go by the trend, whenever dollar is weak gold tends to go up thus purchasing gold ETF when dollar is sliding can give a good support to the investor portfolio and vice versa.

• While the investor invest on gold, they need to look for a locker or safe in a bank where they can keep the physical form of investment and end up paying locker fees annually for the purpose whereas there is nothing as such in buying a gold ETF.

• While the investor plan to resale their physical gold, some amount is deducted by the jeweler or the bank during the resale but in case of gold ETF this does not happen.

• Gold ETFs provide a lot of liquidity. The investor can purchase or sell them very easily. They prove to be good investment option for short term and medium term investors.

• There are chances that a jeweler can fool the investors but in the case of gold ETF, there is no scope of being cheated. These are pure and they are unlikely to be stolen.

• In physical gold there is a lot of scope for price disparity. The price will vary from jeweler to jeweler, bank to bank. So if the investor feels that it is not very good when it comes to bargaining then investing in gold ETF is the right choice for the investor.
• In comparison to physical gold, gold ETFs are more tax efficient.

• Gold ETFs are available in small denominations and that’s another benefit. When the investor thinks of investing in physical gold they cannot think of buying a gram or so. The one gold ETF stands for one gram of gold.

• Wealth tax comes into play when the investor holds more than a certain amount of physical gold. While in case of gold ETF there is no such tax applicable.

3.8.3 Disadvantages of Investing in Gold ETFs

• When it comes to gold ETFs the investors can redeem them only in terms of cash and not gold as they are gold contracts and derivatives.

• There are cases where capital gain tax breaks that are applicable to traditional exchange traded fund and not applicable when it comes to gold ETF.

• While trading the gold ETF the investors cannot ignore the demat account cost and annual maintenance cost.

• Before investing on gold ETF it is important for the investors to check the performance of the ETF.

• While invest in gold ETF the investors cannot ignore the market risks attached to them.

There is no doubt that gold ETFs have gained a lot of popularity and have an edge over the physical gold but nothing can be matched the satisfaction and happiness that the investors get when they hold that yellow piece of metal.
3.9. Factors influencing and reasons for repeated investment in gold ETF

Buying physical gold is very different from buying and owning gold ETFs, though one must admit that ultimately the value of both would remain the same, barring marginal differences. Remember if an investor buys, he own gold, whether it is Gold ETFs or physical gold, though the costs, mechanism to sell and tax implications differ.

- **Liquidity**: Investor can buy and sell paper gold very fast. All it takes is the click of a mouse or a phone call to the broker. Gold ETF units are freely traded on stock exchanges and they can execute the transaction at any time during market hours.

- **Transparency in pricing**: The price of paper gold is completely transparent. The price of an ETF unit is linked to the price of 1 gram of gold. There are no making charges or premiums involved. The investor has to pay only a small brokerage of 0.5%.

- **Capital gain and Tax efficiency**: Profits from gold ETFs and gold funds are treated as long-term capital gains and taxed at a lower rate (flat 10% or 20% with indexation) if the holding period exceeds one year. In case of physical gold, the holding period has to be three years before the profits are treated as long-term gains. Paper gold does not attract wealth tax (except e-gold).

- **Affordability**: Paper gold is suitable for investment purposes because it can be bought in small denominations of one gram. Some companies even offer 500 mg units. It is not possible to buy gold Jewels in very small denominations. The smallest ornament would weigh about 4-5 grams.
➢ **Assurance of purity:** There's no need to worry about the purity of gold while buying ETFs. Gold ETFs are required to hold equivalent quantity of gold bullion of 99.5% purity whereas in physical gold, the buyer has to ensure that they get the purity for what they had paid for.

➢ **Convenience and safety:** Physical gold can be stolen and therefore it needs to be stored in a locker. Gold ETF and e-gold units are held electronically in the demat form. The gold fund of funds can be either in the demat form or held with the custodian.

➢ **Conversion possible:** Paper gold can be converted into physical gold by re-materialization. Till now, e-gold was the only form of paper gold that allowed conversion to physical gold. Now, gold ETF units can also be exchanged for bullion.

The above mentioned are the factors which influence the investors for the repeated investments in the gold ETFs.

**Conclusion**

Now a day’s gold is an important investment option in the world. When world was facing the recession every stock market, countries economy was going down at that time gold show his real value as an investment option over mutual funds, stock market and many other investment. The factors effecting gold and gold ETF market as an investment option was discussed in the preceding paragraphs.

The general rule of thumb in the market is that gold is always attractive when all other investments are unattractive. As gold is negatively co-related to stocks, bonds, and real estate, gold is considered to be a safe haven and hence during any crises, investors would like to sell off
what they would term as risky investments and be invest the funds in gold. Countries which are primarily responsible for this growth are India, China, Italy, Turkey and the USA.

The demand for consumption of gold in Indian market for jewelry has been increasing year by year, especially during the marriage and festival seasons.

In the recent years the gold ETF was on surge and experiencing vast deals in venturing capital appreciation for the investors. Thus by accelerating the financial market through ETF can be a success for many investors.

An endeavor has been embarked on to study the socio economic profile of the sample investors with a view to analyses the influence and impact of various socio economic factors such as age, gender, education, marital status, religion, residence, educational qualification, occupation and income on investment habits towards gold ETFs and behavior of the investors by using regression, ANOVA and hypothesis.