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Sovereign Gold Bonds trading at steep discount: Here's how to invest in them

BY NARENDRA NATHAN, ET BUREAU | UPDATED: SEP 11, 2018, 10.21 AM IST

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Planning to buy gold this festive season? You can get it at a steep 14-16 percent discount to the prevailing price. No need to worry: the gold is 24 carat pure.

What's more, you also get a cashback of about 2.5% every year. Don't dismiss this as another fraud scheme by fly-by-night operators. This is what you will get if you buy Sovereign Gold Bonds (SGBs) in the secondary market.

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SGBs issued by the RBI are trading at significant discounts to prevailing gold prices, offering a lucrative opportunity for those wanting to invest in the metal.

The slide in the value of the rupee, which crossed 72 to a dollar last week, has fuelled the interest in gold. Experts believe the rupee will continue to be weak for some time.

The main reason is India's dependence on imported crude oil, which is trading at an elevated $77.81. "Since a spike in crude prices increases our current account deficit, it is impacting the rupee negatively," says Amit Kachroo, Managing Partner, Aaneev Wealth.

The rupee's pain has been compounded by a strengthening dollar. "The US Fed is on a rate hike mode, while other central bankers are on wait and watch mode. The US dollar should continue to do well against all currencies. The rupee may fall to 74 per dollar by December," says Praveen Singh, AVP, Sharekhan Comtrade.

gher gold prices. This is because a strong
$1,200 per troy ounce. "The US dollar is king
ct will be limited in India due to the fall in the
d Rs 1,500," says Singh.

g position in gold. However, it makes sense to
st in gold now for returns. Equity should do
have a small portion of around 5% of the
irus Wealth Management. High valuations in
ld. "Since gold has an inverse relationship
tio based on your risk appetite. While the
says Kachroo.

The lure of discounts
Once you decide to invest in gold, the next step involves figuring out the route. You can buy bullion or bars, ETFs or open-ended gold funds, gold bonds, etc. Experts do not recommend gold bars over purity concerns, the risk involved in handling physical gold, additional expenses like bank locker charges to keep it safe, lesser price at the time of liquidation etc. Gold ETFs or gold funds offer better liquidity and therefore, are useful for someone who wants to deal in it for the short to medium term. Sovereign gold bonds listed on stock exchanges, on the other hand, are not very liquid. While that is bad news for existing investors, they offer a big opportunity for investors who want to get in now. Some of these bonds are trading at significant discount to prevailing gold prices. For the chart, only bonds with reasonable liquidity have been considered. The discounts are higher on less liquid ones.

Low liquidity has fuelled discounts
Only investors who can hold till maturity should consider these bonds

NSE SYMBOL	AVG DAILY VOLUME	FACE VALUE (₹)	COUPON RATE* (%)	CLOSING PRICE (₹)	DISCOUNT TO GOLD PRICE**(%)	RUNNING YIELD (%)
SGBMAR25	130	2,943	2.50	**2,650.02**	16.41	2.78
SGBNOV24	181	3,007	2.50	**2,699.99**	14.26	2.78
SGBAUG24	402	3,119	2.75	**2,713.20**	13.70	3.16
SGBFEB24	100	2,600	2.75	**2,720.00**	13.42	2.63
SGBSEP24	214	3,150	2.75	**2,725.00**	13.21	3.18

** Coupon will be calculated on face value. ** Compared to gold price of Rs 3,085 per gram (999 purity) Data as on 3 Sept; Source: NSE, ETIG Database*

Sovereign gold bonds offer several other advantages. First, there is no expense ratio involved unlike gold ETFs or gold funds. Second, all bonds offers a small interest in the range of 2.5-2.75%. This taxable interest is declared on its face value and since its market price is lower, the actual running yield is higher (between 2.78% and 3.18%). This means the net additional returns compared to gold funds can be 3.78% and 4.18% per annum (assuming 1% annual expense ratio for gold funds).

As explained earlier, the discount is available now due to low liquidity and therefore, only investors who can hold till maturity should get in here. Else, they may also be forced to sell at a discount. There is another reason why investors in gold bonds need to hold them to maturity. Long term capital gain from these bonds are tax free if held till maturity. The symbol of the bond includes its maturity month and year. To get the maximum benefit from the prevailing high discount, sovereign gold bond buyers should follow the 'buyers' discipline'— a strategy followed by investors of less liquid counters. Since one big buy order can fill the current discount, they need to buy slowly and in small quantities. This slow buying will also help investors to do price averaging, a necessary strategy in periods of weak gold outlook.