

Gold for Portfolio Diversification

Possessing gold has been a mark of prestige ever since it was discovered, but now it has gradually turned into an important asset for investors looking to diversify their portfolio. Portfolio diversification is distributing one's wealth into different asset classes like cash, debt, equity, property, gold, art and so on. These asset classes have a certain return expectation and risk attached to it.

Portfolio Styles: The composition of various equity portfolios may differ across the category of stocks. For example, for some portfolios the investment universe may be restricted / focused on large-cap, mid-cap, small-cap or specialty stocks.

Personal financial plan, investment horizon, return expectation & risk profile of an investor should be taken into consideration while selecting the asset classes and diversifying the portfolio.

We need to look at gold as an essential part of your portfolio. Speaking about splitting your money into two buckets - equity and debt, a third one can be added- it is smaller than the other two and it is called gold. And you need a dash of gold in your portfolio for 3 golden reasons.

So, WHY GOLD?

Inflation hedge: Gold is a hedge against inflation. If stocks give good returns, debt products give predictable but low returns; gold's role is to protect your money against inflation or the continuous rise in prices year after year.

Diversification: A good portfolio is one that has assets that don't move up and down together. Gold does not move in tandem with either stocks or debt products. So we reduce the risk of a portfolio by adding gold to it. What this means is that by adding gold to your portfolio, at the same risk level, you get a higher return. A stock portfolio that had gold last year would have lost less than one which had no gold.

Liquid emergency funds: Gold acts as emergency money. Imagine if you were laid off and were looking at a 3-6 month period before you got another job. How would you pay your EMI and other expenses? The markets are down, to sell now would be to book huge losses. If you have gold in your portfolio, you can quickly liquidate gold to raise cash which you can use to tide over such emergencies.

Gold has been able to buy the same basket of goods and services over 400 years. What your great grandmother could buy with one gram of gold, you still can, we can't say the same for 100 rupees can we? How much gold?

5-10 per cent of your portfolio

Aim is diversification

can increase this in inflationary times to full 10 per cent

WHAT TO BUY?

There are several forms in which you can buy gold in . While jewellery might be most tempting, we recommend that you buy gold in one form- Gold ETF's or Gold Exchange Traded Funds.

What are GOLD ETFs?

These are funds that mimic gold prices closely; they are very much like your open ended mutual funds.

Gold ETF funds take your money, buy physical gold and then break value into units (one unit of the fund equals one gram of gold)

Units can be traded in stock exchanges, just like shares

Why Gold ETFs?

Cheaper to buy, hold and sell

Safer, as you do not have to worry about storing it in a safe place

Small units can be bought; minimum amount is just 1 unit that is one gram. So if Gold is 15,000 rupees per tola, you can buy for as little as 1500 rupees a unit of Gold ETF.

More liquid: you can buy and sell during market hours every day

COST OF HOLDING GOLD

There are three kinds of costs to look at when you buy a financial product. GOLD ETFs are better than bars or jewellery on all three counts. They are:

1. Buying cost: The maximum you will pay is 1.5-2.5 per cent as an entry ticket in a gold ETF; it can be as little as 40-60 basis points if you buy straight from a NSE broker. Bars cost 10-20 per cent of the price of gold , and jewellery has making charges of 15-20 per cent.

2. Maintenance cost: ETFs charge between .5 to 1 % only each year whereas the cost of insurance or jewellery and the rental charges on the bank locker could be much higher.

3. Selling cost: Brokerage of just 60 basis points to 1 per cent in the ETF. Exit is difficult from bars because banks don't buy it back and so you lose the premium. For jewellery - again you lose upto 30 per cent when you go to sell. So the clear evidence points towards including GOLD ETFs in your portfolio and we have some good ones out there for you to buy.

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An Investor Education Initiative



Mutual fund investments are subject to market risks. Please read the scheme information document carefully before investing.