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Bullion Markets

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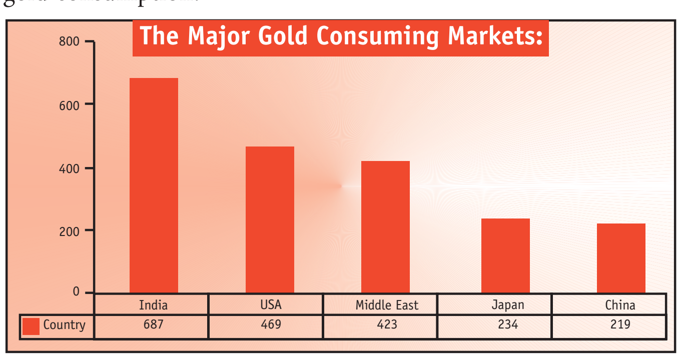
India has always been a significant player in the international gold market and had a thriving bullion spot and futures market till the enactment of the Gold Control Act in 1963 which debarred the general public from holding or trading in gold. Since 1990, the government has been taking a number of steps to reform this sector and ensure that India benefits from the demand influence it has on the gold business internationally. The liberalisation of the gold sector has been in stages; first allowing a number of banks to import gold – braking the monopoly of the State Trading Corporations; then considerably reducing the import duty – destroying a lucrative parallel smuggling channel and now allowing traders, manufacturers as well as investors to trade in gold futures in India itself.

Since the liberalization of the gold market in India, Indians buy on an average of about 600 tonnes or Rs 40,000 crores worth of gold every year in the form of jewellery & investments. In addition, another 200 tonnes of gold passes through the hands of the Indian jeweller for conversion into new pieces of jewellery. India, USA, Middle East, Japan, China account for 55 percent of the global gold consumption.

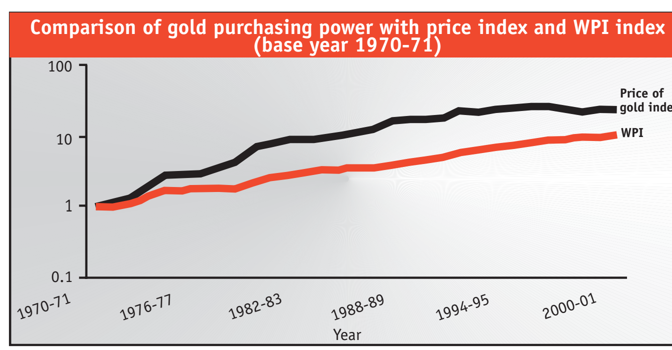


The Indian public is in control of an estimated seven percent or 13,000 tonnes (Rs 780,000 crores) of the global stock of gold. This is equal to the total savings by individuals in the Indian Banking sector!

With the Indian public allowed to invest in only Indian Rupee denominated asset, and with limited alternate assets available to the general public for purposes of investment, over the years gold has provided the Indian investor an excellent asset to hedge against inflation and also to serve the purpose of a currency hedge.

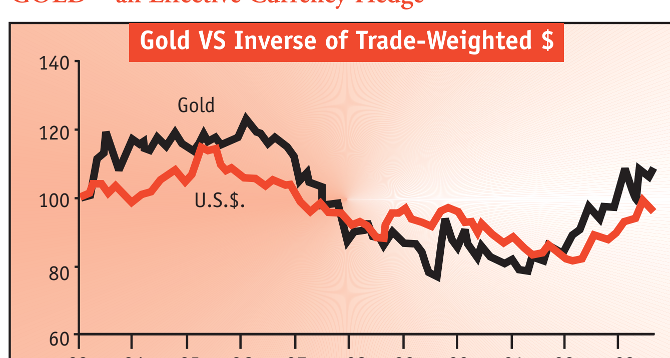
Gold as an Inflation Hedge

Analysis of Gold Price Index with the Indian Wholesale Price Index, over a 30 years period, demonstrates the maintenance of the purchasing power of gold during the high inflationary environment that the Indian investor has passed through.



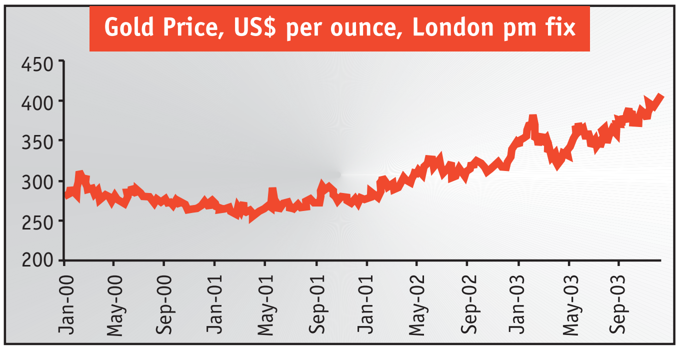
Analysis of the prices of gold in the developed countries such as USA, Britain, Germany, France and Japan over very long period of time has shown that gold's value may fluctuate in the short term but consistently returns to its historic purchasing power parity with respect to other goods.

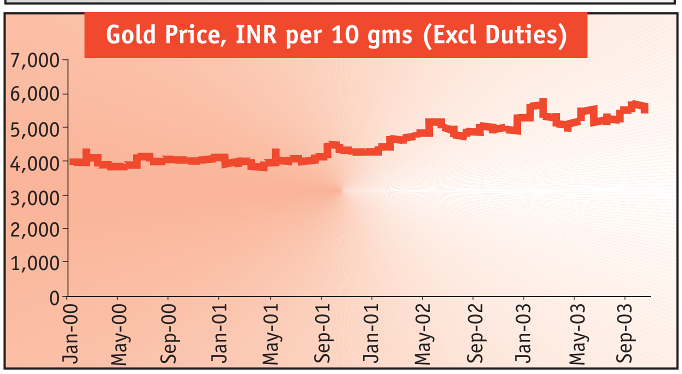
GOLD – an Effective Currency Hedge



Gold is also a currency hedge – it can be shown statistically that a fall in dollar against other key currencies tends to result in a rise in the dollar price of gold. At a time when there is growing concern over the extent of the US current account deficit and hence fears of further dollar depreciation, this is a quality worth noting.

Gold - Price Movements in 2003





Looking at the dollar price movements in the beginning of 2002 the price of gold was $ 280 per ounce and by the beginning of 2003, the price moved up by 25 percent to $ 350 per ounce. Over 2003, the gold prices have moved up further by 17 percent and has been nudging the $ 410 per ounce levels in December 2003. In dollar terms the gold prices have moved up by over 42 percent in the last two years and by 47 percent over the last three years. The primary contributor to the increase in the gold prices has been the inverse co-relation of the Gold prices to the value of the dollar. The geo-political tensions have only added to the volatility and the firming-up of the gold prices.

In Rupee terms too Gold prices have firmed up by 24 percent during the year 2002 and a further seven percent during the year 2003.

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Gold –Outlook 2004

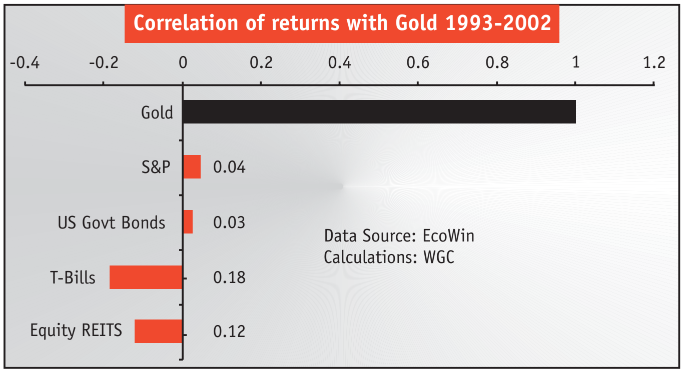
Gold is currently at crossroads. There is a growing interest in gold as an alternative to mainstream financial assets. By no means all investors are convinced that the US and World economies are in sustainable recovery mode. Some of the most astute international financial managers are turning to gold, as well as other currencies and commodities, as top investments while inflation picks up and the dollar deteriorates in value. Low short-term interest rates mean holding cash is an unattractive option and hence supporting investments in alternate assets. Finally, the international political environment continues to create a great deal of anxiety. This suggests the external factors will remain supportive for gold investment.

The supply side is expected to remain fairly inelastic because new mine supply have long gestation periods and the de-hedging of gold by the produces is expected to continue. Gold sales by the Reserve Banks of various countries, is also expected to remain regulated within the Central Bank Gold agreement. Hence the critical factor in the supply side of the equation will be the re-sale of above the ground stockpile of gold held by household in countries such as India, Middle East and some of the South East Asian countries. Price spikes in 2002 and the first quarter of 2003 –during the Iraq war- had resulted in increasing supply of old gold into the Indian & Middle East markets, however such price related disinvestments behaviour has been absent during the recent price spiral in November/December 2003.

One of the strengths of gold as an Asset class is that its price is not determined by the performance of any company or economy and there is significant above the ground stocks - estimated at 147,800 tonnes (present market value Rs 88,68,000 crores) hence the gold prices move in a more orderly fashion as compared to any other commodity or financial asset.

Should Investors still Invest in Gold? Gold as a Portfolio Diversifier

Gold is an ideal diversifier because the economic forces that determine the prices of gold are different from, and in many cases opposed to the forces that influence most traditional financial assets such as shares, bonds and even property.



A number of Professional Financial Planners have been using the Asset Allocation Model to advise the clients on the quantum of investments that should go into different asset classes such as Shares, Bonds, Cash, Gold, Property etc. in order to maximise the invested portfolio's return for a given level of risk or volatility in the portfolio's valuation. Ibbotson Associates – an international financial consultant, have done some groundbreaking research on the performance of an investment portfolio with an addition of GOLD and other "hard assets".

By constructing a Global Hard Asset Index based on gold mines, metals, timber and real estate, the researchers found that Moderate or a Balanced investor would benefit from a 10 percent allocation to "Hard Assets" while an Aggressive investor would benefit from a 25 percent allocation. Reducing a portfolio's volatility or risk by adding gold (and other Hard Assets) allows the portfolio manager to rearrange the asset mix to include a greater weighting in higher-return, higher-volatility assets hence enhancing the performance of the portfolio without increasing the risk.

Although the gold market is relatively small compared to the stock and bond markets, it is a deep and liquid market and is active 24-hours per day. In addition trading spreads are narrow and subject to market conditions, tend not to widen until sizeable volume is being requested. In addition trades of up to five tonnes ($ 65 million) have been executed through the market without having any significant impact on price.

Alternative assets compared

	Potential Return	Liquidity	Diversification Benefit	Risk	Holding Management Cost
Private equity VC	V high	Low	Moderate	V high	high
Private equity buy ins/outs	high	low	Moderate	high	high
Hedge funds	various	low	various	various	high
Gold	**low**	**high**	**v high**	**low**	**low**
Commodities	Volatile	high	high	high	low
Timber	medium	low	high	moderate	high
Art & Collectibles	medium	v low	high	high	high

Source: UBS Global Asset Management: Pension Fund Indicators 2003