

P E R S P E C T I V E

Ruling the Roost – Precious Metals



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Over the past decade, the growth that commodities have seen as a unique asset class is difficult to ignore. This commodity boom has given rise to a new class of investors who bet on price movements in commodities.

Commodities form the base of the production chain and investors prefer buying such resources or commodities directly over investing in the companies that are using them. Commodities are natural resources which are supplied without any difference in the quality across a market.

UP, UP & AWAY			
Commodity	Current Price (₹)	Returns in 2010 (%)	Outlook
Gold	20660/ten gram	24	Positive
Silver	47206/kg	72	Positive
Copper	434/kg	31	Positive
Aluminium	110/kg	9.5	Neutral
Sugar	2877/Quintal	26	Positive
Soy Oil	614/ten kg	40	Positive
Crude Oil	4111/barrel	15	Neutral

Source: Bloomberg, ETIG Database

Why Metals?

Precious metal prices are increasing in the wake of the insistent global crisis of confidence in paper. The appetite and the need for alternative hard assets have been increasing.

Investors are looking at them for long term profit. The metals market is relatively a stable market. The metal price is bound to stay high and will generally rise over time for the given reasons:

1. Metals are a hard commodity so they do not get spoiled and retain value for an prolonged period of time
2. Metals are not affected by weather change or delay in transport.
3. Metals are a rare resource and tend to get exhausted over time. Scarcity drives prices higher.
4. Metals add diversification to a portfolio and protect it against inflation

In this market there are chances of price bubbles as well as crashes. Historically, investors who have remained aloof to short term fluctuations in the price of gold, silver and copper have gained from such investment in the long term. However, investors who have not taken benefit of the spikes in the market run the risk of being too conservative.

Why Precious Metals?

By investing in precious metals the investor can reduce his portfolio risk, without reducing the average return of the portfolio. Of all the precious metals like Gold, Silver, Platinum and Palladium, Gold is the most popular. It has been used as a currency for more than 3000 years now.

The world's governments have crossed the point of no return by printing currency in abundance and taking huge debt. Few people trust the actual purchasing power of the currencies and the ability of the governments to provide for their high and staggering debt loads. The price of paper financial assets has been declining. Similar is the case with the values of currencies they are denominated in. In such situation, gold and silver seem to be the only refuge for anyone trying to preserve his wealth. Investors might prefer the small precious metals markets over the next few years which could result in a bull market where prices could rise by 300-500%. Newmont Mining (NYSE:NEM) believes gold prices to easily touch \$2,300 per ounce by 2012 and AngloGold Ashanti (NYSE:AU) expects gold would reach \$2,200.

Price Trends

Gold retains its value much better than other financial and currency backed assets. Supply and demand pressure is always there but volatility is comparatively lower.

The bull-run in gold which has been happening since the global financial crisis in 2008 is expected to stay in 2011. The global economy is uncertain and there is a growing demand to hedge risks on the investment front. This

reinforces gold prices should remain higher in the time to come. Gold has given returns of 25%. Given the weak economic scenario worldwide, the trend is likely to continue.

Investment Trends

The demand for gold as an investment was up by 26 percent on a YOY basis during the first quarter of 2011 as per The World Gold Council report. In China, demand for gold was more than that of the combined gold demand of the U.S., Germany, Italy, France, Switzerland, the U.K. and other European countries put together.

Investing in gold can be done in different forms. A few Gold Investing Methods are:

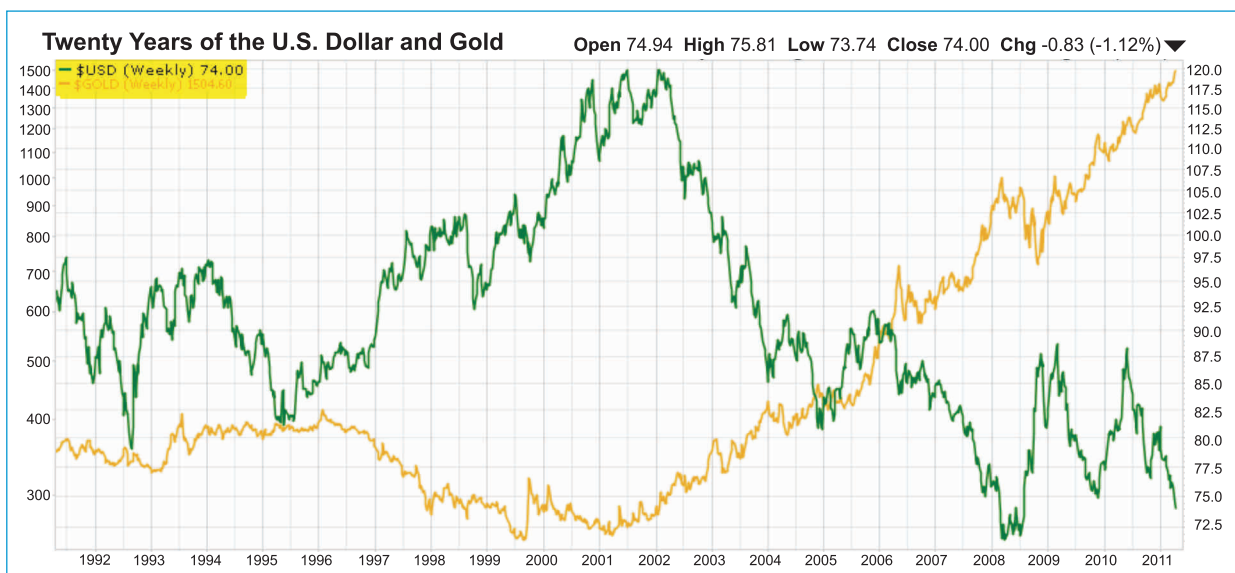
- Gold Bars: These are the most recognized method of investment in gold. However, it is least used by non-institutional investors.
- Gold Coins: Gold coins are another of the most recognized methods of investment in gold.
- Gold Certificates: Certificates represent an ownership of Gold that is stored in a Vault or held by Government.
- Gold Investment Accounts: Users of Gold Investment account are able to purchase

gold that are held in the account and can be bought and sold. Physical transfer is not required in this case.

- Exchange Traded Funds: Exchange Traded Funds, or ETFs, are traded in a manner similar to how mutual funds are traded on the common stock exchanges. There are fees charged that can cause an increase in the price of ownership.
- Gold Mining Stocks: Investors invest in the shares of the companies that engage in gold mining.

Economic Trends

The US owes approximately net \$3 trillion to overseas nations. This puts downward pressure on the USD. USA pays more interest on the debt on the country to overseas nation than the interest they receive in all. Low interest rates, inflation concerns and budget deficit have been contributing to low dollar value. As BCA Research puts it, “[gold] prices have benefited from a ‘perfect storm’ in recent months: falling real interest rates, a weak dollar, fears of a U.S. recession and/or debt default, and European stress.”



Source: www.stockcharts.co

The domestic economy has impact on the exchange rate of a country. International investors would prefer to invest in a country that can pay higher interest on their investments. FED has reduced its interest rate time & again. Countries like China, England, Russia and Japan hold vast reserves in foreign currencies and USD has reduced to just one of the many they hold. If the US economy continues to exhibit such a weak stand it would have a negative impact on USD which would in turn continue to plunge. This might result in many countries that hold USD as foreign currency reserves in selling it and replacing it with some other nation's currency, or with gold. Central banks also hold gold in their reserves to handle the situation in case there is a geopolitical tension or inflationary pressures start building up.

A short term reversal is very much possible both in case of USD and gold prices; however, overall USD and gold share an inverse relationship as is visible from the graph below.

Gold Market Trends

There are multiple trends that seem to ensure gold prices would be on an upward trajectory.

1. Inflation has been on a rise owing to the ongoing global stimulus initiatives and this is highly bullish for gold.
2. Gold being a limited resource, its price is bound to increase as the miners continue to extract less of the metal going forward.
3. In emerging economies, wages are on a rise and this has resulted in increase in disposable income.
4. Penetration of gold in the portfolio held by investors is limited and most of the investors have no exposure to commodities as an asset class.

Of the various investment avenues available to the investors, the concept of Gold Investment Account has gained popularity in the recent past. Banks offer two types of gold accounts - allocated and unallocated:

- **Allocated account**

This is the most secure way of investment in physical gold. The gold that an investor invests in is stored in a vault owned and managed by a recognized bullion dealer or depository. The bars or coins are numbered and are identified by hallmark, weight and fineness. These bars / coins are then allocated to investors. However, investors are supposed to pay the custodian for storage and insurance in addition to the price paid for the gold. The investor in this case has complete ownership of that gold. The bullion dealer or depository owning the vault where the gold is stored is not allowed to carry out any transaction (trade, lease or lend) on the gold unless directed by the investor himself.

- **Unallocated account**

In case the investor in investing in Unallocated account, he does not get any bar/ coin that is allocated to him in his name. However, the investor has an option of taking the physical delivery of the gold. The bank would not hold the gold on behalf of the investor. One advantage of unallocated account is that there is no storage and insurance charge as the bank has the right to lease the gold out.

Few banks that offer these accounts are:

- CIMB Bank – Gold Deposit Account (GDA)
- Maybank – Maybank Gold Investment Account (MGIA)
- Kuwait Finance House (KFH) – Gold Account – I (GAi)
- United Overseas Bank (UOB) – Gold Savings Account (GSA)
- Public Bank – Gold Investment Account (GIA)

Banking Phraseology

Most of the banks offer Gold / Silver Investment Account as a separate investment option and

not under wealth management. Even the retail customers have confidence in precious metals as an investment and more so because of the current market situation and the precious metals price trend. Banks either issue a passbook or a statement to enable investors to track their accounts. For most of the banks, the mode of payment accepted for purchase of precious metals are cash, debiting of current/savings account maintained with the bank or house cheque. Gold sale is based on the bank's prevailing gold "buying" price. Banks maintain both the buying rate as well as the selling rate. Depending upon the customer segment, category etc. there could be a provision for differential pricing as well. The withdrawal options available with the investor are cash or crediting of current/savings account maintained with the bank. Generally, these accounts are not interest bearing accounts. However, bank might choose to pass on interest component to the customers. The banks might also define the currencies in which the investor can transact.

Bank might choose to store precious metals in their own vault or they might have it managed by a depository. In that case the customer would have to pay the depository for storage and insurance.

Various types of fees that are applicable in these kinds of accounts are:

- Annual service fees
- Stamp duty fee on agreement
- Physical metal withdrawal
- Account closure fees
- Fee for failure of collection of physical gold ordered
- Annual administrative fees / holding fee / Storage Fee
- Replacement of lost / spoilt passbook
- Charged every time there is buy/sell
- Insurance fee

Key Points

1. Investment demand for bars and coins in Q2 2011 was 307.7 tonnes (value of USD 14.9 bn), due to the wide geographical base of demand. Year on year growth was primarily from the north western markets primarily from Asia and Middle East. This indicates that the investors in these regions accept gold as an investment even at high price levels and also anticipate further rise in price of the metal.
2. China, Vietnam, Indonesia, Thailand and South Korea are key gold consuming countries. Thailand recently launched a physical gold backed Exchange Traded Fund, which goes to prove the maturity of the market and change in the investment habits of the people.
3. With the increase in urbanization and also increase in disposable incomes, interest in investment in gold has been steadily increasing.

The above points go to prove the significance of gold as an investment opportunity and the changing customer preferences. Investors are more informed now and take logical investment decisions that help them get higher returns and with minimal hassles.

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