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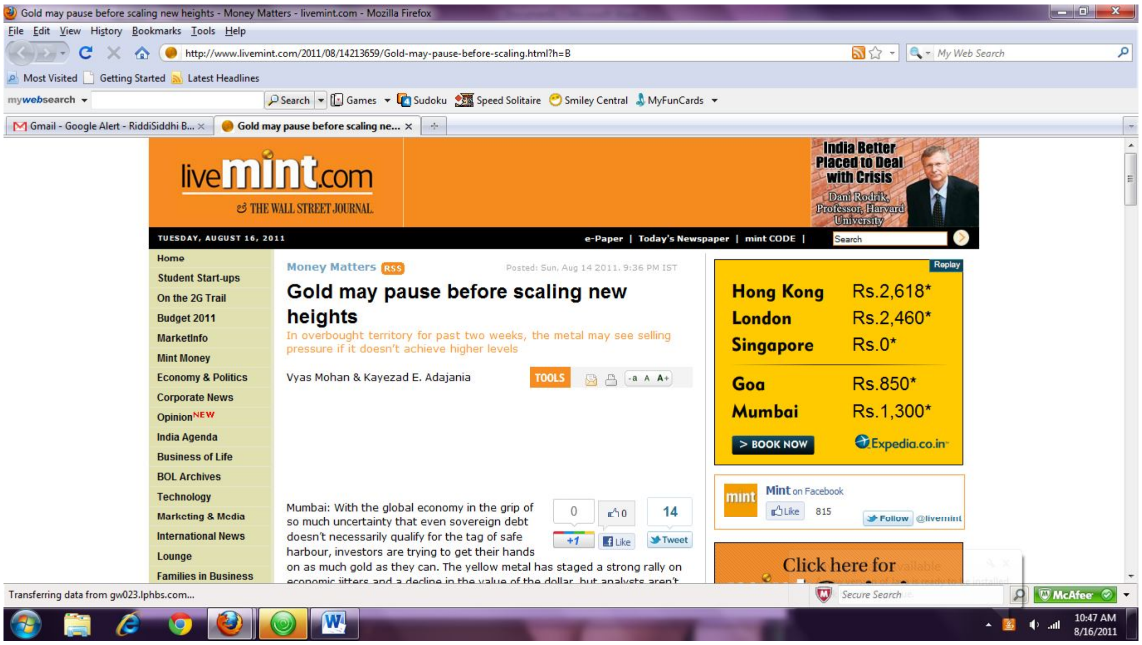

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Gold may pause before scaling new heights

In overbought territory for past two weeks, the metal may see selling pressure if it doesn't achieve higher levels

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TOOLS

Mumbai: With the global economy in the grip of so much uncertainty that even sovereign debt doesn't necessarily qualify for the tag of safe harbour, investors are trying to get their hands on as much gold as they can. The yellow metal has staged a strong rally on economic jitters and a decline in the value of the dollar, but analysts aren't advising investors to buy it at current levels.

Gold traded at $1,757.18 per ounce on Friday on FTSE, up 24.2% in the calendar year so far.

"There has been no correction in this rally. Technically, it has been in the overbought territory for the last two weeks and may not remain so for long. If it fails to achieve higher levels, it will be under selling pressure," said T. Gnanasekar, director of Commtrendz Research, a commodity research firm.

Though gold's run up has been rapid and a cause for concern for some technical analysts, it doesn't seem to have defied fundamentals.

Historically, the yellow metal has seen a continued rise in prices during uncertain times.

Research shows that the appreciation has been in line with its long-term trends.

According to a World Gold Council (WGC) report, the rise in the metal's prices has been in line with its 10-quarter average.

Further, on a risk-adjusted basis, its realized volatility was 13.4% below its 20-year average volatility of 15.8%, reflecting the underlying strength of the rally.

However, the reason behind gold's unidirectional move is the fact that unlike previous crises, this time around, the global economic outlook is gloomier and investors have little to choose from.

"In the Western world, people don't use gold as jewellery as much as Indians do. So, the rise in price only reflects the kind of uncertainty that the world economy is undergoing," said Ketan Kothari, director, RiddiSiddhi Bullions Ltd. "There is a lot of doubt about investing in equities, bonds, currency, real estate and any other asset classes. People simply have no choice. We think gold will see $2,000-2,200 per ounce levels by the end of December."

One of the fundamental signals often cited by many analysts in predicting the gold price trend is its movement relative to crude and the dollar. Gold, according to them, moves in the same direction as crude and in the opposite direction to the dollar as investors shift to the yellow metal when the greenback weakens and vice versa.

"Correlation is a short-term thing," Gnanasekar said. "Silver was hot sometime back. Now gold, silver and crude are all moving in their own directions."

According to him, gold should undergo a healthy correction before gathering steam again.

He expects a fall in prices to $1,650-1,670 levels per ounce before the rally resumes.

According to an April WGC report—*Gold: A Commodity Like No Other*—the positive correlation between gold and crude prices is a wrong notion. Instead, investors are chasing gold because of its independent asset status.

"Contrary to popular belief, there is no stable correlation between gold and oil prices; at times the prices of two commodities move in the same direction, at others in opposite directions, but most of the time there is simpl
in its April report that studied the correlation between the two from 1988 to 2010.

Gold's apparent lack of correlation with other assets when they decline in value and positive correlation when they move up, makes the yellow metal an inevitable asset in any portfolio.

Historical data shows that when equities fall beyond their normal swing range, gold starts rising. More interestingly, when the economy recovers and equities start rising sharply, gold follows suit as investors spend more on jewellery and technological devices.

This quality makes gold different from all other assets.

"When equity prices fall by more than two standard deviations, the correlation between gold and equities tends to turn negative while the correlation of most other commodities to equities rises significantly. However, when the economy recovers and equity prices rise sharply, their correlation to gold tends to be slightly positive," WGC said in its April report.

Given global uncertainties, retail investors are trying to get a piece of the gold story in any form they can. Which is why, gold fund of funds that invest in gold exchange-traded funds have seen strong growth in their folios.

"People are buying and systematic investment plans are happening. It is seeing more and more retail interest," said Sandesh Kirkire, chief executive officer, Kotak Mahindra Asset Management Co. Ltd.

Kotak's gold fund saw a 255% jump in its assets under management in the March-July period to Rs252 crore. The fund's folios grew 98% to 58,000 in the same period. Theoretically, a folio represents an investor. But since several investors have multiple folios, a single investor is said to hold about four folios, according to the industry average.

Folios under Reliance Mutual fund's gold fund have risen from 88,000 in March to 3.11 lakh in August. While its new fund offer collection was Rs487 crore, its assets under management now stand at Rs1,340 crore.

Even as the key equity indices, the bellwether 30-share Sensex of the Bombay Stock Exchange and the 50-share Nifty of the National Stock exchange have lost more than 17% in the year so far, net asset values of gold exchange-traded funds (ETFs) have clocked good returns. Axis gold ETF topped the pack with an year-to-date return of 24.95%, followed by the Religare gold ETF (24.91%) and the UTI gold ETF (24.82%).

"The world is so uncertain these days that every day is a new situation. Over a one-three year horizon, gold has enough steam left for a rally," said Naveen Mathur, associate director, commodities and currencies, Angel Broking Ltd. "Our conservative estimate is $1,900 per

Shares of companies that are involved in gold and jewellery production and offer gold loans have outperformed the Nifty and the Sensex.India, with 557.7 tonnes of gold, had the 11th largest reserve of the yellow metal in the world, said WGC in its August report. The US tops the list with 8,133.5 tonnes, followed by Germany (3,401 tonnes) and Italy (2,451.8 tonnes).

Photo by Bloomberg; graphic by Sandeep Bhatnagar/Mint

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