Is investing in gold a good idea?

Gold is the new favourite of the media. Pick up any newspaper or magazine and there are umpteen reasons listed in favour of investing in gold. Unfortunately, this could be just another instance of the media latching onto an idea whose time has already come and gone.

The last three years have seen a spurt in gold prices. Indeed, the performance has been impressive, especially given the fact that in the 1980s and 1990s gold turned in a poor performance. In 1980, the closing price of gold was $ 593.8 per ounce. The closing price in 2004, after a three year gold 'bull market', was $ 442.1 per ounce. This 'safe' investment surely did not live up to its image! Investors would have been better off keeping cash in a savings bank account!

The face off: gold vs other assets

	1 year	3 years	5 years
Diversified Equity Fund	40%	65%	22%
BSE Sensex	12.3%	26.5%	5.7%
Liquid Fund	5%	6%	7%
Gilt Fund	4.7%	11%	14%
Dow Jones (USA)	3.8%	2.7%	-1.1%
Income Fund	3.8%	9%	11%
Gold ($)	2.7%	17%	9.3%
Gold (in Rs)	1.5%	13.7%	9.5%

So this rally has come as a relief to the gold bulls, who were all but extinct. Back in year 2000/2001, few were recommending gold, when it was trading at about U$ 260 per ounce. Today however, after a 70 per cent rise in the price of gold, the interest in this commodity has only increased. Our advice to you, be realistic and invest in gold only to the extent it suits your risk/return profile.

The comparative table (Table 1) puts in perspective the returns generated by different asset classes viz. equity, debt and gold over different periods of time. It is important to note that during these different time periods, the stock and debt markets have been through at least one significant instance of erosion in value. Gold however, has pretty much had a steady run. Despite this, gold, purely from an investment perspective, does not compare well with the other avenues. Then, why the persistent interest in gold?

There are a few reasons for the same:

- The increasing uncertainty pertaining to the US economy and fear that the US Dollar will continue to weaken has led investors to move some money into real assets such as gold.
- Rising oil prices, coupled with high liquidity, have contributed to a rise in inflationary pressures globally. Inflation, simply put, is an erosion in the value of money and therefore in such times there is a strong case to move money into real assets such as gold.
- The threat of terrorist attacks has led investors to diversify into assets such as gold, which is considered to be a good store of value (an attack on the US may cripple the US economy and result in lower stock and property prices for example, but will not have a material impact on the price of gold).
- Then there is a belief that the long-term bull market for commodities, including gold, may just be taking off. This view has been underscored by a persistent rise in the prices of other commodities too.

Indeed, over and above these, there are 'emotional' reasons why you should have gold in your portfolio. But in such instances, the 'return' is really not that important.
In our view, gold is a "must" in every portfolio as it brings in an element of diversification. The price of gold is driven by factors, which are broadly speaking different from those that drive the price of other assets such as stocks. This results in what is generally seen as a contrararian

trend. To take an instance, even as stock markets corrected after the 9/11 terror attacks and the worsening economic outlook, the price of gold spurted.

Another argument in favour of gold is that from time to time, like all assets, it may present an attractive short-term investment opportunity (like in 1999 when it was undervalued by a significant margin). So if, and that is a big 'if', you can identify such an opportunity, an investment makes sense. Of course it is important that you square off the transaction when the price has corrected. Such a transaction would suit few investors as it involves a very good understanding of fundamentals as well as timing of the purchase and sale.

But having said that, gold should ideally not account for more than 5 per cent of your long-term investment portfolio. The reason is that in the long term it is likely that other asset classes, including equities and property, will outperform gold in terms of generating a return. While this may not hold true for economies like the US which are likely to slow down in the future, surely for investors in markets such as India, other investment avenues are more beckoning.