Gold Funds vs Gold ETFs vs SGBs

Traditionally, **Gold has been regarded as a safe haven for investors, especially during financially turbulent markets.** We can invest in gold in various forms: **jewelry, gold bars, or coins**. However, most financial advisors suggest that rather than buying physical gold, one should invest in **gold exchange-traded funds (gold ETFs), gold funds and sovereign gold bonds, owing to better returns and lower risk of storage and theft.** In these investment options unlike the yellow metal, an investor will not possess any physical form of gold but will hold it like an investment and will have the option to redeem it as and when we need them.

In this article we will understand the key differences, pros, and cons of investing between Physical Gold vs Gold Funds vs Gold ETFs vs Sovereign Gold Bond.

Physical Gold:

Most individuals & Families prefer to hold/buy gold in physical form such as Jewelry. These form of gold can be considered as a status symbol rather than investment asset. The reason these are not considered as an investment is the charges associated along with it. Some of the major charges associated while buying & Selling the jewelry are the Making Charges, Wastage Charges, Taxes etc which vary between 10% - 35%.

Hence if one is looking gold as a part of investment, it is better to avoid in jewelry form and consider something like Gold Funds, ETFs & SGBs.

Gold Funds:

Gold mutual funds are investment funds that hold physical gold bullion as part of their investment portfolios. While they don't directly invest in gold ETFs, they invest in other securities representing ownership of a certain amount of gold bullion. The most common type of mutual fund is an index fund, which tracks an index such as an industry group or market sector.

Gold mutual funds can be used to buy gold at any time, unlike an ETF which only trades during certain times daily. However, they also have higher fees than ETFs. They are not listed on stock exchanges but are managed by professional fund managers.

They are an easy way to invest in gold. They're also a good option for investors who don't have the time or resources to buy physical gold or for those who want access to safe gold exposure without purchasing and storing the metal themselves.

Pros:

- Ease on Transaction level.
- Diversification.
- Liquidity.

Cons:

- High Volatility.
- Less control over price Fluctuations.
- Higher Expense Ratio.

Investments in Gold Funds comes with 3 charges as below –

- Fund management charge – approx. 0.5% ~ 1% (Expense Ratio)
- Stamp Duty & other charges at the time of entry and exit from the fund
- Administrative charges arising from cash holdings and expenses involved in the fund

Capital gains from gold funds are taxable at 20% of capital gains tax is applicable and is available with indexation benefits. Short term capital gains tax is the applicable basis on the tax slab of the investor.

Gold ETFs:

Another alternative method to invest in paper gold is Gold ETFs or exchange-traded funds. **These are kinds of mutual funds that are listed and traded on exchanges via BSE and NSE just like shares.** Gold ETFs have gold as their underlying asset. Thus investors can trade their holdings of Gold ETFs on either of the exchanges at a price close to the original price of physical gold. 24ct gold being the underlying asset, each ETF is completely secured and protected in secured vaults.

Pros:

- Pricing of ETFs is more transparent and close to the actual market price of gold, compared to its physical forms as it is devoid of any premium resulting from the making changes, purity of gold, etc.
- Gold ETFs are more liquid compared to SGBs as they can be traded in the open market at the free will of the investors as it does not have any lock-in period. Thus Gold ETFs can be used for the short term, medium-term, or long term investment objectives as desired.
- Gold ETFs are generally known to be open-ended mutual fund schemes and investors can remain invested for as long as they feel like and enjoy returns generated from the fluctuations on 24ct gold price.
- One can look at investing in Gold ETFs in the form of a systematic investment plan (SIP) mode. Thus the pocket pinch involved in bulk one-time investments is minimized if this option is chosen. This makes investment in Gold ETFs more rewarding.
- Gold ETFs are known to be accepted as collaterals for loans as well, even though they are traded like stocks.

Cons:

- Unlike SGBs, there is no fixed interest/ income assured from any ETF as the returns in the latter investment depend on market fluctuations only. Capital erosion cannot be ruled out if the redemption is not timed appropriately.

Investments in Gold ETFs come with at 3 charges as below though there are no entry and exit loads as such –

- Fund management charge – approx. 0.5% ~ 1% (Expense Ratio)
- Brokerage at the time of entry into and exit from the fund – approx. 0.22% including entry & exit.
- Administrative charges arising from cash holdings and expenses involved in the fund.

Capital gains from ETFs are taxable. 20% of capital gains tax is applicable and is available with indexation benefits. Short term capital gains tax is the applicable basis on the tax slab of the investor.

Sovereign Gold Bonds (SGBs):

Launched in November 2015, by RBI in consensus with the Government of India, SGBs is an alternate option to invest in gold. **The minimum investment permitted in this bond is in 1 gram of gold and its multiples thereafter. There is an assured rate of interest on the bond which is 2.5% currently which is disbursed half-yearly.** The bonds can be purchased from nationalized banks, selected private sector and foreign banks, selected post offices and Stock Holding Corporation of India Ltd. (SHCIL), and designated stock exchanges either directly or via authorized agents. The SGBs are opened for purchase several times in a financial year.

Pros:

- SGBs are a safe investment option for someone who is looking for an investment option for a long term of 5 to 8 years.
- The assured rate of interest available on the bond is 2.5% disbursed half-yearly. The last interest is paid along with the maturity amount at the end of 8 years from the bond issue date.
- Capital gains tax is exempted on the redemption amount on the bond. The interest earned on the bond is however taxable in the hands of the investor, though there is no tax deducted at source.
- Anyone can invest in SGBs viz. Individuals, Trusts, HUF, charitable institutions, and universities. Both single holding and joint holding are allowed. Nomination too is possible. This is unlike Gold ETFs where only individuals can invest.
- SGBs can be used as collateral in case anyone wishes to take loans. RBI stipulated 'loan to value' ratio for gold loans is applicable here as well.

Cons:

- The maximum that an individual can invest in SGBs is in 4kgs, unlike Gold ETFs where there is no upper limit to investment.
- The redemption price at maturity is calculated basis the simple average of the closing price of 999 purity of gold of the last 3 business days before redemption. The prices or rates are stipulated by The India Bullion and Jewelers Association Limited. Thus there can be a marginal loss in the actual price of gold received compared to the prevailing price of gold on the redemption date.

Investments in SGBs come with much reduced charges when compared with Gold Funds or Gold ETFs as mentioned below –

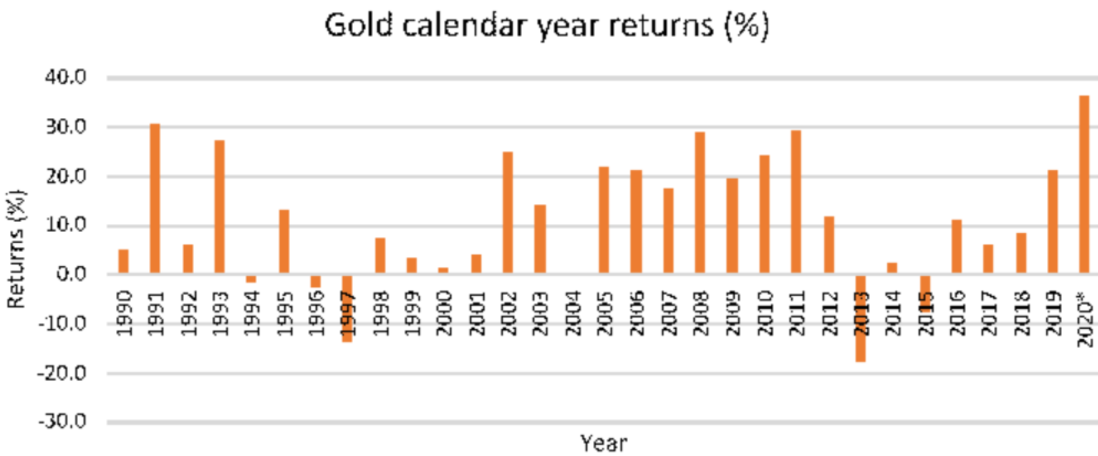
- Brokerage at the time of entry into and exit from the bond if executed through secondary market.

Capital gains from SGBs if held till maturity is tax free. Short term capital gains tax is the applicable basis on the tax slab of the investor. Interest payouts taxable as per individuals tax slab.

Comparison b/w Gold Funds vs Gold ETFs vs SGBs

Parameters	Gold Fund	Gold ETF	SGBs
Undelying Asset	Physical Gold	Physical Gold	Physical Gold
Expense Ratio	0.5 ~ 1.0 %	0.5 ~ 0.75 %	No
Other Charges (Brokerage, Taxes etc)	Yes	Yes	Yes
Mode of Holding	Demat/Folio	Demat	Demat/Physical
Liquidity	High	High	Low
Tenure of Holding	Open Ended	Open Ended	8 years
Interest Payout	NA	NA	2.5% p.a. (Semi Annual Payout)
LTCG (>3 years)	20% with Indexation	20% with Indexation	20% with Indexation before 8 years. If held till maturity Tax free
STCG (<3 years)	As per Tax slab	As per Tax slab	As per Tax slab

The graph below shows the calendar returns of gold since 1990. Strong returns have come in periods such as 2008, 2010 and 2011, which were turbulent times for equity markets. But these gains have helped propel gold's long-term returns, even as earlier years saw less exuberant performances.



Gold as an Investment

Gold generates outsized gains primarily due to events that cause a global risk aversion to equity. Such events are, obviously, hardly predictable. So it becomes hard to time entry to capture those gains, though gold investing works very well on correct timing. It's usually in hindsight after returns have shot up – like now – that the interest in gold investing surges.

Gold is mostly used as a hedge. The returns delivered by gold on an average is around 10 per cent range, owning gold as the main portfolio component is not the best idea. The key gold price driver is equity turmoil. And given the very sharp gains gold can make, it can neatly compensate equity losses. For example, in an SIP run for the past 10 years, a 10 per cent allocation to gold and debt each, with the rest in equity, increased portfolio IRR (internal rate of return) by 80 bps.

Gold is best used only in long-term portfolios. While gold is useful as a hedge, such hedging is best done for long-term portfolios only. This is because gold is equally volatile over shorter periods. Hence, if you have very short-term goals of less than two years, safer options would be debt options such as deposits would serve to protect capital better than gold.

Although gold fund vs gold ETF vs SGBs is a viable investment option, one should understand their differences before making any decisions. Gold may be a solid addition to your investment portfolio. **Still, the type of gold product you buy shouldn't be based solely on the numbers—your goals, timeline, and preferences should all be factored into your decision.**

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