Gold and Investor’s Perspective in Different Market Conditions

Purav Parikh\textsuperscript{1} and Anurika Vaish\textsuperscript{2}

\textsuperscript{1,2}MBA & MS-CLIS Department, Indian Institute of Information Technology, Deoghat, Jhalwa Campus, Allahabad (U.P), INDIA.

Abstract

Demand for Gold as an investment commodity has been always seen by the investor’s, as a most preferred investment since centuries. The focus of investment amongst the investor’s have changed recently and they are investing into Gold not for the sake of hoarding the commodity as traditionally been observed, but also as the part of the risk mitigation strategy in their investment portfolio. In this light, the research paper provides an analytical perspective from the investor’s point of view. The paper helps in enlightening the reader with the findings published by reputed journals and institution on the various inflationary market conditions such as Baseline Inflation, Deflation, Stagflation and High Inflation. How the financial markets in emerging as well as developed economies of the world, react, in order to sustain the economic losses due to these conditions is well explained in this paper. At the same time, what is the impact on the Gold within the various inflationary conditions is also shown with an analytical perspective.

\textbf{Keywords:} Gold Investment, India, Market risk, Investment Portfolio, Risk Mitigation, Intrinsic Value.

1. Introduction

India is a land of different cultures and sub-cultures, customs, religions, food and ethnic dress preferences. With culture and tradition, a deep affection for gold and a thrust for accumulating it have the traces back in the history of the nation from many centuries. It is the only commodity which is universal across the length and breadth of
the country. It is observed (WGC 2010) that every class of the Indian society, whether its urban or rural investor, would prefer to possess it or make savings to purchase it in their life span. The obvious reason for this is that possessing gold for Indians is more to do with the sign of purity, prosperity and good luck in their lives.

Pattanaik (2010), observed in his study, there are two main reasons for Indian community being so much passionate about the Gold. He defined it in terms of ‘Logical’ and ‘Cultural’. In logical terms, as he explained in his research study, gold being a tangible asset is also a portable investment. In addition, it is also a beautiful ornament, which could be worn on daily basis. This is not the case with the investments such as shares, bonds or real estate for that matter. On the other hand, as he explains the Cultural significance of Gold, he observed that Indians tend to believe that Gold is very auspicious as well as a sacred metal. In addition, every Indian also considers Gold as divine, whereas Hindu community also considers it as a symbol of their goddess called ‘Lakshmi’ and worshipping it in this sacred form would bring them with lots of good luck and prosperity in their life. These observations made by Pattanaik (2010), have been recently endorsed by WGC (2010), in one of their published research report, where they have observed the consumer purchasing trends for the Gold as an investment commodity and predicted that its demand in India is expected to grow at the level of 30% in real terms during the next decade. The report further added that this rise in the demand in India is backed by the growth rate in terms of GDP, rapid urbanization, growing strong middle class population as well as rising savings rate of 30-40% of income (as expected to continue for coming decade).

This research paper provides a broad overview of the customer demand for gold as a sound investment in the context of different market conditions. Initially, the paper focuses on the reasons for the surge in the demand of Gold among the Indian investor’s and then it progresses with explaining the influence of financial markets of the emerging as well as developed economies on Gold and its movements. The research methodology used is descriptive and analytical, based on secondary sources of data from the relevant data gathered from various renowned publications, journals and financial agencies as well as from the Internet.

2. Sections
2.1 Economic & Growth Reasons Pushing the Demand for Gold in India
Indian economy is currently in its transition stage. The growth opportunities have multiplied in recent years as the economy and country is moving from the state of developing to the developed nation. The employment opportunities have increased due to the rapid rise in the growth sectors. The Indian economy has become growth intensive and this has led to more wealth creation. The middle income group which accounts for one of the biggest consumer class of the population has seen an unprecedented spur in their incomes and this has led to channeling of larger savings and investments into the financial markets of the Indian economy. In this scenario, the investment demand has become highly volatile. Consumers and Investor’s in India
have started to invest more of their savings into assets which promise them safety and security during their good as well as bad times (turmoil). Due to all these exponential growth and rise in the incomes of the Indian consumer, Gold has emerged as one of the most preferred investment asset class in India and thus has seen manifold spur in its demand.

A. Suresh (2012) has identified into her recent research study, the demand for Gold as a sustained investment is seen and felt by many Indians, especially in the inflationary situations which the country is facing currently. According to the statistics provided by various government agencies, the total annual consumer demand in India for 2010 was 963.1 tones. The studies conducted reveal that primary reason for such a high level of demand and investment urge amongst the Indian customers are due to rise in their savings and real income levels, and not by price of the commodity. In fact, the commodity price value has appreciated many times in the last decade in continuation to the trends in the international markets. It is believed that the sustained growth rate and economic development taking place in India would accelerate the level of consumption and thus the demand of Gold in India in coming years. This will also be underpinned by India’s traditional and deep cultural affinity for Gold.

2.2 Indian Investor’s & Change in their Investment Outlook
Consumers are always in the search for an asset which would maximize their returns and at the same time provide stable growth and returns in the times of economic turmoil. Recently, due to rapid expansion of economic development as observed in India, the Indian consumers have started investing more and more of their savings into Gold which has a high level of risk diversifying quality.

Green (2005) has written about the risk diversifying quality of Gold extensively. In fact, he had empirically also proved that the returns on Gold as investment are independent in comparison with other class of assets. In his study of four hypothetical portfolios of varying risk, he showed that the inclusion of Gold in each of these classes of assets increases the average returns while reducing standard deviation. Based on his findings and reports published by World Gold Council (WGC*) (2010), it could be well suggested that if an investor wishes to invest in an asset, which is largely unrelated to the fluctuations and speculations in the different market conditions, then Gold is the best commodity for this purpose. Even, the mutual funds which considered for risk mitigation won’t be able to give reasonable amount of returns in comparison to Gold (See Table 1).

WGC (2012) conducted a new research study to determine the factors which influence the demand of gold in India. Their finding reveals that the demand of gold in India was mainly driven by rapid GDP growth, urbanization and the migration of people from rural to urban pockets within the country as well as rise of income and savings among the people due to economic prosperity. The study further projected that there would be an increase in demand of gold in India in next decade and that the gold purchasing would increase by the level of 3 percent on annual basis in India for coming years.
Table 1: Performance of other financial instruments vs. gold (in per cent), CAGR = compounded average growth rate (Source: World Gold Council)

<table>
<thead>
<tr>
<th>(As at the end of)</th>
<th>Gold Lon Fix (INR/oz)</th>
<th>Gold Lon Fix(US$/oz)</th>
<th>DJ UBS Comdty Index</th>
<th>Brent crude oil (INR/bbl)</th>
<th>MSCI India</th>
<th>BSE SENSEX 30 spot</th>
<th>Westpac effective FX INR</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-month</td>
<td>0.2</td>
<td>4.9</td>
<td>2.5</td>
<td>4.7</td>
<td>0.3</td>
<td>11.1</td>
<td>11.7</td>
</tr>
<tr>
<td>3-month</td>
<td>1.7</td>
<td>5.1</td>
<td>8</td>
<td>6.7</td>
<td>0.6</td>
<td>11.7</td>
<td>13.4</td>
</tr>
<tr>
<td>6-month</td>
<td>17.2</td>
<td>17.2</td>
<td>6.3</td>
<td>0.2</td>
<td>1.8</td>
<td>12.9</td>
<td>14.5</td>
</tr>
<tr>
<td>1-year</td>
<td>22.7</td>
<td>31.3</td>
<td>2.8</td>
<td>12.5</td>
<td>4.2</td>
<td>19.1</td>
<td>17.2</td>
</tr>
<tr>
<td>3-year</td>
<td>98.9</td>
<td>75.9</td>
<td>-8.6</td>
<td>15.9</td>
<td>23.3</td>
<td>18.3</td>
<td>16.1</td>
</tr>
<tr>
<td>5-year</td>
<td>182.6</td>
<td>176.7</td>
<td>-9.7</td>
<td>32.1</td>
<td>43.2</td>
<td>144.4</td>
<td>132</td>
</tr>
<tr>
<td>3yr CAGR</td>
<td>25.8</td>
<td>20.7</td>
<td>-2.9</td>
<td>5</td>
<td>7.2</td>
<td>5.8</td>
<td>5.1</td>
</tr>
<tr>
<td>5yr CAGR</td>
<td>23.1</td>
<td>22.6</td>
<td>-2.0</td>
<td>5.7</td>
<td>7.4</td>
<td>19.6</td>
<td>18.3</td>
</tr>
</tbody>
</table>

These all reflects the notion that Indian investor’s are no more traditional buyers of commodity such as gold, rather, they see it in terms of safety of their investments in the turbulence period of in the Indian economy which is experiencing the era of stagflation. As documented by A. Suresh (2012), the Indian investor’s are seen, purchasing gold as hedge or safety against economy, political or social crisis and most importantly currency crisis which are resembled by sudden market crashes, currency failures, nation debts, inflation, war and other social unrest. The studies conducted on the demand of gold in India has also revealed the fact that, during the past 10 years the value of gold and its demand in India has increased on an average of 13 percent per year, which has super sided the country’s real GDP, inflation and population growth, taken altogether by six, eight and twelve percent respectively. Some other estimates have been derived from the analysis of the Indian commodity market which indicates that in India around 30 percent of per-capita income is saved and out of which, 10 percent directly is invested into Gold which shows a change in perception of Indian consumers and investor’s. They see Gold as a safe and most reliable investment asset class which has help in surging the prices of this commodity in recent times. In recent times, looking to the acceleration in the investment demand for gold in domestic markets in India, various new vehicles and products have been launched by the government as well as private investment firms such as Gold Trust and Gold Exchange Traded Funds (ETFs). In comparison to investing money into bonds and stocks which are the forms of equity investments, the consumer’s perception towards gold is more definite.
2.3 Alternative Economic Market Conditions & Performance of Gold

In this section we would try to analyze the performance of Gold in comparison to various other asset classes such as stocks, bonds, cash and housing prices. The basis of our analysis is the secondary data in terms of a recent report published by the World Gold Council (WGC) with the collaboration of Oxford Economics (2012), as part of the analysis, various market conditions such as Baseline Inflation, Deflation, Stagflation, and Inflation in the market economy which impact the consumer investment decision have been analyzed and compared. The market reactions in terms of various asset classes and their performance have been observed as part of this research paper.

1.3.1: Baseline Inflation scenario and Performance of Gold

Baseline inflation scenario is defined as a condition where there is steady economic recovery, inflation level is moderate and the financial conditions are normalized. In this condition, the study finds that the global recovery is reviewed mostly by the growth taking place in the emerging market countries. The study estimates that the growth rate for the recovery with the emerging Asian countries is expected to be 7-8% per annum to 2015; while world overall growth rate is about 4% per annum, when compared to pre-crisis levels.

The report finds (See Figure 1) that during the baseline inflation scenario, US dollar strengthens this also leads to slightly down ward pull in the prices of gold. The report concluded on the fact that as result of these various factors (negative real rates, wide credit spreads and the rapid expansion of the monetary base), the price moments in gold witness downward trends and it underperformed in comparison to other classes of assets from 2011-2015, with the best performing asset class being equities and cash reserves.

![Relative performance of gold versus other assets, baseline inflation scenario](image-url)
1.3.2: Deflation scenario and Performance of Gold

Deflation scenario is defined by a condition, wherein, there is a massive financial shock leading to feeling of recession and fall in the consumer prices. In this condition, the study finds that during this period, there are major defaults in the countries which are especially associated with euro zone, resulting into major losses for creditors. They resort to squeezing their profitability, leading to the fall in the asset prices. Although the inflation in centered in the euro zone, but its impacts of the financial crisis are felt globally due to intern linkages with world economies.

![Relative performance of gold versus other assets, deflation scenario](image)

**Figure 2**: Relative performance of gold versus other assets, deflation scenario (Oxford Economics 2011).

As observed in Figure 2, the government tries to loosen up the monetary policies, impacting the strengthening of US dollar and a positive shift in the real interest rates; it results into the reduction in the credibility of the government. This is a negative effect of deflation. At the same time when comparing Gold’s performance with other assets such as property and share prices, the study finds that, they perform poorly, whereas, cash and bonds post modest but positive returns.

1.3.3: Stagflation scenario and Performance of Gold

Stagflation scenario is defined by a condition, wherein, there is a high level of inflation and interest rates but at the same time weaker growth in comparison to the baseline inflation. In this condition, the study examines the consequences of the sudden increase in the oil prices to US $ 150 per barrel which was the level in 2008 (WGC, 2011). The study finds that due to such a sudden rise in the oil prices in the international markets, it transforms into the headline inflation, while triggering the
wage inflation amongst the worker community. This results into workers restoring to the savings and investments for maintaining their purchasing power in the economy.

Figure 3: Relative performance of gold versus other assets, stagflation scenario (Oxford Economics 2011).

The study finds (See Figure 3) that due to abrupt slowing down of the world economy in 2012-13; it leads to the loss of investor confidence and rise in the financial stress in the economy, resulting into rise of bad debts and loans. This ultimately damages the credit positions of the banks and they are forced to adopt policies relating to tightening of the credit standards. Despite the conditions created due to stagflation, the study concludes that, the gold’s relative performance from 2011-15 is better in this scenario, in comparison to the baseline inflation, while it is lagging that in the deflation scenario.

1.3.4: High Inflation scenario and Performance of Gold
High Inflation scenario is defined by a condition, wherein, there is a double digit inflation which is the resultant factor of the wage-price imbalance and the tight monetary policy. This scenario ultimately leads to the sharp monetary tightening and then into the recession. In this condition, the study finds that during this period, the economic growth at the beginning of the scenario is very strong in comparison to the baseline inflation. This is because of the policy initiatives and the consumer and business confidence which is recovering rapidly, resulting into the narrowing of the margins of spare capacity in the global economy. Thus, giving rise to the inflation.
As indicated in Figure 4, in this scenario, the study finds that due to the high inflation, it has a positive impact on gold. The study finds that the performance of gold is boosted by high US inflation in the period under observation, coupled with the weaker dollar and often negative real interest rates. Further the study observes that as the global economy shifts towards recession later in this scenario, gold also receives a big push due to the rise in the financial stress, thus created. The study concludes that this rise is comparable in scale to the recent global and financial crisis as being witnessed.

3. Conclusions
As observed part of the study in Section 2, the Investor’s could very well benefit by investing into Gold as its performance has remained stable during different market conditions. It could be further concluded that, Gold’s optimal share as part of sound investment in the portfolio rises in a more inflationary case in order to mitigate the risk and ill effects of the returns on the investment into alternative assets.

These findings further reveals that the optimal allocation of the investor’s fund to different asset classes varies differently based on the perceived risk and change in their tolerance limit based on the economic and market conditions. The study finds that investor’s with higher risk tolerance are more inclined to allocate and invest into riskier assets such as equities, whereas, the low risk investor’s allocate and invest more into so called ‘safe’ assets such as cash and bonds.

Our research study also finds that the spur in the investment and demand into commodity such as Gold has been recently on rise due the rapid growth and development been observed in the Asian developing economics, especially in India. In future it would be interesting to further investigate the impacts of gold on inflation rate in the Indian Economy. More empirical research would be required wherein a new
framework could be derived using Gold as a mechanism to arrest the level of inflation rate to the baseline inflation.

4. Acknowledgements
I would like to acknowledge the opportunity provided by Krishi Sanskriti Foundation for providing this wonderful opportunity to present this research paper at their MBEMSNA -2013.

References


