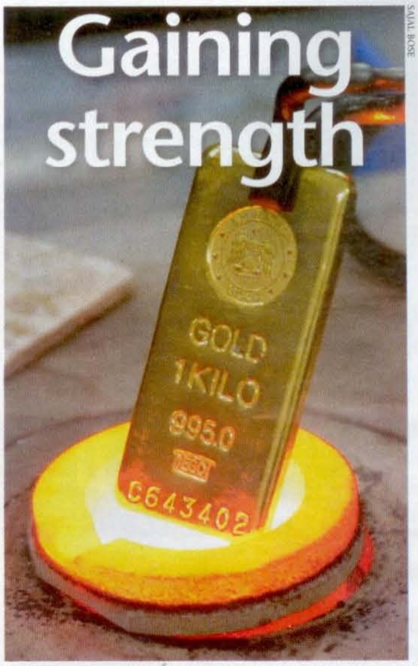
**Publication: Business India**

**Headline: Gaining Strength**

**Edition: National / International**

**Date: February, 2011 Issue**

**Coverage –**



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**After a major recovery in 2010, commodities will find a strengthened place in the 2011 portfolio**

Commodities have long offered investors an attractive opportunity to diversify their portfolio, as they are a hedge against high inflation and uncertain economic events. They are often seen as an asset class that provides lower volatility compared to stocks. The year 2010 was eventful for commodities as they made significant gains. One of the most precious commodities, gold, saw its prices rally more than 28 per cent during the year as compared to the previous year. This was the strongest rise for the yellow metal since 1979, when the price more than doubled. In the global market, gold prices touched a record high of $1,432 per ounce (₹21,600 per 10 gm in India) in December 2010 on the basis of economic concerns emanating from the US and the EU.

In India, the largest repository of the metal in the world, gold continued to garner buying support even as prices spiralled. In 2010, Indian buyers invested over ₹100,000 crore in gold. "For Indian households, gold is an integral part. Apart from buying jewellery, we are now also seeing growing interest in coins and gold-backed exchange traded funds. With increasing awareness, people will look at gold as an asset class for their investment portfolio," says Rajiv Jain, chairman, Gems & Jewellery Export Promotion Council.

Though gold, being a precious metal, draws more attention, it was silver that was the best performing commodity in 2010, with prices appreciating a whopping 80 per cent during the year. Prices of the white metal rose above $30 per ounce (₹47,100 per kg in India) in the global markets for the first time in 30 years. "Silver has outperformed all commodities. In fact, over the last 10-year haul, silver has performed at 21 per cent CAGR, well above the current food inflation figures," states Hansal Thacker, director, Lalkar Securities.

Both gold and silver are expected to continue their good show during the current year. But most analysts are of the opinion that silver may once again outperform gold. "Unlike gold, silver has significant use in industry and any revival on the industrial front leads to an increase in demand," says Anand James, chief analyst, Geojit Comtrade.

Silver is benefiting from a strong recovery in industrial activities, particularly in China, where double digit industrial production has led to a massive growth in imports of the white metal. In India, with prices of gold rising to higher levels, demand for silver in jewellery has gone up substantially in recent years. "Globally also, silver has caught the attention of investors as an alternative investment avenue to the dollar, and even gold. With the base metals themselves hitting new highs, silver has got further support," states Tarang Bhanushali, assistant vice-president research, IIFL.

However, there are analysts who view that the current gold and silver price ratio that has fallen steadily, hitting a four-year low of 45, is a matter of concern. "At present, our biggest cause for concern remains the silver and gold ratio, which is quite extended and vulnerable to a reversal of significance. In the past, the silver and gold ratio has always fallen back in line via both metals declining in price, but with silver falling more than gold," says Thacker.

Market observers believe that it is unlikely that the bullion market will decline. Even at higher prices, people are not hesitating to buy both yellow and white metals. In fact, rising inflation has augured well for both these metals as investors are adding them to their portfolio as hedging mechanism. Apart from various global cues extending support to the bullion market, there is a newfound demand in China for gold and that has boosted the global demand immensely. Analysts are expecting silver prices to touch ₹50,000-55000 per kg (from the current levels of ₹43,000-44,000 per kg) in the domestic market by the end of the 2011 calendar, with some intermittent corrections due to profit booking. Similarly, gold prices may move up to ₹21,000-21,500 per 10 gm from the present ₹20,300.

Bullion investors in India have now the options of investing in physical and as well exchange traded funds (ETFs: so far only gold ETFs are allowed by the authorities). Moreover, the National Spot Exchange has recently started electronic trading in gold and silver for retail investors.

While precious metals have staged a remarkable show, base metals such as copper, aluminium, zinc and lead, have gone from strength to strength with benign macro picture and robust

## New phenomenon

Gold-backed exchange traded funds or gold ETFs are finally taking off as Indian retail investors are showing huge interest in holding gold in paper form in their portfolio. According to Association of Mutual Funds in India, value of assets managed by Indian gold funds jumped to a record ₹3,520 crore last year from ₹1,350 crore in 2009. The total gold holding by ETFs jumped by nearly 75 per cent in December 2010 to 15 tonnes. In case of gold ETFs, investors don't hold purchased gold directly (or physically), instead, it is held by an asset management company on behalf of the investors. These funds are listed on National Stock Exchange and Bombay Stock Exchange in India and most of them have a share size of 1 gram.

"With gold prices soaring, more and more investors are coming forward to invest in gold ETFs. Future for such funds is extremely bright in a country like India, where people always like to get associated with the yellow metal, whatever may be its form," says Rajan Mehta, executive director, Benchmark Asset Management Co, which was one of the first companies to launch a gold ETF (Benchmark Gold BeES) in the country in 2007. The company's fund, currently the largest one among the nine such funds operational in India, has performed smartly last year with an annual return of around 23 per cent. Other ETFs listed with bourses are from asset management companies by UTI, Reliance, Kotak, HDFC, SBI, Religare, ICICI and Quantum.

Even as Indian households prefer to keep gold in physical form, particularly as jewellery, now with the growing awareness, they are coming forward to invest in gold ETFs. Experts view that, in 2011, the emerging markets in the world led by China and India will attract a huge chunk of investments in ETFs in commodities led by gold. "The mindset of Indian household is gradually changing. Along with physical sales of gold, they will also now opt for investment in Gold ETFs in a big way," says Prithviraj Kothari, managing director, Riddisiddhi Bullions Ltd (RSBL).

Harmesh Arora, managing director, of National Indian Bullion Refinery feels that ETFs are still a very new phenomenon. But as the awareness spreads and more products get introduced, the investment in ETFs will pick up. "The demand for ETFs have just started and Indian households having special bonding for gold will definitely offer huge potential for such products," adds Arora.

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demand from China and India. "Driven by huge demand from emerging markets like China and India, base metals have been the best performing commodities in the year 2010, says Basant Vaid, senior research analyst, Bonanza Portfolio Ltd.

Copper has led the base metal pack from the front. On the global market, copper prices recorded a new high of $9,000 per tonne in 2010. The metal appreciated around 30 per cent (y-o-y) during the year. Going forward, copper continues to exhibit strong fundamentals, given that the global balance is in danger of reaching a 0.5 million tonnes deficit. "Copper prices are set for a bull run in the global market as demand for the metal is strong from China, the largest copper consuming country in the world," says Bhanushali, who has set a target price of $11,000 per tonne for copper in 2011.

A new wave of ETFs in copper hitting the global commodities market is going to drive up the base metal prices further. Metal analysts predict that ETFs in copper is going to be another big investment opportunity for commodity players across the world. "Copper is the most favourite base metal commodity for traders in the world. ETFs in copper will certainly result in bigger investment flows. This will lift the physical stocks of the metal to a higher level," says James.

Other base metals are also likely to do well in 2011. Aluminium prices are expected to be higher in 2011. However, price increase will be limited due to strong production growth and higher inventories. During the current year, the world production is forecast to increase by 8 per cent to 43.8 million tonnes as large capacities are expected to be completed in China, India and the Middle East. As per analysts, global aluminium prices are likely to average 7 per cent higher in 2011 at $2,315 per tonne on strong consumption growth from developing countries. "Margins of miners as also companies involved in the production of these metals are likely to improve and this may get reflected in their stock prices," says Arun Kejriwal of Kejriwal Research.

Most of the companies into the production of base metals have seen their margins getting a significant boost. For the half year ended September 2010, Hindustan Copper, which is both in mining and production, has witnessed its net profit almost growing six times to about ₹84 crore as compared to that in the corresponding period in 2009. Similarly, Sterlite Industries, with copper as well as zinc in their portfolio, saw its net profit more than doubling to ₹820 crore during the same period. Hindalco, engaged in the production of aluminium as also copper, and Hindustan Zinc have also gained on the margin front. Outlook of the base metals seems to be bright, and these companies are expected to do well on the bourses.

All in all, the outlook remains bullish for commodities. There are still concerns over currency stability, even as emerging economies will drive the demand for commodities. Keeping this in mind, investors should consider including commodities as part of their portfolio for achieving long-term investment goals.

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