

MARKETS IN MOTION

developments that matter in financial markets

The Bullion Rush 2011

"Gold still represents the ultimate form of payment in the world."
Alan Greenspan, Former Chairman, Federal Reserve, US

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Introduction

The recent surge in bullion prices and the rush for bullion investments may not have a drastic effect as it did on California's Natives whose population collapsed due to the influx of hundreds of thousands of fortune seekers into California in the 1850s. However, for today's investors, the implications for future investment strategies in bullion will be tremendous. Prices of bullion have been gaining momentum across the globe and investors are attracted to this segment. Bullion is a precious metal— gold, silver, platinum and palladium—that has a high economic value.

Current Trends

The price of silver rose by 23.6 percent in the first quarter of 2011, well above US\$35/oz and the trend continued till the last week of April. However, silver prices started declining last week and the decline was primarily caused by a spike in silver margin requirements of COMEX, which prompted many investors to reconsider their silver positions and the ensuing sell-off pushed the prices further down. Gold prices also slowed down during the past four days, but the prices are expected to stabilize sooner as central banks in many countries are adding gold to their reserves amidst continued weakness of dollar. The IMF reports that around \$6 billion worth of gold was added to the central bank reserves of Mexico, Russia and Thailand during February and March 2011.

Gold and Silver: Returns and Volatility

	%QoQ	%YoY	%Vol*
Gold London PM fix (US\$/oz)	2.40%	29.00%	13.00%
Silver London fix (USD/oz)	23.60%	116.40%	39.90%

Source: World Gold Council * Annualised volatility in Q 1, 2011 based on daily return

The bullish trend of bullion can be attributed to the following factors.

Demand and Supply: In the recent years, industrial uses of silver and platinum group metals have driven prices high and, in turn, the metals are being chased by investors. Demand and supply factors currently favour a northbound price movement for gold and silver and the weakness in the global economic environment helps shore up the higher levels of prices.

Unstable Growth: Recessionary conditions prevailing in advanced economies such as the United States and Europe have added to the spurt in commodity prices, including the bullion segment.

Increase in Dollar Reserves: The dollar reserves with countries in the world have created an inflationary situation, putting pressure on the currency, which is historically negatively correlated to commodity prices. Some countries, especially India and China, have been adding gold to their reserves.

Cyclical Pattern: Prices of commodities move in a cyclical pattern. The bullion segment is seen to be on an upper curve for the past eight years and may go up further before it retracts.

Unforeseen Events: Japanese earthquake and the political unrest in the Middle East and North Africa (MENA) have created doubts about global economic growth in the minds of investors who are increasingly attracted to the bullion segment, reviving the legacy of precious metals as monetary commodities.

All these factors have a positive effect on bullion prices, attracting investors in droves, just like the Gold Rush in California in the 1850s.

Investment Options in Bullion

An investor has a number of instruments to choose from. Each of these instruments has its own merits and demerits. For instance, the physical holding would require a secure vault, gold exchange-traded fund attracts a share of the fund maintenance costs, e-Gold and e-Silver on the National Spot Exchange have the convenience of buying, storage and selling. Derivatives in bullion require constant monitoring during the life of the contract.

Instrument	Method
Physical Biscuits/Coins/ Bars	Direct Investment
National Spot Exchange (e-Gold, e-Silver)	Direct Investment
Mutual Fund: Gold Exchange-Traded Fund (ETF)	Indirect Investment
Commodity Stock (Mining and Refining Companies)	Indirect Investment
Commodity Futures: Strategies (Jobbing/ Spreads/Arbitrage)	Direct Investment

The current trend in gold and silver prices has seen a surge in investments in this segment. This surge is not limited to India alone but spread across the world. In the global environment, economic equations are changing and investors hover around time-tested investment vehicles for securing their future. However, investments in bullion will stabilize when the global economy gets back to normalcy.

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