Dhanteras & Diwali Gold Outlook - 2021

Domestic gold prices have corrected by 9% over the last 1-year as of September.
This number could either disappoint you or excite you.
It could either lead you to exit the asset class or nudge you to increase your allocation at lower prices.
It all depends on whether you view gold as a tactical or strategic asset.
We hope you are in the latter category.
That is because Diwali-Dhanteras are around the corner, and just like every year, it is a good idea to honour the tradition and invest in gold.

After handsomely rewarding investors through the worst of the pandemic, the metal's prices have now retreated, naturally disappointing investors and giving us reason to revisit the relevance of the asset in an investment portfolio.

While gold benefitted from the risk aversion through the Covid-19 crisis, the sentiment has now changed thanks to the roll-out of successful vaccines and subsequent opening up of economies. Normalization of ultra-accommodative policies, which have been the key driver of gold prices, is thus expected. Sure, that could negatively impact prices. But do not discount this multifaceted asset class yet.

Demand for gold comes from various sources like jewellery, bars and coins, investment demand, central bank demand and use in the technology sector. While investment demand through Gold ETFs is showing signs of contraction, consumption demand for gold which usually accounts for ~50% of total demand is improving. Economies of major gold consumers India and China have bounced back from the pandemic induced recession. Consumer incomes and sentiment have improved. A recent report by the World Gold Council reveals that for each 1% increase in gross national income per capita, domestic gold demand in India has historically risen by 0.9%. Pent up demand thanks to lockdowns and postponed marriages is now supporting prices. A good monsoon and the upcoming festive season in India should further aid the uptick in consumer demand.

While the Covid era ultra-accommodative monetary and fiscal stimulus measures have helped bring back consumer demand, they have thrown up a new challenge. Global supply chains, disrupted by the pandemic, haven't been able to match up to the rebound in demand, resulting in prices of goods and services going up. At the same time, major developed countries like the US and UK are seeing fewer people returning to their jobs post the pandemic, which is pushing wages up. Energy prices too have been on the rise as supply accommodates the pent-up demand, pushing up transportation costs of all goods and commodities. All of this is translating to higher global inflation. Gold prices have historically been in line with inflation. As per the World Gold Council, for each 1% increase in inflation from 1990 to 2020, Indian gold demand increased by 2.6%, proving that Indians have used gold to tackle higher inflation.

While on the macroeconomic front, things look cheery now - economies opening up, consumer sentiment and spending improving, stock markets rallying - higher inflation, dissipating growth, and potential effects of tapering are risks to the outlook. Higher inflation could hurt consumer demand and slow down the economic recovery. Corporate earnings supported by low factor costs will be under pressure; as interest rates and inflation inch up, which could result in stock market volatility. Drying up cheap liquidity could unveil debt or housing crises which could spill over to the larger economy. Prevalence of these economic risks demands a 10-15% allocation to gold, which, unlike other mainstream assets, tends to benefit during times of stress and uncertainty, cushioning the overall impact on the portfolio.

The gold market is large, global, and highly liquid. Recent data from the World Gold Council shows that gold is the second most liquid asset in the world after S&P 500 stocks. At the peak of the pandemic last year, savings in gold proved to be a ready source of liquidity for many seeking funds for medical or income setbacks. Gold's liquidity does not dry up, even at times of financial stress, making it a handy and much less volatile asset to own in today's unpredictable world.

While returns are a major motivation to invest in gold, one should remember that gold's utility extends beyond that. It is also a source of liquidity, a portfolio diversifier and an asset that can help combat the effects of higher inflation on a portfolio. Buying gold can thus be a good move for your overall financial well-being. So as tradition demands, go ahead, appreciate gold's strategic role in your portfolio, take advantage of lower prices, and buy gold this Diwali. Preferably through efficient financial forms like Gold ETFs and Gold Mutual Funds.