



**“GOLD IS WHERE YOU FIND IT..”**

*Adeel Shakir*

UBL Fund Managers Limited

A child finds a sparkly rock in a stream, thousands of years ago, and the human race is introduced to the Gold for the first time.

For centuries, Gold has enjoyed a symbol of status and wealth and rightly so. Since its discovery, no other asset class has appealed to the masses as much as the Gold. So what has caused this rush for Gold?

### History of Gold

Early civilizations equated gold with gods and rulers, and gold was sought in their name and dedicated to their elevation.

Egyptians performed the first melting of gold circa back in 3,600 BC. A thousand years later, gold jewellery appeared as the goldsmiths of ancient Mesopotamia crafted a burial headdress partially made from leaf-shaped gold pendants.

Following the advent of gold as money, gold's importance continued to grow. The British pound (symbolizing a pound of sterling silver), shillings and pence were all based on the amount of gold (or silver). Eventually, gold symbolized wealth throughout Europe, Asia, Africa and the Americas.

The United States government continued on with this gold tradition by establishing a bimetallic standard in 1792, which meant every monetary unit in the United States had to be backed by either Gold or Silver. But this gold standard did not last forever. During the 1900s, there were several key events that eventually led to the transition of gold out of the monetary system.

In 1913, the Federal Reserve was created and it started issuing promissory notes (the present day version of our paper money) that guaranteed the notes could be redeemed in gold on demand. The Gold Reserve Act of 1934 gave the U.S. government title to all the gold coins in circulation and put an end to the minting of any new gold coins. In short, this act began establishing the idea that gold or gold coins were no longer necessary in serving as money. And the United States abolished the gold standard in 1971 when the U.S. currency ceased to be backed by gold.

### Emergence of Gold as an asset class

The abolition of Gold Standard did not affect importance of Gold. It has grown as an investment class, having a stronger demand for use in jewellery, and even used in the manufacturing of certain electronic and medical devices. This isn't surprising - Gold has appreciated by a staggering 400 percent in the last decade or so – a testament to its growing demand.

Many professional and retail investors view investments in gold as a hedge against inflation and risks in the financial system and is widely considered a “safe-haven”. This can be witnessed if we analyze recent history of Gold. Last year Gold has grown by over 60% alone - a period marked by economic slowdown and financial crises. During the 1970s, another period characterized by economic slowdown, gold prices went up by an astonishing 2500%.

Knowing the importance of Gold, it has grown immensely as an investment class for virtually every genre of investors. So what are some of the factors that affect the prices of Gold and why one should consider Gold as part of their investment portfolio? Now is the time to learn about this form of investing so that you are prepared.

### Gold Production

Gold mining production increased by about 5.5% in 2011 to about 2,700 tonnes, as several new large-scale mines began operations. Despite this small increase, however, gold mining production has been in a decline since the early 2000s. The fact that gold is more challenging to access raises additional problems: the miners are exposed to additional hazards; in

short, it costs more to get less gold. These add to the costs of gold mine production, hence resulting in rising gold prices.

### Global Demand

The demand in jewellery and by industry continues to increase with India, China and the United States being amongst the largest consumers of gold for jewellery in terms of volume. Additionally, demand has increased over the recent years due to India's and China's (two of the biggest emerging economies) Central Banks diversifying their investment base by increasing their gold reserves.

While witnessing this global phenomenon, many investment firms are increasingly launching gold based investment products to give investors exposure to this unique asset class, causing further increase in global demand. To quote an interesting fact, SPDR Gold Trust, the biggest gold based Exchange Traded Fund in the world, holds more gold reserves (worth over USD 55 billion as at October 2011) than the Chinese Central Bank and is the 6th largest gold reserve holder in the world; just behind France and Italy.

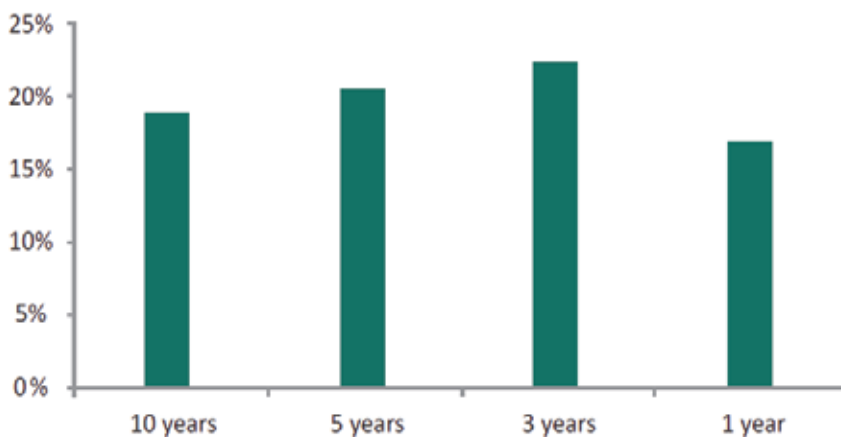
### Inflation and Currency Hedge

Gold has consistently proved to be one of the most effective assets in protecting against dollar weakness. If the world's main trading currency appreciates, the dollar gold price generally falls. On the other hand, a fall in the dollar relative to the other main currencies produces a rise in the gold price.

Gold's value, in terms of the real goods and services that it can buy, has remained remarkably stable for centuries. In contrast, the purchasing power of many currencies has generally declined, due for the most part to the rising price of goods and services. Hence investors often rely on gold to counter the effects of inflation and currency fluctuations.

### Gold - A consistent performer

Gold has delivered consistent returns in various time horizons as shown in the graph below.



*Source: Bloomberg Returns are in CAGR. Return of Gold in USD as on May 31, 2012. Past performance may or may not be sustained in future.*

### Central Bank Reserves

The World Gold Council has stated that Central banks have recently begun buying more gold than they are selling, the first time this has happened in two decades. As the central banks diversify their monetary reserves by accumulating Gold reserves the price of gold rises. Many of the world's nations have reserves that are composed primarily of gold, including the United States, Germany, Italy and France.

### Investing in Gold

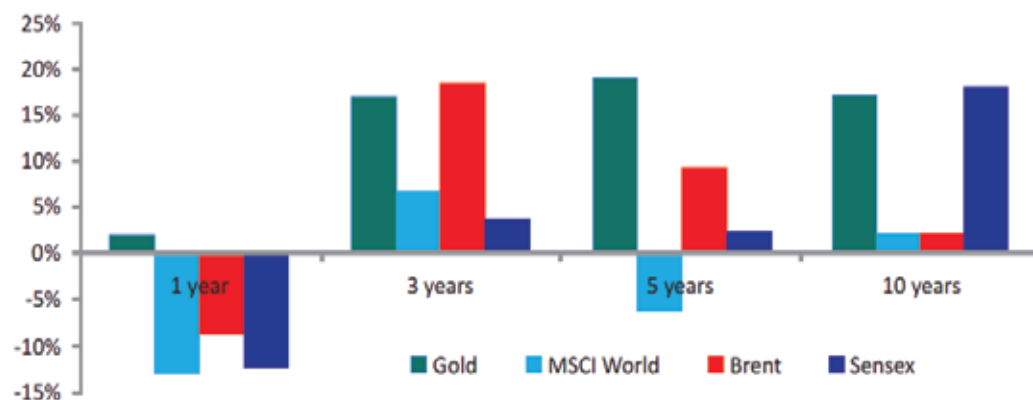
Investing in Gold serves as a great way of diversifying one's portfolio since historically, Gold has maintained low correlation with other asset classes like equity and bonds. It has low correlation with economic downturn in volatile times and is a



good hedge against inflation. Coupled with strong appreciation for over a decade, Gold has emerged as an important asset class for investments in one's portfolio. Most experts recommend gold holding of at least 5%-10% of your portfolio. However, as with every investment, investing in gold may also carry risks for the investor. The price risk, i.e. the likelihood that the gold investment will drop in value due to a decrease of the gold price, is the most obvious risk of a gold investment.

### Gold vs other asset classes

10 year returns of gold shows that it has performed relatively better than many asset classes.



Source: Bloomberg; Data in USD; Data as on May 31, 2012; Returns are CAGR. Past performance may or may not be sustained in future.

There are various ways of investing in Gold but the ultimate decision on the type of gold investment is based on a careful assessment of each option with regard to safety and cost implications. Following are some of the ways of investing in Gold:

- Gold-backed securities like Exchange Traded Funds (ETFs) or physical gold mutual funds.
- Non-gold backed securities such as gold index mutual funds (index trackers) or gold futures contracts.
- Physical Gold bars and Coins.
- Other forms of gold investments like gold certificates, gold accounts or gold trusts.

### Gold Exchange-Traded Funds

The investment objective of the Gold ETFs is to invest in physical Gold and Gold related instruments with the objective to replicate the performance of Gold in domestic prices. The ETF will adopt a passive investment strategy and will seek to achieve the investment objective by minimizing the tracking error between the Fund and the underlying asset. These securities offer investors a new, innovative, relatively cost efficient and secure way to access the gold market. All of the securities are backed by allocated gold held in a vault on behalf of investors. They are intended to offer investors a means of participating in the gold bullion market without the necessity of taking physical delivery of gold, and to buy and sell that interest through the trading of a security on a regulated stock exchange. The introduction of exchange-traded gold securities is intended to lower many of the barriers such as access, custody, and transaction costs, which have prevented some investors from investing in gold. The first gold exchange-traded product was Central Fund of Canada, a closed-end fund founded in 1961. It later amended its articles of incorporation in 1983 to provide investors with an exchange-tradable product for ownership of gold and silver bullion. It has been listed on the Toronto Stock Exchange since 1966 and the AMEX since 1986.

### Gold Mutual Funds

Mutual funds labelled as "gold mutual funds" are viewed as "specialty funds" because of their portfolio's focus on gold mining stocks, though some do own small amounts of gold bullion. Typically included are mutual funds that pursue capital appreciation by investing primarily in equity securities of companies engaged in the mining, distribution, or processing of gold and other precious metals. Most gold mutual fund portfolios concentrate on gold mining stocks, but some have significant exposure to silver, platinum, and base metal mining stocks as well.

Gold mutual funds often concentrate investments in smaller companies and foreign securities, with mining and exploration risks of precious metals. So, gold mutual funds are riskier and more speculative than general, diversified funds.

### Gold investments in Pakistan

Gold is culturally ingrained into our lives – Gold is used for weddings and also as gifts and has also been a traditional means of storing wealth in Pakistan. Due to cultural value attached to gold, people generally prefer investing in Gold by purchasing gold jewelry or gold bars/coins. However, with emergence of Pakistan's first-ever commodity exchange, Pakistan Mercantile Exchange Limited (PMEX), we also see sophisticated investors moving to the commodity exchange for gold exposure.

Development of the commodities market have also paved a way for the mutual fund industry of Pakistan to explore developing gold based investment schemes for investors who would like to have exposure to the yellow metal at an affordable cost.

### Conclusion

Gold has played many roles in the lives of people as well as nations. It had brought riches and fame to some and at the same time, the lust for it has been the demise of many as well. Nations have also gone to war because of this metal.

With the stock markets in disarray, gold prices have been moving upwards with the demand for the traditional safe haven very strong. The consistent rise in gold prices over the past few years have led to a growing interest of investors in gold exchange traded funds (ETFs) and Gold mutual funds. Gold funds are a valuable tool for investors and those wishing to hedge against geopolitical instability. Gold is also valuable as a bet against a falling currency.

Gold funds are typically attractive for those who want to take the benefit of rupee cost averaging principle through a systematic investment plan. However, for those who are actively involved in the market as traders and not as long-term investors, this may not work because the net asset value (NAV) of the fund at which the fund sells the units is based on the closing NAV calculated based on the closing price of the gold on that day. Therefore, for active traders, gold ETFs provide an opportunity to benefit from sudden price movements of gold as the prices of gold ETF reflect the value of the underlying gold on real time basis rather than on the closing price of the gold that day.

With everything said and done, Gold has indeed maintained its precious value over the course of history and it goes without saying that Gold will continue to fascinate us just like the child who discovered this shiny rock thousands of years back.

