

How to Buy Gold and Silver TODAY

A Practical Guide, 2d Edition, August 2011

by Jerry White

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Introduction

How to acquire precious metals (gold, silver, platinum and palladium) for investment and how to create a diversified precious metals investment portfolio are the subjects of this book. It is addressed to individual investors and to their financial advisors who are familiar with investing in stocks and bonds but have little or no experience with precious metals.

Right off, let me answer a question that you might have in the back of your mind.

“Why do we need a guide?”

While buying precious metals may be as easy as calling your stock broker to place an order to buy an exchange-traded fund, an ETF is not a sufficient solution for some investors. Because gold and silver are available for investment in several forms, each of which entails some costs or risks, deciding what form to buy makes the basic buying decision more complicated than buying stocks or bonds — not least of all because investors’ motivations in buying them are more complex and not always clear.

In their physical forms precious metals are heavy, valuable and need to be kept somewhere safe. Shipping may be expensive.

Terminology is unfamiliar and arcane. Precious metals are priced at *fixing sessions* and on futures exchanges in unfamiliar *troy ounces*.

Nearly all forms of gold and silver for investment sell at premiums to the reference prices of London and Comex — and, without a guide, most investors will never learn that they did not have to pay a high premium to satisfy their investment needs. When it comes to selling back what you bought, if you took physical delivery the buyer will need to verify that your material is genuine.

You may discover only after you sell that the tax consequences of your investment depend on form you bought — and only sometimes on how long you owned it.

A guide is useful — even essential — because there is no one profession called “gold seller” that handles all forms. Rather, there are commodity brokers and securities brokers and

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coin dealers and fund managers, all of whom offer legitimate ways for investors to buy precious metals, competing with one another but with varying degrees of regulation. Add to the population of serious sellers those who are looking to make a fast buck — especially the tv advertisers and telemarketers who make exaggerated, misleading or false claims. Because their prospective customers do not have the experience to challenge them, the emotional appeals they make can cost customers dearly who fall for them.

Lastly, there are several myths and misconceptions floating around -- some coming from gold sellers of various stripes, but more coming from the mainstream press whose misinformation or biased views echo the limited asset allocation views of the financial industry it serves -- that potential buyers will benefit from the experience of a precious metals specialist who is not a gold seller and has no axe to grind.

Fewer than 5% of American investors own gold — perhaps fewer than 2%. Many more have looked at the possibility but gave up after seeing the complications and marketing contradictions. That is too bad because owning gold and other precious metals can provide security and opportunities not available with other investments. And buying precious metals does not need to be difficult.

Similarly, the average institutional holdings of gold are said to be under 2%, reflecting the lack of familiarity with the gold market by most institutional fund managers. Even after a decade of steady outperformance, gold is not accepted as an asset that can provide the benefits of diversification to institutional investors. Perhaps the low institutional holdings number will increase as the gold price rises further. If institutional interest increases, even modestly, such new buying demand will impact the gold price in a big way.

In this book we look at the various ways that individuals can acquire precious metals and analyze the benefits and risks of each. The presentation here is modeled more or less after the work of a generation ago by the eminent and irascible economist and monetary expert Dr. Franz Pick, who wrote that ***“devaluations are inevitable. They can be effected only by increasing the gold price. To devalue via peanuts, onions or paper is simply not possible.”***

Disclaimer

This commentary does not represent a recommendation to buy precious metals, and is not a representation of their suitability for a particular investor. Precious metals are

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risky investments. Their prices can fall as well as rise. If you act on the information presented, you do so at your own risk.

We are not investment advisors and are not suggesting that buying gold or silver will result in a benefit to a particular individual. That will depend on your own individual circumstances and your appetite for risk. But if you are contemplating the idea of including a precious metal in your investment portfolio, this guide will inform you about the benefits and pitfalls of various means to do that.

The markets and the global economy are dynamic, so some of the information presented in this book may become out of date. New sources and new vehicles for owning gold and silver may become available that are more appropriate than the ones cited here. Yet many of the principles that govern investment and risk have been relevant for centuries, and that is a reason that investors continue to buy gold and silver today.

Now let's get started.

Market prices of precious metals

What is a troy ounce?

Precious metals (gold, silver, and platinum-group metals) are measured and priced in *troy ounces* (from the medieval fair town of Troyes in northern France), and large quantities are sometimes stated in *metric tons*. Historically, one troy ounce was 1/12th of a troy pound (a measure no longer used), 480 grains (sometimes used to define weights of coins), or 20 pennyweights (still used by jewelers and jewelry scrap buyers).

By definition, one troy ounce is equivalent to 31.1034768 grams; thus there are 32.1507466 troy ounces in a kilo (1000 grams) and 32,150.7466 troy ounces in a metric ton (1000 kilos), typically rounded in the trade to 32,150 troy ounces. For the curious, there are 14.58333 troy ounces in an avoirdupois pound; thus a troy ounce is about 9 percent heavier than an avoirdupois ounce.

The London fixings

The most abundant precious metals (gold, silver, platinum and palladium) trade freely on and off exchanges. Their market prices are based on supply and demand as reflected by bids and offers and by thousands of daily transactions. The London gold and silver bullion markets and Comex exchange futures market are the most liquid precious metals trading

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forums. They are kept closely in line with each other through dealer arbitrage. Prices of all other forms of gold, silver, platinum and palladium are based on these markets, including coins, ingots, certificates and growing physicals and futures markets in Asia.

The so-called London fixings of gold, silver, platinum and palladium are actually auction markets. The mechanism of the fixings is to find the single price for spot (that is, physical for 2-day settlement) at which all orders of buyers and sellers (primarily bullion dealers/banks and their largest customers) are matched. The bullion dealers who are members of the fixings act as brokers and charge a small commission on business transacted at the fixings. While the amount of metal that is bought/sold at the fixings varies greatly in quantity from day to day, it represents just a small fraction of the transactions that take place based on the fixing prices among non-participants. Because a fixing price is trusted as a truly representative market price at the time of the fixing, it is used as a reference for pricing contracts between dealers, mining companies, refineries and fabricators throughout the world, especially for contracts based on the *average fixing price* for a given month.

Gold is fixed daily through conference calls starting at 10:30am and 3pm London time by the five members of the London Gold Market Fixing, who act as brokers for their customers. Silver is fixed daily at noon by the three members of the London Silver Market Fixing. And platinum and palladium are fixed daily at 9:45am and 2pm by the four fixing members of the London Platinum & Palladium Market.

Bullion dealers/banks, whether in London, New York, Zurich, Hong Kong, Singapore, Sydney, Dubai or anywhere else in the world trade throughout the day, and their realtime bid and asked prices for spot gold, silver, platinum and palladium are published on various sites on the web, including *goldprice.org* and *thebulliondesk.com*. Coin dealers base their prices for bullion coins and small bars on the bullion dealers' London delivery spot prices and will add a premium representing the mint fabrication cost and the dealer's shipping cost from the mint, overhead and profit.

Comex futures and options contracts

The Comex division of the CME Group trades gold futures and options contracts of 100 ounces minimum .995 fine during the New York day and electronically on Globex, plus "E-micro" gold futures contracts of 10 ounces on Globex; and silver futures and options

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contracts of 5,000 ounces minimum .999 fine during the New York day and electronically on Globex, plus mini-silver futures contracts of 2,500 ounces on Globex.

How not to buy gold and silver

Before we look at how to buy gold, here are some warnings about pitfalls. There are many competent and legitimate sellers. There are also a few scam artists and unscrupulous dealers. TV advertising and telemarketing have proven to be immensely profitable ways for dealers to make pitches directly to investors worried about their future well-being, and the buyer will pay for the promotions and commissions.

Hopefully we will always have the freedom to make stupid decisions, to make fools of ourselves, and to be parted from our money. That freedom puts a burden on the buyer to analyze a proposed transaction thoroughly before buying. High prices attract nefarious characters who actively try to convince unsophisticated investors into buying precious metals at outrageous premiums. Here are a few simple rules to help keep you out of trouble:

1. Know whom you are dealing with. I have listed several legitimate gold sellers in this guide and give you criteria for determining whether others are worthy of your trust. The guy who calls you unsolicited on the phone, pitches you on cable tv, or has just set up a website to sell you a “rare coin” (real or fake), may have been selling used cars yesterday. ***Do not buy anything from a cable tv seller or a telemarketer.***
2. Some gold coin dealers you may find on the web, even those who have been in business for a long time, have salesmen whose commission is based on premium over the reference gold price. They may steer you away from inexpensive bullion coins to so-called “pre-1933 rare coins” like US Double Eagles (more properly called “pre-1933 common coins”). They will tell you that these coins are not subject to confiscation. There is no truth to this assertion. You should not trust them or buy from them. Read this guide before you buy.
3. Gold coin dealers sometimes offer the convenience of holding the gold you buy from them in their “secure vault” — which really means owing you the gold. Though the dealer may be legitimate, you are its general creditor. You should avoid this arrangement. You could even find yourself a general creditor of a scam artist who has sold you non-

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existent gold and happily stores it for you in a non-existent “secure vault”. Always take delivery of physical gold you buy from a gold coin dealer.

4. Selling participations in fake or very early-stage gold mining ventures is also a popular scam. It takes years to put a new mine into operation — and that presupposes that the company has actually made a discovery that is economically feasible to exploit. In addition, a mining venture will likely fail if it does not have financial resources adequate to develop a mine and management experienced and capable of doing so. In fact, while a few new exploration ventures turn out to be very successful, the risk of failure is very high, and most new mining ventures fail. According to an old joke, a miner is a liar standing next to a hole in the ground.

Many mining exploration and development companies are registered in Canada, trade on the Venture section of the Toronto Stock Exchange, and must follow the rules of the exchange and of securities regulators with respect to representations they make regarding their resources. Some of these companies are well-financed, well-managed and have started or are nearing gold or silver production. Doing your own due diligence is essential.

5. Don't get caught up in a bidding frenzy on eBay. In fact, there is very little to recommend buying a pig in a poke, no matter how enticing the description may sound. Even a graded numismatic coin may actually be an “overgraded coin” slabbed by a third-tier grading service and presented online with a misleading link to a top-tier grading service showing a much higher value for a coin of that grade. The worst part is that you won't know you overpaid till you go to sell, years later.

6. Don't buy rare coins if you are not a knowledgeable coin collector or not willing to become one. ***No matter why you want to buy precious metals, buying rare coins is not an efficient way to invest in gold or silver.***

Now that the pitfalls are out of the way, we can look at the issues that can help you make the right choices in buying gold or silver.

Motives for owning precious metals

There are many reasons to buy gold, but it is easy to lose sight of your own motivation among the hype and chatter. Why are you considering buying? What do you want to accomplish? (For the most part, the rationale for owning gold applies to the industrial precious metals silver, platinum and palladium, all of which will be treated in this book. There are also several other very rare platinum-group metals, such as rhodium, that may be suitable for some very long-term investors, but they are not currently traded on an exchange, and their markets are not liquid.)

The main reasons people buy gold and silver today are listed below. There is some inevitable overlap in the list, and there are other considerations that will motivate an individual to buy or not buy at a particular time and which will influence the appropriate form or vehicle. Among them: one's time horizon, how much wealth one has to protect, the importance one attaches to the risk of confiscation, one's outlook on future inflation rates and future tax rates, what other assets one holds, and one's views of the economy, government actions and public debt.

Why do we care about your motivation? Because, depending on why you want to own precious metals, one form may be more suitable for you to buy than another. It may be helpful to an understanding of your own motives to look at the bull cases for gold and silver in the next section.

Six motives for owning gold

1 “Gold provides portfolio diversification”

The low correlation of gold prices to prices of bonds and equities makes gold a worthwhile addition to a mixed investment portfolio in order to smooth returns and lower the portfolio's long-term volatility. Many institutional investors will pay to avoid volatility and are attracted to gold and/or commodities as an asset class for this reason. Typical amounts are in the 3 – 5 percent range, though some fund managers maintain as much as a 15 percent allocation to commodities, including precious metals. It makes sense for every investor to include at least some precious metals in his or her portfolio.

2 “Gold is an inflation hedge — a store of value — in normal times”

Goods, land and equity prices tend to rise in price over time pressured by consumer demand as the government increases money in circulation. Increasing the money supply (a tenet of Keynesian economics) supposedly supports rising personal income, which encourages both savings and consumer spending, which stimulates the economy. The downside of such price inflation is its adverse effect on purchasing power. As prices rise, purchasing power measured in currency units (dollars) decreases. Because prices of gold, silver and other commodities will rise over the very long term — ignoring the short and medium-term effects of economic changes (booms and recessions) — owning them preserves the value of your wealth (at least before taxes).

One of the problems with the Keynesian theory is that it fails in practice if wages do not in fact increase. During the past 20 years or so, labor competition, first from Mexico and later from Asia, encouraged manufacturing to move out of the US, ultimately contributing to layoffs and a painfully slow recovery from the 2007-2008 recession. The result has been that both family living standards and business profit margins have been squeezed by higher costs.

The Fed’s view is that, at least traditionally, they can correct for inflation. When inflation is higher than the Fed’s somewhat elastic Keynesian target, the Fed might choose to raise short-term interest rates to discourage speculation and contract the money supply to reduce liquidity and aggregate demand. This would make ownership of gold and other commodities (which require financing to hold them) more expensive, leading to lower prices. It would also attract foreign currencies into dollars, bolstering the dollar’s exchange rate. Today, however, the Fed cannot raise interest rates to reduce inflation without further slowing the economy. With persistently high unemployment, taking action that would slow the economy is not a policy option.

3 “Gold is an effective hedge against dollar weakness”

When fiat money (money established by law, with no intrinsic value and not convertible into something with intrinsic value) depreciates because investors are less inclined to hold it (for any reason), gold prices in that currency are likely to rise. Among the factors that might lead an investor to avoid dollars: expectations of an expanding money supply,

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inadequate return on dollar balances because of very low or falling interest rates, fear of asset deflation, increasing risk of systemic problems affecting the banking system, increasing bond default risk. Dollar holders would exchange dollars for other currencies or gold.

The escape from fiat currencies is seen in Europe too, as Europeans concerned about bailouts of peripheral European countries trade their euros for stronger currencies — those of Switzerland, Singapore, Canada, Australia and New Zealand — and especially for gold. As the costs of maintaining pensions, medical care and other expensive benefits in the socialist countries of Europe continue to rise, the risk of failure of the entire “European experiment” also rises. The fear that bailouts will be necessary for larger countries including Spain, Italy and eventually France, continues to pressure the euro and contributes to the rise in the gold price.

The US economy is weak, characterized by deleveraging of household debt, saving rather than spending by consumers, falling housing prices amid record foreclosures, persistently high unemployment and underemployment, falling personal income, and a high percentage (approaching 20%) of families requiring food stamps to survive. The Fed has decided to counter the risk of asset deflation by increasing the money supply through whatever means it can, such as buying Treasury bonds and keeping short-term interest rates near zero. Each negative economic report is met by a rise in the prices of precious metals.

Historically, gold has exhibited an inverse relationship to the dollar, on the order of a correlation of -0.6, making it an effective hedge against dollar weakness. Official US economic policy is to encourage exports — specifically to double exports within five years. This can happen only if the value of the dollar declines against other currencies. In addition, the Fed’s money printing increases the monetary base and causes inflation, enabling the Treasury to pay off maturing debt with dollars of much lesser value than those they borrowed — essentially monetizing the public debt. Given these policies, the dollar’s value is likely to continue to fall.

The amount of the Federal debt outstanding was recently highlighted when a group of Tea Party-supported freshmen Republican representatives refused to support an increase in the Treasury’s authority to issue bonds without a decrease in government spending — or at least a decrease in accumulated deficits over time. The amount of the decrease was not all