Is e-gold better than gold ETF?

42%

*was the one-year (August 2010-August 2011) return delivered by e-gold compared with 40% for gold ETFs. While the marginal difference in returns can be attributed to the cost-effectiveness of e-gold, both these avenues provide ease of investing by allowing people to hold gold in the demat form. However, each product has its pros and cons—while gold ETF is a more tax-efficient means of investing, e-gold offers the option of physical delivery. This is perhaps the reason experts remain divided on which route makes for better investment, finds out **Shobhana Chadha**. Based on their opinion and depending on your individual needs, find out whether you should go for e-gold or gold ETF.*

Anjani Sinha
Managing Director, National Spot Exchange

E-gold

The biggest advantage that investing in e-gold has over gold ETF is that it involves no management costs or other recurring expenses. So the product is a lot more cost-effective for people who have a long investment horizon. The only charges involved are a one-time transaction fee of 2-3 paisa per gram and a brokerage fee of 0.2-0.3%. Both these charges are also levied in case of gold ETFs, but are much higher. E-gold can be converted into physical gold for quantities as small as 8 gm, while gold ETFs offer the option of physical delivery but only for a denomination of over a kilogram. Accumulating such a huge amount of gold is not feasible for small investors. Besides, the delivery centres of the National Spot Exchange are located in 15 cities, while ETFs have only one delivery centre in Mumbai.

E-gold is more cost-effective for those planning a long-term investment. The only charges involved are a one-time transaction fee and brokerage fee. Both these are much higher for gold ETFs.

E-gold can also be directly converted into jewellery through select, reputed jewellers that conform with the purity and transparency guidelines. The investor only has to pay for the making charges. The National Spot Exchange aims to bring all branded jewellers under its umbrella of empanelled jewellers within a year. The liquidity in e-gold is also increasing phenomenally, with the current average daily turnover being ₹200-250 crore compared with ₹15-20 crore in case of gold ETFs. Liquidity is of utmost importance for a retail investor as it makes buying and selling more efficient by reducing the impact cost (which is the bid-ask spread). The impact cost for e-gold is only 10-15 paise, as opposed to ₹4-5 in gold ETFs.

Naveen Mathur
Associate Director, Commodities, Angel Broking

E-gold

E-gold wins hands down against gold ETF. In India, the rural community and the middle-to low-income group have a tendency to flock to gold. For the typical Indian investor, e-gold is more suitable as it provides the option of delivering the yellow metal and, hence, bridges the gap between using it for investment and the traditional, auspicious reasons for buying it. Unlike in gold ETFs, where prices are measured in terms of the net asset value, it is simple to understand e-gold because of the transparency in pricing. A small investor, who wants to accumulate gold for his daughter's wedding or a festival, can easily do so through planned, monthly or weekly investment in e-gold. In this manner, he can also guard his investment against price volatility. E-gold has also been providing better returns than gold ETFs. The primary reason for the differential is that in the case of investing in gold ETFs, there is a range of charges, such as management and advisory fees, marketing and distribution expenses, custodian charges and other operational expenses. The expense ratio of gold ETFs is around 1%. Apart from the charges, tracking error also brings down the returns of gold ETF's a little bit. Tracking error is a measure of how closely a portfolio follows the index against which it is benchmarked. A gold investor always aims to achieve returns in line with the ones provided by physical gold. While e-gold directly tracks the domestic, physical gold prices, gold ETF only mirrors them. Certain gold ETFs have the flexibility to invest up to 10% of the total net assets in money market instruments and this can lead to tracking error. Some ETF companies also invest in gold futures and in a basket of gold mining companies. The earnings of a gold mining company may not reflect the price movement in gold, thereby reducing the impact of the price rise. As a result, the returns from ETFs may not be similar to those from investing in physical gold. The market-timing is another crucial factor that an investor should consider. One can trade in gold ETFs only till 3.30 p.m., while e-gold can be traded till 11.30 p.m., providing the investors greater flexibility and global cues while trading in gold domestically.

Unlike in gold ETFs, it's simpler to understand e-gold due to the transparency in pricing.

Mukesh Gupta
Director, Wealthcare Securities

Gold ETF

The idea behind both the options is the same—both e-gold and gold ETFs aim at relieving investors of the worry of storage and purity, making gold investment more efficient and convenient. However, gold ETFs make for a more sensible investing option compared with e-gold because of the different tax treatment meted out to the returns from the two. While the short-term capital gains tax for both the products is charged according to the marginal rate (tax slabs), the tenure for the application of this rate differs. An investor has to hold e-gold for over three years for it to be considered a long-term capital gain, while gold ETFs need to be held for only over a year. Also, the long-term capital gains tax for gold ETFs is levied at 10%, while the tax is 20% for e-gold. E-gold also invites wealth tax, whereas gold ETFs don't. Besides, the investors have to go through the inconvenience of opening a separate demat account to be able to trade in e-gold, while one doesn't have to do so for gold ETFs as the demat account for shares can be used for the ETFs as well. Hence, administration is not at all cumbersome. However, if an investor is primarily interested in getting physical delivery of gold then, e-gold is the ideal mode of investing. However, investors also need to keep in mind that for physical delivery, they will have to pay a charge and VAT at the rate of 1% each.

Gold ETFs are a better option than e-gold due to the better tax treatment meted out to its returns.

Charul Shah
Director, Greshma Wealth Advisors

Gold ETF for now

At present, investing in gold though ETFs would be more prudent for small investors. While it's true that investing in e-gold is relatively cost-effective, it's also a new product. It was launched only in March 2010 and, hence, should be given more time to evolve before retail investors venture into it. Gold ETFs, on the other hand, have been around since 2007, are traded on reputed stock exchanges and are backed by good fund houses. The average daily volumes are significantly higher in the e-gold segment, but this could also be due to the authorised participation and contribution of high net worth individuals as the commodity markets have been seeing encouraging turnover growth for some time compared with that in the equity markets. It is also true that being linked to physical, domestic gold prices, e-gold mitigates the currency risk better than gold ETFs. According to the norms of the Securities and Exchange Board of India, the actual benchmark for gold ETFs is not the domestic price of physical gold but the London Bullion Market Association's (LBMA) gold price. This price is in terms of the US dollars and has to be expressed in domestic currency, thereby allowing exchange rate fluctuations to adversely impact the gold ETF NAVs. However, not being linked to LBMA's guidelines also has its drawbacks. The purity of e-gold is not approved by LBMA and there is no standard benchmark in domestic gold prices. E-gold will definitely overtake gold ETFs as an investment route over the next two-three years. Till then, stick to gold ETFs.

E-gold is cost-effective, but it's also a new product and needs time to evolve before retail investors venture into it.