

## Exchange traded Funds (ETF)

Buying gold on the stock exchange?? Impossible, it is a commodity; we have to go to the commodity market. Well, buying gold on the stock exchange is now possible with the eminent introduction of Exchange Traded Fund that will invest in Gold only. Accumulation of gold for a marriage in the family is a popular Indian custom. Instead of physical acquisition of gold or demating the same we go a step forward and buy shares that represent gold. Let us first understand the concept of Exchange Traded Fund (ETF) then understand about the advantages of buying gold ETF.

EFT is defined as a security that tracks an index, a commodity or a basket of assets like an index fund but trades like a stock on an exchange and experiences price changes throughout the day as it is bought and sold. ETF were first launched in 1993 in United States. Their popularity as a structured product has grown immensely because of the benefits it provides to investors and traders. The issuance of EFT is just like a primary market IPO or a mutual Fund NFO. Shares are issued by the Fund manager and listed on the exchanges. Investors can buy and sell these shares from the secondary market through their brokers. ETF are often called as index shares, are a hybrid of index mutual funds and stocks. Some popular funds are

ETF name	ETF Symbol	Underlying Asset which it tracks
StreetTracks Gold Shares	GLD	Gold
NASDAQ ETF	QQQQ	NASDAQ
Spider	SPY	S&P 500



The advantages of a Traded fund shares are :

- **Tradable and diversifiable:** ETF offer a unique advantage as they are diversifiable like mutual funds and also can be traded like stocks. Mutual funds cannot be traded each day like a stock.
- **Low cost:** ETF like an Index fund does not require active fund managed and is therefore cheaper as passively managed.
- **Transparency:** ETF is a very transparent instrument, as everyone knows the underlying asset.
- **Makes multiple trading strategies possible:** Arbitrage opportunities between cash and futures market can be availed at low cost. Trading strategies can be applied with stop loss orders.

The disadvantages are:

- **Broker and commission costs:** ETF are traded through brokers and hence every time brokerage has to be paid which becomes costly affair if regular trades are done.
- **Premiums and discounts:** An ETF might trade at a discount to the underlying shares. This means that although the shares might be doing very well on the bourses, yet the ETF might be traded at less than the market value of these stocks.

There are different types of ETF unlike close-ended funds can create or cancel units as investors enter or leave the fund. The size of the ETF, rather than the price, will fluctuate based on the demand and supply for the ETF. There are several ETF launched till date they can be broadly categorized as follows:

- **Global ETF:** There are ETFs tracking indices beyond the domestic markets. Ex specific regional funds that track fast growing markets in China and Korea.
- **Fixed Income ETF:** ETF tracking fixed income products. ETF in this case may declare and pay dividends.
- **Commodity ETF:** ETF that track commodity or commodity indices take advantage from the gains in the commodity market.
- **Currency ETF:** ETF tracking currency or currencies. Ex ETF- Euro Currency Trust (FXE) was introduced in Dec 2005 which trades on the NYSE. Hence investors can take exposure in Euro through this fund.

It is also important to understand the difference between a Mutual Fund and ETF. Trading in ETF takes place on the stock exchanges during trading hours. The Mutual fund units are however purchased from the Mutual Fund at NAV at the end of the day. The expenses are low in an ETF since there is no active fund management involved as in case of mutual funds. The costs in mutual funds are higher in short term since they are subject to load fees, annual management fees, exit fees etc. These are intended to discourage frequent trading. Dividends are rarely made in EFT whereas there are frequent dividends made depending upon the stocks the mutual fund is holding. As per Indian tax laws redemption amount received from mutual fund units are not subject to tax, however in case of EFT if representing gold, which is a commodity and not stock there would be tax payment in event of

appreciation. ETF are regulated by the same authority, which regulates mutual funds. In the Indian context SEBI is the regulator.

ETF is not a new concept in India. There have been two ETFs launched in India one is based on Sensex which was called Spice and another was launched with Nifty as an underlying asset, it was gold Nifty Bees. However both these instruments failed to attract the attention of investors. These instruments allowed the investors to buy index in the form of shares. The investors apparently preferred to buy shares included in the index directly by buying index baskets or purchased index in derivatives markets.

Falling interest rates has forced Indian household to look at other classes of assets to hedge their portfolios as well as improve the yield on their basket of assets. Given the fascination for gold among Indians the current launching of gold-based EFT has obvious advantages. Gold can be bought like a share on stock exchanges; storage will be done by the Fund manager, no security risk, no impurity risk, and no cost of making charges. Costs will be low and same channel of trading and delivery like shares will be used. Innovation of products in Indian markets is welcome. Time will tell whether despite obvious advantages Indian savers will continue to buy gold from jewelers and banks or from the stock exchanges.

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