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PERFORMANCE OF GOLD ETFs AND GOLD FoFs: A COMPARATIVE STUDY

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Abstract

Gold products are considered a highly valuable means of investment in the present scenario of financial markets. There are many alternatives to invest in gold like Gold Exchange Traded Funds (GETFs), Gold Fund of Funds (GFoFs), e-gold, stocks of gold mining companies, gold futures, gold bars, gold coins, gold jewellery, etc. Amongst these, the Gold Exchange Traded Funds (ETF) and Gold Fund of Funds (FoFs) have emerged as the most successful source for investment and ETFs industry has witnessed rapid growth in the last decade. The Gold ETF and Gold FoF provide a convenient way to the investors to intervene in the gold market. This paper attempts to compare the performance of Gold Exchange Traded Funds and Gold Fund of Funds. Return and risk of Gold ETFs has been compared with the return and risk of Gold FoFs. Monthly Net Asset Values (NAVs) for the period from March 2011 to March 2014 were used for both the schemes. The study concluded that the Gold ETFs recorded lesser variability as compared to the Gold FoFs and therefore, the performance of Gold ETFs was better than the performance of Gold FoFs.

***Keywords*:** Gold ETFs, Gold FoFs, Risk-Return, Net Asset Value.

***JEL Code*:** G10, G11, G14, G15

1. Introduction

In the current economic environment, low real yields around the globe force the investors to look for additional or alternative sources of investment for return. However, uncertainty and market volatility have increased the importance of risk management. A distinct allocation to gold within a portfolio, including alternative assets such as private equity, hedge funds, real estate and commodities, can preserve capital and reduce risk without diminishing long-term returns, concludes a research from the World Gold Council **(WGC, 2011)**. The report suggests that even if investors hold alternative assets, they are no substitute for the protection that a distinct allocation to gold can offer.

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Findings demonstrate that portfolios with an allocation to gold between 3.3% and 7.5% (depending on the risk tolerance of the investor and the currency of reference) show higher risk-adjusted returns while consistently lowering Value at Risk (VaR).

Gold ETF has emerged as a strong asset due to fluctuating equity market, weakening of Indian rupee against US dollar and growing uncertainty of global economy. Gold ETFs provide the opportunity to institutional investors as well as to small investors, to make investment in gold through ETF scheme **(Vidhyapriya, P and Mohanasundari, M. 2014).**

The demat form of gold investment options viz. Gold Futures, Gold ETFs, Gold FoF and E-gold are better than the physical form of gold. An investor can make investment in any demat form of gold investment options as there is no significant differences in the return of the various demat form of gold investment options **(Prashanta Athma and Suchitra K, 2014).**

A direct investment in gold bullion is difficult for many investors due to high storage cost and the lack of a liquid exchange for gold bullions. In order to gain exposure to gold, investors can alternatively trade in various instruments such as Gold Futures, Gold Exchange Traded Funds (ETFs), Gold Fund of Funds (FoFs) and e-Gold.

2. Review of Literature

Lixia Wang et al (2010) explored the developments of gold exchange traded funds and future prospects, specifically in China. The research concluded that the investments in Gold ETFs in China are significant. The launch of Gold ETFs will improve the China's ability to deal with problems such as diversification, inflation protection and currency hedging.

Gallagher and Segara (2011) examined the performance and trading characteristics of classical exchange traded equity funds on the ASX (Australian Stock Exchange). The study concluded that classical ETFs in Australia provide investors with returns commensurate with the underlying benchmark before costs and these instruments incur lower tracking error relative to index managed funds. The variation between Net Asset Value (NAV) and traded price for ETFs is small and does not occur with high frequency.

Prashanta Athma and Mamatha B. (2012) found that the introduction of Gold ETFs and growth in the prices of gold have led to the increased performance of the ETFs compared to Index Funds. ETFs can become the best investment alternative if awareness is created among the investors.

Jalpa Thakkar et al (2013) proposed to understand investors' attitude and awareness regarding gold investment decisions. The study found that investors go through an information search and market analysis before making the gold investment decision. Research also throws light on the lack of awareness about the new trends in gold investment alternatives i.e. Gold ETF, E-Gold and Gold Funds.

Jayanthi, M., Malathy, S and Radhulya, T (2013), found that very often the net asset value of the gold ETF gives a skewed picture. It does not accurately reflect the movement in underlying gold prices. Hence Gold ETFs turn out to be a good investment option for investors to hedge their assets against the uncertain global market scenario.

Fons Bok (2012) wanted to find if there was a better risk-return trade-off than a physical backed gold ETF compared to other precious metal ETFs and if there was another precious metal than gold that could be considered as a safe haven. Other metals that are considered precious are silver, palladium and platinum. The study concludes that although sometimes there is a better risk-return trade-off between other precious metal ETFs and gold ETFs, there is no better overall risk-return trade-off with other precious metals ETFs. Hence, the precious metals like silver, platinum and palladium can not be used by investors as a safe haven.

Beyers Bosman (2011) argues that the advent of gold ETFs does take away some of the unique appeal that gold stocks previously held. The gold ETFs are a different type of investment from gold stocks and gold ETFs appear to have more investment appeal. The findings suggest that the impact of gold ETFs on analysts' recommendations is substantial and investing in gold ETFs can be an attractive alternative way of participating in gold price movements with lower risk than gold stocks.

Dirk G. Baur (2013) found that gold ETFs were more liquid than its underlying physical bars and coins and this liquidity fluctuated through time and depended on the structure of the ETFs. It was concluded that gold ETFs were partially responsible for the strong hike in the gold prices between 2002 and 2011. There was high volatility in gold price because of the ease of trading facilitated by gold ETFs.

3. Statement of the Problem

Gold ETFs and Gold FoFs emerged as innovative liquid flexible products for investors for their viable alternative investment. The investors' preferences led to the growth of index funds, making providers the world's largest asset managers (Gerasimos, 2008). An investigation into the existing literature reveals that most of the research, carried on Gold ETFs and ETF industry, is growing and becoming popular investment product but there is relatively no research on Gold Fund of Funds (FoFs), which is also an emerging asset class. Therefore, this study was undertaken to compare the performance of Gold ETFs and Gold FoFs to find out which of these two performed better in the given study period.

4. Need for and Importance of the Study

Gold ETFs and Gold FoFs are increasingly popular investments among investors. As per the data available from the Association of Mutual Funds in India (AMFI), Assets under Management (AUM) of Gold ETFs has shown a growth of 1858% since its inception in 2007 and AUM of Gold FoFs has shown a growth of 3662% since inception in 2011. These two products' immense growth since their respective years of inception in India, prove that both corporate and retail investors value the advantages associated with these products.

According to AMFI, the AUM as on March 31, 2014, for total ETFs stood at Rs.13,204 crores, of which AUM for Gold ETFs stood at Rs. 8676 crores, this comprises 66% of the total ETFs AUM and the remaining 34% is that of other ETFs. As on March 31st, 2014, AUM of Gold FoFs stood at Rs. 3812 crores, which is 44% of the total AUM of Gold ETFs. It is imperative from these figures that the Gold ETFs and Gold FoFs have emerged as the most successful innovation for investment in gold and ETFs industry has shown a rapid growth in the last decade. The Gold ETFs and Gold FoFs provide a convenient way to the investors to intervene in the gold market. The purpose of this study is to analyze the performance of Gold ETFs and Gold FoFs. The study was designed to serve as a tool for investors searching for the opportunities in gold investment.

5. Objectives

The objectives of the study are:

1. To study the growth of Gold ETFs and Gold FoFs.
2. To compare the performance of Gold ETFs and Gold FoFs.
3. To critically appraise Gold ETFs and Gold FoFs.

6. Data and Methodology

This study was based on secondary data. The data were collected from various published sources which included research articles, Association of Mutual Funds in India Reports (AMFI) and relevant company websites. In this study, risk and return of Gold Fund of Funds (FoF) was compared with the risk and return of Gold ETFs. Simple statistical tools like Averages, Standard Deviation and Co-efficient of Variation were used. As Gold FoFs were launched in India in early 2011, only those schemes which were launched during the same period (i.e. February & March 2011) were considered for the study such as schemes of Reliance Gold Fund of Fund and Kotak Gold Fund of Fund. The same fund houses' scheme of Gold Exchange Traded Funds was also studied. Monthly Net Asset Values (NAVs) for the period March 2011 to March 2014 were used for both the schemes.

The study was limited to only the Indian mutual fund industry. As Gold FoFs were introduced in 2011 in India, the period of study covered three years from March 2011 to March 2014.

7. Modus Operandi of Gold ETFs and Gold FoFs

Gold Exchange Traded Funds (ETFs) and Gold Fund of Funds (FoFs) are mutual fund products. Gold ETFs are similar to equity shares and they are listed and traded in the stock exchanges whereas Gold FoFs are mutual fund schemes.

A Gold Exchange-Traded Fund is an exchange-traded fund that aims to track the price of gold. Gold ETFs are units representing physical gold which may be in dematerialized form. These units are traded on the exchange like a single stock of any company. Gold ETF's 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 participation through the trading of a security on a stock exchange (NSE).

Gold Fund of Funds is an open ended scheme that invests predominantly in the units of Gold Exchange Traded Fund. The fund house pools the money from the public and invests them in ETFs. The scheme seeks to provide returns that closely replicate the returns provided by the Gold Exchange Traded Scheme. Gold FoFs do not require a DEMAT account and its key benefit is availability of Systematic Investment Plan (SIP).

8. Growth of Gold ETFs and Gold Fofs In India

Globally, in May 2003, the first Gold Bullion Security was launched in Australia. In Nov 2004, the World's first Gold ETF - Street Tracks Gold Trust was launched. Benchmark Mutual Fund was the first Asset Management Company (AMC) to launch a Gold ETF in India, "GoldBeEs", in February 2007. Reliance Mutual Fund was the first to launch Gold FoFs in India, in February 2011. There are over 44 mutual fund companies present in India. As of today, 14 fund houses offer Gold ETFs (Table 1) and 11 fund houses offer Gold FoFs (Table 2). Indian Mutual Fund industry has seen a rapid growth over the last decade and the Indian Gold ETF market witnessed a significant development. As per the data available with industry body, the Association of Mutual Funds in India (AMFI) and the Assets Under Management (AUM) of the Gold ETFs witnessed increasing trade substantially from Rs.96 crores in March 2007 to Rs.8,784 crores in December 2013, representing 1% of the mutual fund industry AUM.

The graph **(Fig 1)** displays that in a span of three years, the Gold ETF corpus grew 1.97 times from Rs.4400 crores as on March 2011 to Rs.8676 crores as on March 2014, whereas the Gold FoFs **(Fig 2)** corpus grew

36.65 times in a span of three years from Rs.104.1 crores as on March 2011 to Rs.3812 crores as on March 2014.

Rising spot gold prices and growing awareness about gold investments among the retail investors, triggered such a growth in these schemes during these years. Total traded volume in Gold ETFs also witnessed a rise on the National Stock Exchange (NSE), a daily average of Rs.25.92 crores in 2013, Rs.25.44 crores in 2012, Rs.41.09 crores in 2011 and Rs.14.43 crores in 2010, which indicate the healthy volume in the Indian Gold ETFs industry (HDFC Securities, 2014).

The total Assets Under Management (AUM) of Gold ETFs, as of March 2011, stood at Rs.4400 crores while the AUM of Gold FoFs was at Rs.104.1 crores. The total AUM of Gold ETF by March 2012 was Rs.9886 crores, which is an increase in inflows by 124.68% while AUM of Gold FoFs was Rs.3510.2 crores, an increase in inflows by 3275%. The total AUM of Gold ETF by March 2013 was Rs.11648 crores, an increase in inflows by 17.82% while AUM of Gold FoFs was Rs.4474.1 crores, an increase in inflows by 27.46%. The total AUM of Gold ETF by March 2014 decreased to Rs.8676 crores, there were outflows to the extent of 25.52% while total AUM of Gold FoFs also decreased to Rs.3812 crores, an outflow of 14.8%. These outflows were due to the downslide of spot gold prices and weakening investor confidence.

The AUM of these two schemes was at the peak by March 2013. One of the reasons that could be attributed to the growth of Gold ETFs was the introduction of Gold FoFs in the year 2011 **(Figures: 1, 2 and 3),** which gained immediate investor attention due to its exclusive facility of Systematic Investment Plan (SIP) and non-requirement of a DEMAT account. Gold FoFs witnessed a greater rate of inflows, 3275% and 27.46%, than that of Gold ETFs, 124.68% and 17.82%, during the period 2012 and 2013 respectively. With regard to the outflows, Gold ETFs were at a greater rate (-25.52%) than that of Gold FoFs (-14.8%) by March 2014 and the same is reflected in Fig 3.

9. Results and Discussion

The **Table 3** reveals that in terms of risk and return, the performance of Gold ETFs as well as Gold Fund of Funds was sliding down year by year. To make a comprehensive comparison of these two schemes, Coefficient of Variation (CV) was used.

The coefficient of variation allows investors to determine how much volatility/risk they are assuming in relation to the amount of expected return from an investment. Lower the ratio of risk to the mean return, better risk-return trade-off. If the expected return is negative or zero, the ratio will not make any sense.

From **Table 3** it is observed that even though Gold ETFs and Gold FoFs generated almost identical returns over the three years, under study the Coefficient of Variation (CV) of Gold ETFs was relatively at a lower side. As seen in the Tabulation, Reliance Gold ETF CV was 6.89%, 63.25% and 59.70% during 2011, 2012 and 2013 respectively whereas CV of Reliance Gold Fund was 20.31%, 97.90% and 62.92% in 2011, 2012 and 2013 respectively. Kotak Gold ETF CV is 7.01% and 62.67% in 2011 and 2012 respectively where as CV of Kotak Gold Fund was 7.40% and 67.58% in 2011 and 2012 respectively. In both the cases, CV of Gold Funds was higher. This signifies that the returns of Gold ETFs suffered lesser volatility/variability than Gold Funds and hence the performance of Gold ETFs was better than that of Gold Funds.

10. A Critical Appraisal of Gold ETFs and Gold FoFs

If investing in gold is to protect portfolio from the vagaries of the equity or even debt markets, then Gold Exchange-Traded Funds or

Gold Fund-of-Funds are better bets than jewellery or coins. These products closely mirror gold prices and provide good liquidity, saving the investor from the hassle of safekeeping physical gold and hunting for a buyer when you need money. But these two are different and each one suits differently to different needs of investors.

Gold ETFs are traded on a platform of stock exchange whereas gold funds are purchased directly from the mutual fund. Currently, there are fourteen Gold ETFs listed on the stock exchanges in India and their traded volumes on the stock exchanges are not significant except that of Goldman Sachs, SBI, Kotak and UTI **(Table: 4)**. The size of the volume traded decides the degree of liquidity of any investment and therefore, low traded volumes of Gold ETFs will hamper the liquidity of the investment. In the case of Gold Fund of Funds, investors can redeem the units from the mutual fund at any time and based on the payment cycle, they will get back their money. This ensures that they are able to get their capital back whenever they want.

According to Securities and Exchange Board of India (SEBI), Gold ETF fund houses should invest about 90-100 per cent of their corpus in physical gold and the rest being in debt securities/ money market instruments whereas in Gold FoFs, fund houses pool money from the public and in turn, invest in gold ETFs from their own stable. For example, Kotak Gold FoF will invest in units of Kotak Gold ETF. They invest about 90-100 percent of their corpus in the underlying ETF and the rest in debt securities/ money market instruments.

A demat account is required with a broker in case of investment in Gold ETFs whereas Gold FoFs do not require this. Thus a larger population would find it convenient to invest in gold funds which provide investment in mutual funds without having a demat account rather than in gold ETFs.

Gold funds provide the benefits of Systematic Investment Plan (SIP) where investors can invest a fixed sum of money every month in units of gold fund, sailing through the highs and lows of gold. SIP ensures that an investor can buy fewer units when the prices are high and more units when the prices are lower. This way, Gold FoF facilitates better average cost of purchase, known as 'rupee cost averaging'. This benefit is not available for investments in gold ETFs, as investors can only buy a fixed quantity of units of gold ETF at varying prices.

The underperformance of Gold FoF is because the underlying ETF is not traded in accordance with its NAVs. SEBI rules say that a Gold FoF can be invested only in ETFs from its own fund house. If the gold ETF is quoting at a discount to the NAV, the fund manager should buy from the exchange instead of going through the creation of units.

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 price of the gold on the previous day. However, 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 price of the gold yesterday **(Balwant Jain, 2011).**

Tax implications on Gold ETFs and gold funds are the same as those on debt mutual funds. A unit of a Gold ETF or gold fund that is held for less than twelve months is treated as a short-term capital asset. Gains on the same are taxed at investor's marginal rate of tax (i.e. as per income slab). Units held for more than twelve months are treated as long-term capital assets and would be subject to long-term capital gains tax at 20% (after allowing for indexation benefit) or 10% (without indexation benefit), whichever is less.

11. Findings

The study findings (see Tables: 1,2,3,4 and Figures 1,2,3) are as follows.

1. The returns from Gold ETFs and Gold FoFs are almost identical (Table-3).
2. Gold ETFs are very attractive investment destination for investors who want to access the bullion market through stock markets.
3. Gold ETFs and Gold FoFs are available in smaller denomination, which allows for easy asset allocation and portfolio diversification.
4. Even though Gold FoFs are late entrant into the market, they give good competition to Gold ETFs.
5. There is a gradual increase in awareness among the investors about the Gold ETFs and Gold FoFs.

12. Suggestions

1. As Gold ETFs and Gold FoFs are less risky in comparison to investment in physical form of Gold in terms of security and purity, there should be new policies from SEBI and new schemes from the fund houses to mobilize the idle gold held by the households.
2. There should be more efforts from the mutual fund houses to increase the awareness momentum among investors in general about investment in gold products.

13. Conclusion

Tim Pullen et al (2011) found that the gold stocks, gold funds and gold ETFs tend to be diversifiers. Another finding was that both gold bullion and gold ETFs show support for the safe haven property. However, gold stocks and gold funds display very little evidence of the safe haven characteristic. They concluded that investors, who are keen on securing safe haven features of gold investment, cannot generally rely on gold stocks or mutual funds. Instead they need to take positions directly in bullion or gold ETFs.

The gold ETFs have lesser variability as compared to the physical gold and hence the performance of gold ETFs is better than the performance of physical gold (Vipin Kumar Aggarwal et al, 2013).

This study has compared the performance of Gold ETFs and Gold FoFs. The empirical results conclude that as Gold ETFs have lesser variability than Gold FoFs, Gold ETFs record a better performance than Gold FoFs.

An investor looking to make a lump sum investment in gold and at the same time, want to trade on the exchange, then Gold ETF is an ideal investment option. But holding a demat account is the pre-requisite to invest in Gold ETF and the investor should bear the demat account charges levied by his broker.

However, investors not having a demat account, but still wish to invest in gold the unconventional way, then gold funds is the appropriate investment option. Gold funds is a cost effective option for investing in gold in a paper form because there are no annual charges of holding a demat account. Moreover, gold funds apart from lump sum investing, offer the Systematic Investment Plan (SIP) mode, which is an effective and convenient way of investing regularly in gold. It is the investor's responsibility to work out his risk-appetite to reap the best returns.

14. Scope for Further Research

This study has compared the performance of Gold ETFs and Gold FoFs in terms of risk and returns. There is a lot of scope for further research. New studies can be undertaken with respect to the impact of liquidity and volume traded of Gold ETFs on Gold FoFs.

Gold derivatives traded on commodity exchanges are relatively less explored and research can be directed in this area also.

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Table 1- Gold ETFs listed on National Stock Exchange

S.No.	*Gold ETF Schemes*	*Launch Date*
1	Goldman Sachs Gold ETF	23-Feb-07
2	UTI Gold ETF	12-Mar-07
3	Kotak Gold ETF	04-Jul-07
4	R* Shares Gold ETF	01-Nov-07
5	Quantum Gold ETF	08-Feb-08
6	SBI Gold Exchange Traded Scheme (GETS)	28-Apr-09
7	Religare Invesco Gold ETF	23-Feb-10
8	HDFC Gold ETF	23-Jul-10
9	ICICI Prudential Gold ETF	27-Jul-10
10	Axis Gold ETF	03-Nov-10
11	Birla Sun Life Gold ETF	09-May-11
12	IDBI Gold ETF	02-Nov-11
13	Canara Robeco Gold ETF	16-Mar-12
14	Motilal Oswal MOSt Shares Gold ETF	16-Mar-12

Source: *Compiled from data given in www.moneycontrol.com*

Table 2 - Gold FoFs

S.No.	*Gold FoF Schemes*	*Launch Date*
1	Reliance Mutual Fund	14-Feb-11
2	Kotak Mahindra Mutual Fund	04-Mar-11
3	Quantum Mutual Fund	28-Apr-11
4	SBI Mutual Fund	22-Aug-11
5	Axis Mutual Fund	30-Sep-11
6	ICICI Gold Fund	04-Oct-11
7	HDFC Mutual Fund	07-Oct-11
8	Religare Mutual Fund	15-Nov-11
9	Birla sun life Mutual Fund	01-Mar-12
10	Canara Robeco Mutual Fund	04-Jun-12
11	IDBI Mutual Fund	25-Jul-12

Source: *Compiled from data given in www.moneycontrol.com*

Table 3: Performance of Gold ETFs and Gold Funds

Period	*Reliance Gold ETF*			*Kotak Gold ETF*		
	Returns	*Annualized Risk*	*CV*	*Returns*	*Annualized Risk*	*CV*
Mar 2011-Feb 2012	2.79	19.23	6.89	2.79	19.57	7.01
Mar 2012-Feb 2013	0.12	7.59	63.25	0.12	7.52	62.67
Mar 2013-Feb 2014	0.47	28.06	59.70	-0.29	26.36	-90.9
Period	*Reliance Gold Fund*			*Kotak Gold Fund*		
	Returns	*Annualized Risk*	*CV*	*Returns*	*Annualized Risk*	*CV*
Mar 2011-Feb 2012	1.32	26.81	20.31	2.64	19.54	7.40
Mar 2012-Feb 2013	0.081	7.93	97.90	0.12	8.11	67.58
Mar 2013-Feb 2014	0.343	21.58	62.92	-0.16	21.2	-132.5

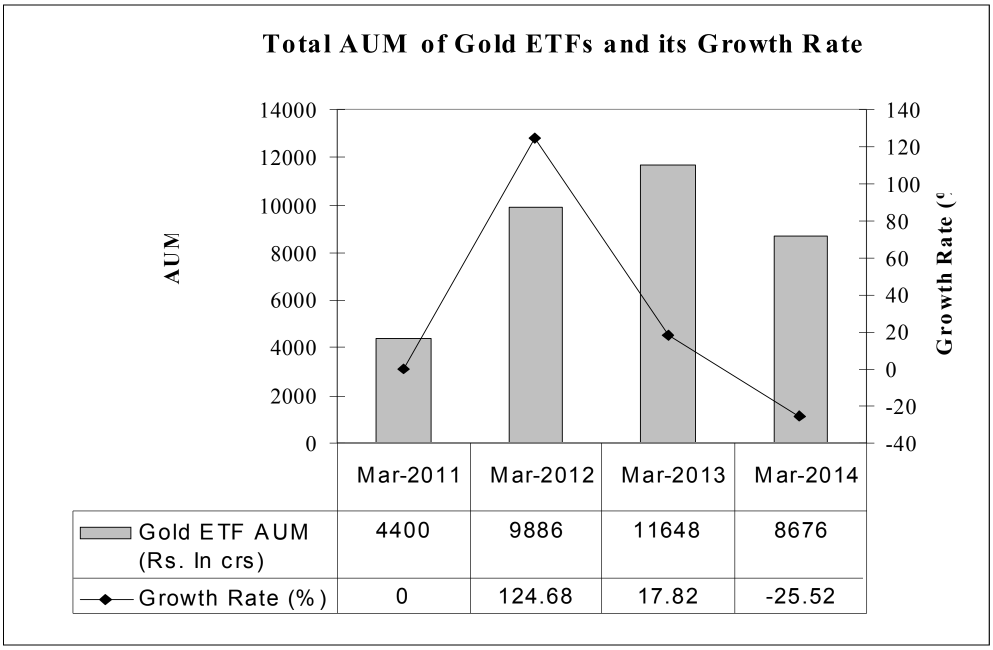
Source: Compiled from the Data given in www.amfiindia.com, www.reliancemutual.com and www.assetmanagement.kotak.com

Table-4: Volume Traded of Gold ETF Schemes on National Stock Exchange (Feb 2015)

S.No.	*Gold ETF AMC*	*Volume('000s)*
1	Goldman Sachs	14.51
2	SBI	8.78
3	Kotak	8.39
4	UTI	2.51
5	HDFC	1.79
6	Motilal Oswal	1.02
7	Reliance	0.74
8	ICICI	0.39
9	Quantum	0.28
10	Axis	0.17
11	Birla Sunlife	0.05
12	IDBI	0.03
13	Religare	0.02
14	Canara Robeco	0.001

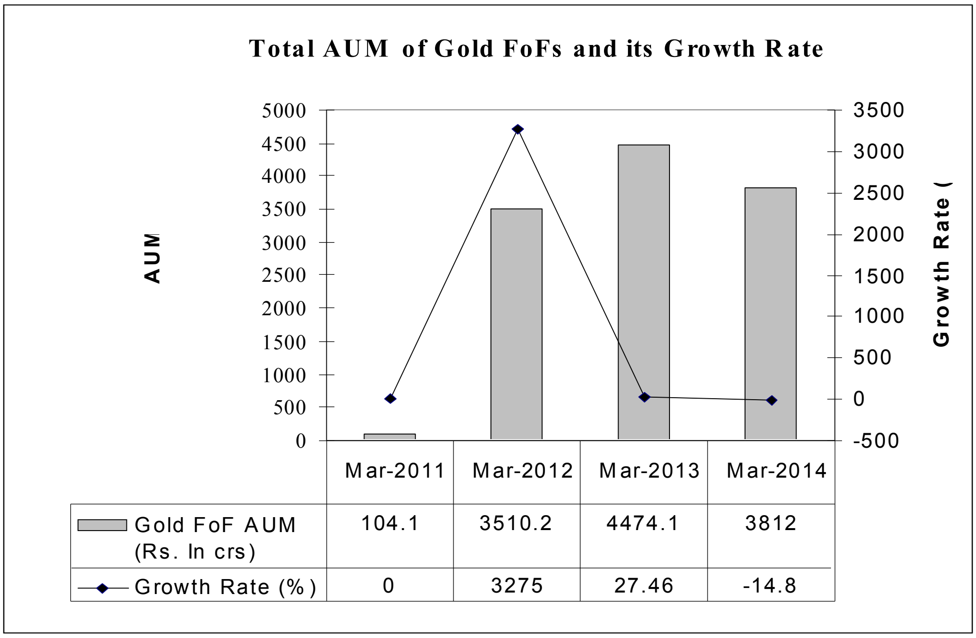
Source: National Stock Exchange

Figure-1: Growth rate of AUM of Gold ETFs



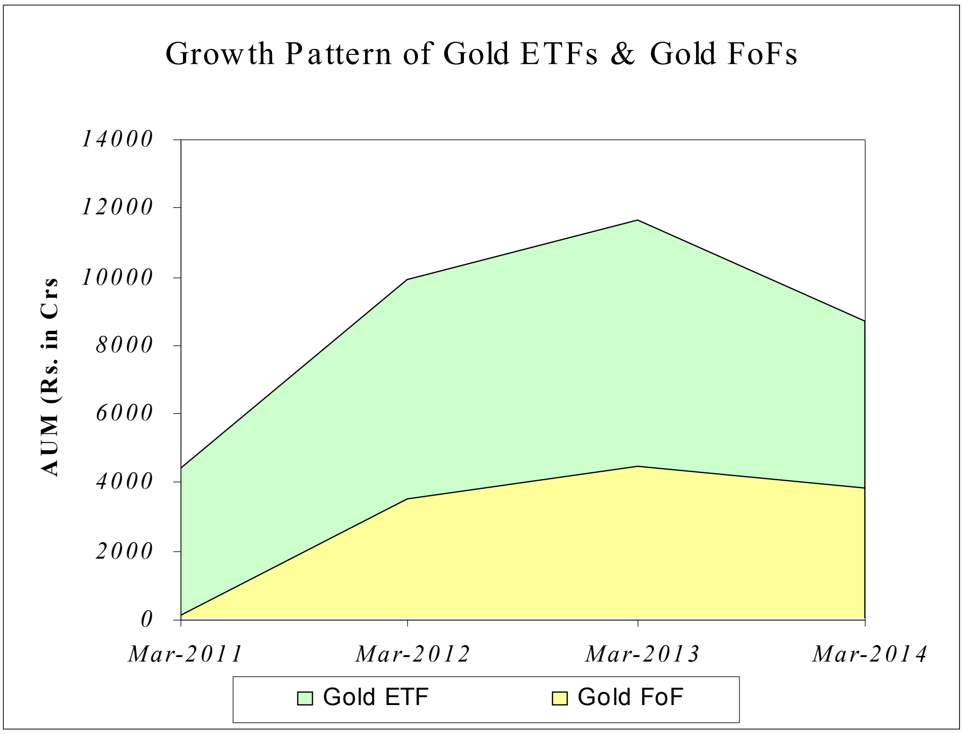
Source: *Compiled from the data given in www.amfiindia.com & www.moneycontrol.com*

Figure-2: Growth rate AUM of Gold FoFs



Source: *Compiled from the data given in www.amfiindia.com & www.moneycontrol.com*

Figure 3: Growth pattern of Gold ETFs and Gold FoFs



Source: *Compiled from the data given in www.amfiindia.com & www.moneycontrol.com*