Ultra High Net worth Individuals (UNHIs) and High Net worth Individuals (HNIs) know that successful investing entails diversifying their assets and building portfolios that can handle any form of turmoil in the markets. The secret to this is to build portfolios with assets that are contrary to each other to a certain extent. Prashant Trivedi, Chairman of Multi-Act Trade & Investments Ltd. states “Essentially the way in which the portfolio is constructed is, you give one-fourth to different asset classes – one-fourth to cash (and/or gold), one-fourth to fixed income, one-fourth goes into equity and one-fourth is given to real estate”.

Why Is Gold So Important?

Diversification:

As mentioned earlier, gold and gold related equities are perfect assets when looking to diversifying a portfolio. By owning appropriate amount of gold, as highest quality of cash, one can effectively protect their investment in case of hyperinflation (adverse macro environment) or during a financial depression. As gold is becoming increasingly financialized, there are now a variety of other ways to invest in gold like ETFs, gold mining shares and futures.

Substitute for Cash:

Gold is an excellent substitute for cash. Its beauty and rarity has made it a universal currency. It is also the only monetary asset without any counterparty liability. Quantitative Easing (QE) by Central Banks is sure to have an effect on gold as an asset class in the future. In fact, Austrian Economists firmly believe that if, or rather when, the current fiat monetary system crashes, gold or some form of it will return as a commodity backed monetary system.

Historical evidence also points to this. Looking at financial history from the 16th century onwards, every time a fiat money system has been implemented, it has failed and some form of a gold backed currency has been implemented in its stead. By owning appropriate amount of gold, as highest quality of cash, one can effectively protect their investment in case of hyperinflation (adverse macro environment) or during a financial depression.

It is also an extremely liquid asset in the form of coins and bullion. However, it is important to remember that unlike other stocks or bonds, gold does not provide a monthly or annual dividend and may actually incur costs for storage, insurance and transaction fees and mark ups.

Hedge against Inflation and Deflation:

Typically, HNI portfolios have consisted of private equity and real estate funds. The world Gold Council states “These asset classes have had a good return on investment which is no longer true in the current scenario.” Our chairman Mr. Trivedi agrees stating “I am negative on global real estate, especially the higher end. There is going to be an impact all throughout because real estate as an asset class has had a multiple price expansion as much of it is backed by liabilities to the banks. At the really top end of course purchasers are paying with cash (but they are only able to do so as some other asset of theirs-usually stocks- is vastly inflated).”

If 10 per cent of your portfolio is invested in gold then you are protected in inflationary and hyperinflationary environments or even deflationary environments. In deflationary episodes while other assets like equity, corporate debt obligations (and maybe even the Government obligations in the future) and real estate- decline by 90 per cent or so in nominal terms, gold usually holds its nominal value. Ergo a 10 per cent position will allow one to restore the asset position at least in terms of its command over equivalent assets at the end of such a deflationary episode and therefore protect your portfolio. Conversely, in rapid inflationary or hyper-inflationary environments, gold becomes the asset of choice and rises 10 times on a relative basis, again allowing one to maintain the asset purchasing power of a portfolio that incorporates at least 10 per cent in gold as a whole. This makes gold one of the best hedges against inflation.

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Gold Mining Shares:

Gold mining share are another great way to invest in gold. Once the market understands that Quantitative Easing is not working and that it has allowed for mis-pricing of credit throughout the global financial system, people are going to flock towards gold.

Gold mining shares will work as a proxy for gold bullion and indeed any asset closely related to a commodity or working as a representation of that commodity will do well.

Futures

While this does not involve actually owning any gold, these products give you the opportunity to 'leverage' your investment so your profits go up if the gold prices move in the right direction and vice versa so losses are very much a possibility. However, futures do have an advantage for HNIs as they are held in a demat form. This allows for benefits like extended trading hours in commodity markets and ease of transactions. Also since no physical gold is held outright, costs associated with its storage and insurance do not apply. Futures allow HNIs to easily initiate short or long positions giving a fair amount of flexibility.

While investing in futures can be lucrative, it is important to know that it can be highly risky for the novice. It is best to use seasoned Portfolio Managers who have the experience and the expertise needed to succeed in the markets.

You may also like:

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