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A study of role of gold as hedge fund against stock market volatility in India

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Abstract
Long-term investors invest their money in funds that offer them better returns and security at a lower risk. The cost of borrowing and risk returns need to be balanced. Due to a number of causes, including both macro and microeconomic ones, capital markets are more likely to experience increased volatility. The stock market is affected when any of the elements change, which makes investors doubt their investments. By hedging their money, investors can reduce the danger of their capital being depleted by stock market volatility while still managing their portfolios. The goal of hedging is to reduce or eliminate the risks associated with investing. Hedging gives investors a safe margin for saving money and aids in risk management. Protecting the money and avoiding gains are the primary goals of hedging. Hedging is akin to insurance in that it shields us from market risks and volatility, just as insurance shields us from unanticipated losses. There are several strategies to hedge money, and buying gold is one of them. The purpose of this study is to ascertain whether investing is a better choice than hedge funds. What function does investing in gold provide as a hedge against the volatility of the Indian stock market? This paper tries to investigate the moment transition between gold and stock market.

Keywords: Investment, gold investment, hedge funds, hedging, risk management, capital markets

Introduction
Capital markets have been a major focus of study in terms of many variables such as interest rate fluctuations, micro-economic factors and other financial variables. Over the globe investors have always urged to secure their portfolios to the volatility of capital markets. According to empirical research, a nation's stock markets become more susceptible to both internal and external variables after financial deregulation. One such factor is gold. In India as a store of value, a prestige and wealth symbol, and an essential component of numerous rites, gold plays a significant role in the nation's culture. Practical concerns of the mobility and security of Jewellery as an investment go hand in hand with the country's rural population's strong fondness for gold.
One important query is which investment vehicles act as a hedge (have a negative correlation with stocks) or safe haven (inversely connected with stocks after sharp drops in the stock market) during various times of market turbulence. This essential question is addressed in our work. Since gold is frequently mentioned in the financial news, we begin with it as a top contender. Jaffe (1989) [6] demonstrates how adding gold to several fictitious portfolios raises average returns while lowering standard deviations.
In order to attain the optimum risk-adjusted returns, long-term stock investors seek to optimise their portfolios. They like to add assets that would give them the benefit of diversification to their stock portfolios. Even in normal times, some investors may choose to hedge their portfolios, while others opt to shield them from severe market downturns.
People, organisations, and governments have traditionally regarded gold as a safe investment and a store of value, particularly during difficult times. It is commonly accepted that gold is a useful investment asset that can be used as a hedge in times of market volatility or uncertainty. Since precious metals perform best at times of significant market volatility, Hillier, Draper, and Faff (2006) [5] point out that the main advantage of precious metals is their capacity to hedge against unfavourable market conditions. However, Baur and Lucey (2010) [2] conducted the first study to formally examine whether gold is a hedge or a safe haven. Meaning of hedging is when an asset that is generally uncorrelated (negatively

correlated) with another asset is referred to as a strong (weak) hedge.

It should be noted, though, that a hedge does not always have the ability to lessen losses during times when markets are sharply declining because the asset may show a positive correlation during those times and a negative correlation during regular times, which could lead to an average negative correlation. Meaning of A safe haven is An asset that is uncorrelated (negatively correlated) with the stock market during times of sharp stock market falls is referred to as a strong (weak) safe haven.

In extreme market situations, a safe haven asset's unique characteristic is its non-positive connection with the stock market. Note that this feature only requires the correlation to be zero or negative during certain stock market drops; it does not require the correlation to be positive or negative on average.

Literature Review

While the stock market fell from 2000 to 2003 and then again in 2008, gold prices have been rising since 2000. Gold prices surged during the global bear market period in 2008 as panic swept through international markets. In India, indications of a stock market rebound have shown since March 2009. Although more slowly, gold price volatility and stock market return in India 50 are nevertheless rising at the same time. The capacity of the yellow metal to shield portfolios during a decline was demonstrated in 2008 when the prices of gold and stock moved in opposing directions. In reality, gold has served as a useful hedge throughout each of the two protracted bear markets (lasting at least a year) that have occurred in the last ten years. Stocks, however, don't appear to be seen as a gold substitute in India. The motivation behind owning gold is mostly determined by personal feelings. Indians' gold-investing practices are deeply embedded in the country's social psyche. Gold has been owned by people in India for many years and has been passed down through many generations. Furthermore, India's equity culture is not as advanced as that of certain other nations. Gold's primary value as a hedge against wealth loss during emergencies has not diminished, (Mishra, Das, & Mishra, 2010) [10].

Using daily data from 1995 to 2005, Baur and Lucey (2010) [2] conclude that gold is a safe haven in times of extreme stock market situations and, on average, a hedge against equities. Another study on this subject was conducted by Baur and McDermott (2010) [2], who test the theory that gold serves as a safe haven against the stocks of significant developed and rising nations in order to investigate the role of gold in the global financial system. They demonstrate, using data spanning 1979 to 2009, that gold serves as a safe haven and hedge for the major European and US stock markets, but not for emerging ones. Numerous pieces of evidence point to the asymmetry of stock market volatility, which suggests a negative correlation between conditional volatility and returns. Sherman (1980) [12] investigates the effects of gold investments for portfolio diversity and inflation hedging and concludes that gold can improve overall rate of return, offer portfolio diversification, and give portfolio managers the flexibility to offset price declines.

In various areas of investing, gold has been noted to be utilised as a hedging strategy. Due to its many advantages, it is regarded as a secure investment option. It assists in protecting against inflation, currency, and political risk (Aggarwal 1992; Capie, Mills and Wood, 2005) [1, 3]; stock returns (Baur and Lucy, 2010) [2]; economic policy uncertainty (Jones and Sackley, 2016) [7]; portfolio diversification (Sherman, 1986; Chua, Stick and Woodward, 1990) [11, 4]; forecasting (Lucey, Tully and Poti, 2004; Smith, 2002) [8]. Gold is superior to other investment options due to its longevity and widespread acceptance.

The findings of this study suggest that Indians have an innate propensity to invest in gold as a hedge against inflation, which is significant in a nation like India, the world's second-largest market for gold jewellery, where people purchase gold more for gifts, personal usage, status enhancement, or during festivals.

This needs to be discussed because, according to the World Gold Council Report (2017), income level is the main determinant of gold consumption. According to the report, the demand for gold rises by 1% for every 1% growth in income. Additionally, the demand for gold rises by 2.6% for every 1% increase in inflation. This demonstrates that gold is purchased by people as an inflation hedge. Therefore, our findings are comparable to those of the 2017 World Gold Council Report.

Gold's capacity to stabilise a portfolio and shield it from market swings is its long-term advantage.

When compared to other investment options, gold prices have historically demonstrated greater stability, especially during times of crisis. The majority of experts say that gold investments are a "must" since they build a strong portfolio that can weather market swings. Due to India's extremely low local gold production, the growing demand must be met by imports. Additionally, gold as a commodity by itself does not significantly increase the economy's potential for production because it is either stored in lockers or turned into jewellery when purchased. Money used to buy gold is prohibited in both situations, Assocham (2011). It was examined how gold might be used as a hedge against the US dollar. They discovered that the two had a bad connection that changed over time, Capie et al. (2005) [3].

Objective of the study

1. To examine the historical relationship between gold prices and stock market returns in India.
2. To analyze whether gold acts as an effective hedge or safe-haven asset during periods of stock market volatility in India.
3. To assess the short-term and long-term correlation between gold prices and major Indian stock indices (e.g., Sensex, Nifty).
4. To investigate how macroeconomic factors (inflation, interest rates, exchange rates) influence the hedging ability of gold in the Indian context.
5. To evaluate the performance of gold as a risk diversification tool in an investor's portfolio during different market conditions (bullish, bearish, and crisis periods).

Research Methodology

The period of study is from 1970 to 2025 particularly focusing on the crucial eight years starting from 2005-2006 to 2012-13. The data for this period is collected from the official website of National Stock Exchange for the Index Value and the data for the spot prices of Gold traded is collected from the official website World Gold Council.

Data Analysis & Interpretation:

Table 1: Annual Closing Value of Index (Nifty) and Returns Calculations

Date	Close	Annual Returns %Age Returns	Annual Returns %Age Returns
4/1/2005	2067.65	-	-
4/3/2006	3473.30	1405.65	67.98
4/2/2007	3633.60	160.30	4.72
4/1/2008	4739.55	1105.95	30.44
4/1/2009	3060.35	-1679.20	-35.43
4/1/2010	5290.50	2230.15	72.87
4/1/2011	5826.05	535.55	10.12
4/2/2012	5317.90	-508.15	-8.72
4/1/2013	5682.55	364.65	6.86

Source - Compiled from NSE website

Table 1 demonstrates that the index's value increased from 2067 to 5682 over the course of eight years, indicating that investors in the index eight years ago saw good returns on their capital during that time. Additionally, Figure 1 illustrates that throughout this time, the index produced negative returns in 2008-09 and 2011-2012, -35.43% and -8.72%, respectively. This was the time of the global crisis and slowdown, which also had an impact on the Indian stock markets. Despite the fact that money has increased over time, stock market negative returns make individuals anxious and indicate that there is risk in this market.

Source: data compiled from website of NSE

The Nifty Index's value from 2005 to 2013 is displayed in the graph above. It displays the movement of the Index's value over this time frame and how it ultimately increased in value at the end of the period. However, if we enlarge it and attempt to comprehend the graph, we can observe the extremely large fluctuations in the index value. Knowing when to invest in the market is extremely challenging since, as we all know, no one can timing the market.

According to the graph, a person who invested in 2005 may receive sizable returns at the conclusion of the investment term, but if the same person made an investment at the end of 2007 or the beginning of 2008, he would still be at the same level and have made no money after five years in the market. Because of their volatility, stock market returns are not consistent and are extremely dangerous, and investing in them requires a high level of market understanding. Investing in the stock market requires a lot of labour in order to get bigger profits.

From the perspective of an individual, it becomes extremely difficult for him to invest directly in the market if he is not familiar with the instruments of investment, lacks technical knowledge of investing, does not comprehend chart patterns, etc. They can invest in mutual funds, but the risk is unquestionably lower than in the stock market, and the returns are once again not as large as in the case of gold.

Table 2: Annual Closing Price of Gold and Returns Calculations

Date	Close	Annual Returns %Age Returns	Annual Returns %Age Returns
Jun 6 2005	6075	-	-
Apr 1 2006	8480	2405	39.59
Apr 2 2007	9357	877	10.34
Apr 1 2008	11831	2474	26.44
Apr 1 2009	15114	3283	27.75
Apr 1 2010	16320	1206	7.98
Apr 1 2011	20704	4384	26.86
Apr 2 2012	28000	7296	35.24
Apr 1 2013	29526	1526	5.45

Source: Data is complied from mcxindia.com

The closing price of gold from 2005 to 2013 is displayed in Table 2, along with the annual returns expressed as a percentage and in absolute terms.
Although there is variation in returns, Figure 2 illustrates that, when compared to returns from the NSE Index, or Nifty, gold returns have never been negative over the course of these eight years. In 2009-2010 and 2013, they even dropped to 7.98% and 5.45%, respectively.
Gold's returns indicate that investing in gold at any given period will provide some favourable returns for the investor, thus it doesn't appear to be a dangerous move.

Source: Data compiled form the website of multi commodity exchange

Graph 2: Monthly closing spot gold price in (Rs.)

The gold spot price data from 2005 to 2013 is displayed in the graph above. It illustrates how the price of gold fluctuated over this time and how it ultimately increased in value at the end of the period. It is quite difficult to determine the best time to invest in the market because, as was previously mentioned, nobody can timing the market. The price of gold fluctuates extremely rarely, in contrast to the stock market index graph, which allows investors to make risk-free investments.
According to the graph, a person who invests in gold in 2005 can withdraw sizeable gains at the conclusion of the investment period. If the same person invests in gold later in any year, he can still receive respectable returns.
In addition to being risky owing to their volatility, stock market returns are rarely consistent, and investing in them requires a high level of market understanding. Investing in the stock market requires a lot of labour in order to get bigger profits. However, investing in gold is less risky and doesn't require a lot of market research skills.
Additionally, gold yields fairly smooth returns.

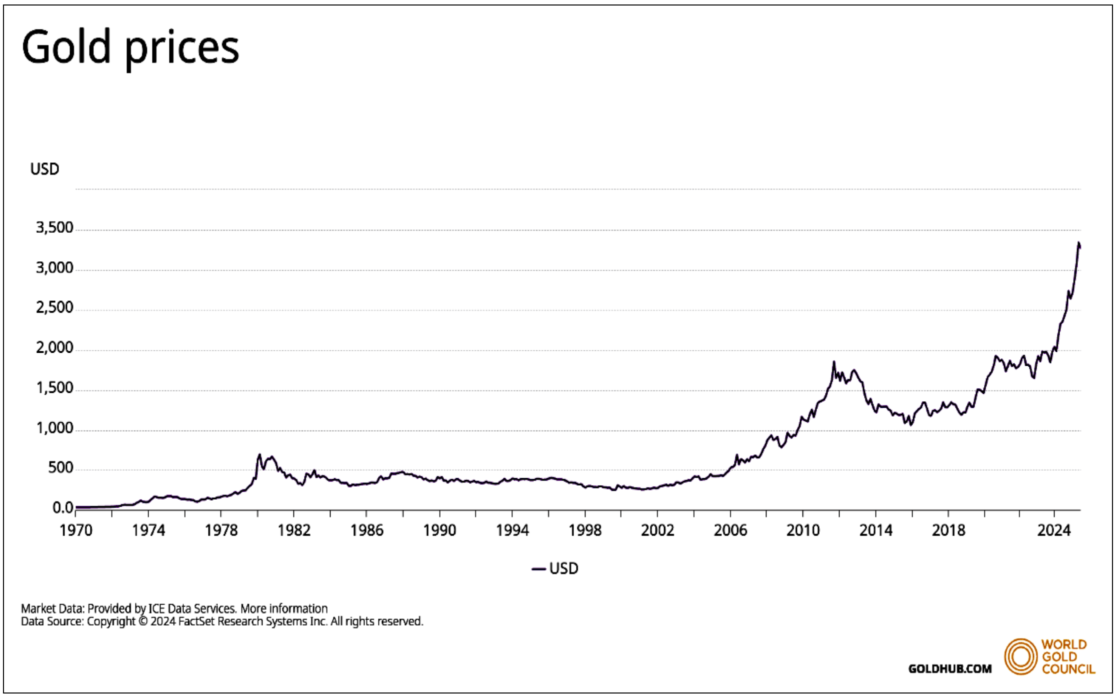

Fig 1: Gold prices in India since 1970 till 2025

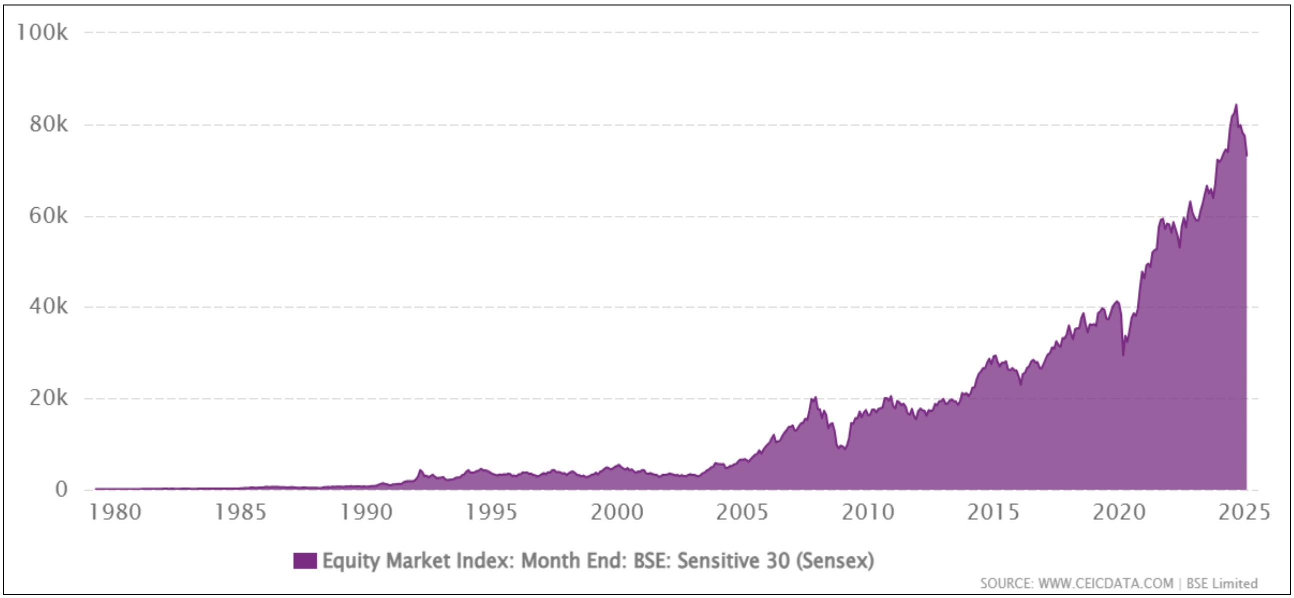

Fig 2: Equity Market Inde since 1980 till 2025

Conclusion

In India, gold investing is quite common, and over the past eight years, gold returns have been significantly higher than stock market returns. People's preference for gold investments pays up in the form of long-term, favourable returns. However, according to the report, the risk associated with gold investments is less than one-third that of stock market investments.

Additionally, investors who choose to invest in gold do not need to time the market, comprehend the intricate business environment, or be familiar with the several investment tools that are necessary if they choose to engage in the stock market. The sole consideration for an investor is that, instead of purchasing jewellery, they should purchase gold mutual funds or exchange-traded funds (ETFs), as the returns of these funds are directly linked to those of gold.

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