Source : www.livemint.com Date : 2022-01-04

IS IT A GOOD IDEA TO INVEST IN SILVER EXCHANGE-TRADED FUNDS?

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The price of silver has moved from around $30 per ounce at the start of 2012 to around $23 per ounce at present. Even if you look at returns in rupees, the 10-year CAGR comes to 1.97%, below the inflation rate of 6%.

India's first silver ETF, launched by ICICI Prudential AMC, is slated to open on 5 January.

An ETF (exchange-traded fund) tracks the price of an index or commodity; in this case, silver. It does so by actually holding the stocks or commodities it is tracking; in this case, physical silver. Although silver in physical form has been freely available to Indian investors, this is the first time that a financial instrument tracking silver is being made available.

The annual expense ratio for the ETF is capped by regulations at 1% of assets but the fund house is likely to maintain it around 0.5-0.6%. ICICI Prudential AMC is also likely to launch a fund-of-funds (FoF) to allow investors without demat or trading accounts to invest in silver. The expense ratio of FoFs is capped at 1%. Several other mutual fund houses have also filed for their own ETFs tracking silver.

Historically, Indian investors have been exposed to gold ETFs. The first ETF tracking gold called GoldBeES was launched in 2007. Two principal reasons given for investing in gold have been that it is a hedge against inflation and it has low correlation with stocks. Due to the latter property, gold does well when stocks are down and hence acts as a good diversifier. However, neither property holds as well for silver, as it does for gold.

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Coming to the second benefit of diversification, silver comes up short here as well. It is more correlated to equities than gold. This is because industrial demand for silver is a big driver, accounting for about half of total demand, according to a presentation by ICICI Prudential AMC. This means that silver does well during economic recovery, when stock markets are also doing well. During market downturns, silver also tends to fall. Experts instead see silver as a tactical play on economic recovery rather than a long-term hedge against inflation.

"There are extended periods of time when silver has not been a good hedge against inflation, particularly when industrial demand is muted. As for diversification, it has acted as a good diversifier in some calendar years but not others. Precious metals overall should not be more than 15% of your portfolio and within that, silver should not exceed 5%. Think of it more as a tactical play on economic recovery, to be bought and sold at the right price points, rather than a long-term asset," said Rushabh Desai, founder, Rupee with Rushabh Investment Services.

Returns on silver ETFs will be taxed at slab rate if sold within three years of purchase.

After this period, returns on silver ETFs will be taxed at 20% under long-term capital gains

(LTCG) tax and you will also get the benefit of indexation. Investors in the ETF may not get sufficient liquidity as has happened with some gold ETFs in the past. This can make it difficult to buy and sell silver ETFs. However, for such investors, AMCs like ICICI Prudential AMC are likely to open up the fund-of-funds (FoF).

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