

Comaprison between equity and gold



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sComparison between Gold and Equity BA 341: Corporate Financial

Management OBJECTIVE Our main objective for this assignment is to find out if an investor should invest in gold or stocks in current economy. Besides that, it is to know why an investor should invest in gold and not stock in current economy.

Other than that, we will make some comparison between the years 2006 until 2010. Therefore, we also learn the main factors that affect investor to buy gold. Furthermore, we have to compare the difference between gold and stock and also the drawbacks between gold and stock. It is because they may have different factors to consider in cooperate financial management. Last but not least, we also want to understand how gold can benefit shareholders even when investors hold diversified portfolios of investments.

INTRODUCTION Gold is a precious metal ore that is mined underground then melted and refined into bars, coins, jewellery, accessories and into units used in industries. In financial terms, Gold is considered a safe haven/ hedge investment, a store of value and a monetary asset.

Equity is defined as one's ownership interest in a corporation in the form of preferred stock or common stock INVESTMENT OPTIONS FOR GOLD Gold is measured in troy ounces. When the reference to gold is obvious, it is much easier to refer to it as an ounce. One troy ounce is equal to 31.

1034768 grams. 1. Bullion Gold Bars – They come in a number of different sizes and weights. These can range anywhere from one gram to as much as 400 troy ounces.

Small bars are defined as those weighing 1000g or less. According to industry specialists Gold Bars Worldwide, there are 94 accredited bar manufacturers and brands in 26 countries, producing a total of more than 400 types of standard gold bars between them. Gold bars contain 99.5% fine gold. 1. Bullion Gold Coins – These are issued by different governments around the world. They are used as a form of currency for their face value and not content of gold.

However for investors, market value is the sum of the value of its gold content and a percentage that varies between coins and dealers. Their sizes vary from 1/20 ounce to 1000 grams. 2. Gold Exchange Traded Funds – These are open ended mutual fund schemes that invest the money collected from investors in standard Gold Bullion. 3. Gold Certificates – Allow Gold investors to avoid the risks and costs associated with the transfer and storage of physical gold bullion. 4.

Gold Accounts – These are accounts, which are available to investors, which hold less 1000 ounces of gold. 5. Derivatives, CFDs and Spread Betting

COMPARISON OF EQUITY AND GOLD Now a day normally most of the investors will ask “ Where should I invest my money to gain more return on investment? ” During the year 2006 until 2008 there have a monetary crisis, which is the value of a country currency fall due to political concerns. Stocks have been a terrible investment over the past decade and they are about to get worse. Gold has been one of the best if not the best investment over the past decade and is about to get better. When you examine investments via relative merits, Gold has trounced general equities. Gold has also trounced

paper cash, regardless of the fiat currency held, as well as real estate and commodities over the past decade.

After all the economy crisis, normally investor will trying to invest in gold, with the reason of they define gold as a safe alternative, furthermore gold prices are does very well to hold its price. The price of gold are holding very well it had increasing from 600 dollar per ounce from year 2006 until 1, 000 dollar per ounce on year 2008, its definitely increase in a huge amount during this two years. Furthermore the performance of stock markets are no longer reflective of the world economies, since year 2006 until year 2008, on that time many investors are try to invest in other solid instrument to create wealth during the “ Black Thursday”, which is the day that the value of share drop down several point in one day, so because of this a lot of investor are changing their mind and invest in gold, because the best way to protect your wealth are invest in gold other than stock. For an example the price of gold in the beginning of year 2007 was 680 dollar per ounce, and all the inancial predictor stated that the price of gold will reach until 850 dollar per ounce, moreover at the end of year the price of gold are increasing to 870 dollar per ounce. Due to this example we are known that the price of gold is always increasing no matter on past or now a day. Other than that, many investors are choosing buying gold as a hedge against inflation. Even though gold had high peaks and low valleys, besides that if compare to other commodities such as oil, silver or investment in other hard assets, gold doesn't beat on inflation.

In addition most of the investors think that the best way to protect their wealth is invest in gold. Besides that during the year 2006 the price of stock
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are more expensive than gold which means those investors are more likely invest on stock compare to gold but because of the monetary crisis the price of gold are increasingly in a short period, because during that time, buying gold are the most diverse ways are also the most risk less. As a conclusion we suggested a good investors should have some gold in their portfolio, due to the research are showing that buying gold are a good investing way to against declines, because of the reason of the value of gold only will increasing dramatically if there have a stock market crash. The research are showing that the gold price increased from year 1999 through 2006, even there is a stock market crash, lastly I can conclude that gold was a longer investment if compare to stock. Moreover gold also tends to gain in value as the value of dollar declines besides that gold also is a store of value. Gold price will go up even there's inflation, furthermore invest in gold will always maintain its value. Graph showing relationship between Gold and Stock returns (2006 - 2008) This graph are showing the return between gold and stock during the year of 2006 until 2008, due to the graft we can see the there was big different between the return of gold and stock.

Other than that, the above graft also highlighted the parabolic rise evident in value of gold, due to that we can prove that the value of gold are always place at the first permanent or first choice for those investors as the investment instrument. The return of stock is more smooth if compare to gold. Gold stock will rise during inflation i had mention earlier but other than that gold also will increase during deflation. Investing in gold is good inflation protection gold rises as the value of the currency falls. But what many people don't understand is that gold stocks will do even better during

deflation, as the government lowers interest rates significantly and wildly prints money or creating inflation to offset that deflation and leading to substantially higher gold prices. DOW JONES INDUSTRIAL AVERAGE (DJIA)The Dow Jones Industrial Average was created in 1896 by Mr Charles Dow. It is a stock market index.

It is infact the most widely used stock market index in the world. Essentially it consists of 30 public owned companies situated in the United States measuring the gains and losses of their stocks in a particular trading session within the stock market. The value is the sum of the 30 companies' stock prices divided by a divisor. The divisor alters whenever one of the company's stocks has a stock split or stock dividend, so as to generate a consistent value for the index. The DJIA performance, though mainly economic, is influenced by both internal and external factors such as corporate information; political factors both domestic and foreign as well as environmental factors that could inflict some damage to the economy. DOW/GOLD RATIO The Dow/Gold ratio compares the price of the DJIA to the price of one ounce of gold. In essence, it is generally considered as the number of ounces it takes to buy one share of the Dow.

This ratio has been used throughout history as a yardstick for economic performance. When the ratio is relatively high it is assumed that the economy is in a healthy state because stocks are performing well. However when the ratio begins to decrease it is assumed that the economy is not performing well and stocks are not performing well. Figure Comparison Dow/Gold Ratio and DJIA The graph shows a comparison between the Dow Jones Industrial Average and the Dow/ Gold ratio. On the right hand side in <https://assignbuster.com/comaprison-between-equity-and-gold/>

red is the number of gold ounces it takes to buy one share of the Dow. On the left hand side in black is the Industrial Average points. The time frame for the graph is from the year 1999 to the year 2010.

From the graph we can see a general trend, the Dow/ Gold ratio has been decreasing from the year 2001 to now. The DJIA increased from 1999 to an all time high in 2007-2008. It then sharply fell in the year 2009 and has recently began to increase once again. However even when the DJIA was at an all time high of 14200 points, the Dow/Gold ratio was 21 and in the year 2010 the ratio has fallen to an all time low of 8. 5. In the last 11 years there are various economic and political factors that affected the American economy and in essence the DJIA which would explain the decrease of the Dow/ Gold ratio to its current level of 8. .

In terms of the economy, the United States has suffered two market crashes in the last decade. In the year 2000 to the year 2002, there was the dotcom crash which was a burst of the internet economy. It was a case of too much too fast with investors blindly investing in anything associated with the internet and expecting fast returns. In the year 2007 to the year 2009, the American economy suffered yet again with the housing bubble and credit crisis which resulted in an economic recession whose effects are still being felt worldwide. The housing bubble was based on real estate speculation as the price of real estate was soaring with many investors assuming that the prices of real estate would remain relatively stable and that's not what happened. The credit crisis was brought about by the bankruptcy of Lehmann brothers which was the fourth largest American investment bank. It

also faced 2 major financial scandals in the year 2001 to 2002 and these were the Enron and Worldcom scandals.

These scandals involved misrepresentation of company statements. All these factors had effects on both the DJIA and the Dow/Gold ratio however the one with the most effect is the housing bubble and credit crisis. In terms of politics, America suffered it first terrorist attack on its own soil with the September 11th attacks in the year 2001. This subsequently led to the American government launching the infamous war on terror by declaring wars in Afghanistan and Iraq. These factors contributed to the decline of the DJIA. We can see on the graph that between 2001 and 2002 the DJIA was at a low of 7300 points. From history, we can infer that Gold performs well in times of uncertainty whilst stocks perform well under political and economic stability.

We can see that all these factors have in contributed to the decline of the DJIA and the decline in the Dow/Gold ratio as demonstrated by these events which created an element of economic and political uncertainty thereby making Gold perform well. REASONS FOR INCREASED DEMAND OF GOLD
Continued weakness of the United States Dollar – All throughout history Gold and the United States Dollar have an inverse relationship. When the dollar gains in value, gold reduces in value and vice versa. However, since the global economic crisis of 2007, the dollar has been losing value and has continued to lose up to now which is the year 2010. As a result of the dollar weakening the price of gold per ounce has continued to rise. Inflationary concerns – Many of the world's major currencies have been dropping in value. This is led by the US dollar whose value has steadily been decreasing.

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It is also the most used currency in international dealings. Because of this drop in value, the prices of most goods and services have increased.

However inflation seems to be on the rise and is showing no signs of reducing. Fragility of markets – Due to the economic recession, markets haven't fully recovered and are still reeling from the effects of the credit crisis of 2008. Economic uncertainty – This again is attributed to the economic recession, inflationary concerns and the continued weakness of the dollar. Industrial Demand – This is due to demand for Gold to be used in electronics specifically the consumer electronics industry which is still thriving. Increased demand for gold jewellery – This is especially true of Asian markets whereby there is a robust demand for gold jewellery.

Infact Gold Jewellery demand is expected to increase 11% worldwide this year despite record-breaking prices, led by buying in India and China

BENEFITS AND DRAWBACKS There is a considerable difference between gold and equity; many benefits and drawbacks. First and foremost, equity has the potential of delivering returns in the form of capital gains and dividends.

Capital gain is the amount by which an asset's selling price exceeds its initial purchase price. A realized capital gain is an investment that has been sold at a profit. An unrealized capital gain is an investment that hasn't been sold yet but would result in a profit if sold. Capital gain is often used to mean realized capital gain. For most investments sold at a profit, including mutual funds, bonds, options, collectibles, homes, and businesses, the IRS is owed money called capital gains tax; opposite of capital loss (Defining capital gain).

Dividends on the other hand are a taxable payment declared by a company's board of directors and given to its shareholders out of the company's current

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or retained earnings, usually quarterly. Dividends are usually given as cash (cash dividend), but they can also take the form of stock (stock dividend) or other property. Dividends provide an incentive to own stock in stable companies even if they are not experiencing much growth. Companies are not required to pay dividends. The companies that offer dividends are most often companies that have progressed beyond the growth phase, and no longer benefit sufficiently by reinvesting their profits, so they usually choose to pay them out to their shareholders; also called payout (Defining dividends). Apart from that, having equity allows easy portfolio diversification as the amount of shares available for investment are almost endless thus investors are able to invest in countless of companies. Being a shareholder in a company also consents to the opportunity to vote on the company board.

This is where shareholders actually have their opinions heard by the board of directors and they are able to get their point of view across in a company they have a certain treaty with. Overall, equity is very liquid which means that investors are able to convert stocks into cash effortlessly as they see fit. Gold conversely offer different forms of advantages. For example, endowing in gold is considered a safe-haven for investors as there are low risks involved. For one thing, gold reacts consistently with the inflation rate of a nation. If inflation is high, the price of gold will be high as well; unlike equity. Besides that, the demand for gold will never die.

Since the 1600, gold has been used as a form of currency. If war breaks out in a country and money is destroyed, gold will be used as a form of exchange rate because of its stability and security. On top of that, the

possession of gold is made convenient. It can be held physically as jewelry or non-physically in safes of banks (where a token is issued as a form of recognizing that ownership of a client's gold has been set aside). Moreover, gold is a universal standard for assessment where gold in United States for example will be appraised anywhere around the world with similar rates (depending on the gold price standard of that particular year). With pros exists cons. Therefore, a number of drawbacks from investing in equity are apparent.

Firstly, shares of a company can decline to zero if a company goes bankrupt. Also, as shareholders gain certain amount of shares in one's company, there is a certain level of control of the business that is traded. This is where total loss of complete control is abided. Besides all of this, estimating the fair value of stock is difficult. For example, shares in the United States cannon under any circumstance be exchanged for shares in Europe for Euros; unlike gold. Furthermore, the securities of equity are tied up to the management sector of a corporation. This is where examples of companies such as Enron and WorldCom come into play.

Enron filed for bankruptcy in December 2001. The former energy giant was undone by accounting fraud and off-the-balance-sheet transactions. In the Enron case, many players were involved in fraud at multiple levels.

Investigations have implicated several former high level executives and have brought into question the roles of many others. Enron's accounting firm, Arthur Anderson, LLP, has already been convicted of obstruction of justice because the firm allegedly destroyed documents pertinent to the Enron case. On top of that, the similar consequences occurred to WorldCom where in July

2002, major accounting errors that hid vast amounts of debt led WorldCom to file bankruptcy. The telecommunications giant faced increasing problems up to that point, but investors were unaware of the company's demise because of the accounting gaffes and intentional cover-ups.

Some former top executives of WorldCom have been accused of altering transaction and account records to conceal company debt; several have admitted wrongdoing so far (Enron and worldcom). The drawbacks of gold on the other hand are such as where dividends or any form of additional income aren't provided. Shares could be sold for almost twice; sometimes more, of its original cost. Besides that, physical gold has insurance and storage prices bestowed upon them. Paying these taxes could be bothersome to a client moreover, the total amount of insurance coverage for gold is up to \$10 000 only. Finally, a high liquidity rate is present with the ownership of gold. Cash is not as easily exchanged for gold as it is for equity.

The number one question on many investors minds are which investment would have netted a better return; gold or equity? The table enclosed below will help clarify this predicament. For example, if u had an investment of \$10 000 in gold bullion in 1999, your initial investment would have grown to \$38, 300 by 12/31/09 – an amazing 283% percent increase. That same \$10, 000 investment in stocks of the S & P index would have lost \$1, 400. That's a 14% loss. Therefore, it is obvious that there is a higher percentage of risk involved investing in equity then there is in gold. However, the benefits and drawbacks of gold have to be weighed carefully before any form of investment is made. Extensive research must be conducted prior to

investment to make sure that all forms of options are carefully understood and acknowledged.

In addition, an investor should never put all his/her eggs in one basket. Diversifying is the number one rule of investment. That way if shares or prices of gold declines, not every all ventures would be affected. Holding both diversified equity funds and precious metals funds actually lower the overall risk in one's portfolio as one can work to offset losses in the other over the long term. It's not really a question of gold vs. stocks for the average investor at the end of the day but rather how much to invest in each as a percent of one's total gold or equity portfolio.