

Investing in Precious Metals

Just because it shines, doesn't mean it is good

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Disclaimer

- Nothing in my outline or said during my presentation is investment advice.
- This is only general information intended to provoke your own thinking and research

What will we cover today?

- Should one invest in gold, silver, and/or other precious metals?
- If no, why not?
- If yes, why and how?

What will we cover today?

- What are the advantages and disadvantages of each option?
- When should someone invest in gold and when they should avoid it?

Is history a guide to investing?

- Those who fail to learn the lessons of history are doomed to repeat the mistakes of the past.
- Warren Buffett's quip to the effect that if history were the guide to riches, the Forbes 400 would consist of librarians.

Factors that Affect the Price of Gold

- Consider current economic and market conditions, the trends, and the outlook for various asset classes including cash, stocks, bonds, and alternative investments such as real estate, timber, private equity, commodities, and other asset classes.
- As of February, 2012, interest rates are very low in the U.S. and the Federal Reserve Chairman has indicated his intent to keep them low thru the end of 2014.

Factors that Affect the Price of Gold

- Interest rates in the market affect a variety of investments and may affect them differently.
- Falling interest rates usually increases the value of real estate because of the lower cost to finance the cost of it. Increasing interest rates deters many buyers so demand falls and prices decrease

Factors that Affect the Price of Gold

- Increasing interest rates usually hurts the stock market too because expected future earnings are discounted at a higher rate thereby lowering the value of those earnings.
- Decreasing interest rates increases the prices of fixed interest rate bonds while increasing rates decreases the prices of bonds especially longer term bonds.

Factors that Affect the Price of Gold

- Interest rates are not the only variable that affects the future performance of various asset classes. Other variables include the true inflation rate, the real interest rate (nominal interest rate – inflation rate), the value of the dollar and whether its value is expected to increase or decrease and how the dollar fluctuates in comparison to other currencies, and market expectations regarding these factors, and other variables.

Factors that Affect the Price of Gold

- Due to very low interest rates, many investors look for other investments where they can be a better rate of return. Low interest rates mean the “cost to carry” investments is low thereby increasing demand by some investors such as hedge funds. As interest rates rise, demand for gold is expected to fall which should mean decreasing gold prices.

Factors that Affect the Price of Gold

- Supply and demand
- What affects each?

Factors that Affect the Price of Gold

- The growth of the middle class in China & India
- Their cultural preference for gold
- Much of the gold they buy will not come back into the market

Factors that Affect the Price of Gold

- China's central bank is buying gold to diversify their reserves
- May buy 50% of the new gold production over the next 5 years
- New gold production increases about 1.5% - 2% per year

Consider

- Not only what people say but who is saying it and why
- What are they not saying?
- Actions speaks louder than words

Should one invest in gold?

- Depends on one's objectives, risk tolerance, and expectations about the future
- Many people have opinions
- Are all opinions of equal value?

What does Warren Buffett say?

- In 1998, Warren Buffett said: "Gold gets dug out of the ground in Africa, or someplace. Then we melt it down, dig another hole, bury it again and pay people to stand around guarding it. It has no utility. Anyone watching from Mars would be scratching their head."

What does Warren Buffett say?

- In 2009, he echoed these thoughts in a CNBC interview. He was asked, “Where do you think gold will be in five years and should that be a part of value investing?”
- I have no views as to where it will be, but the one thing I can tell you is it won't do anything between now and then except look at you. Whereas, you know, Coca-Cola will be making money, and I think Wells Fargo will be making a lot of money and there will be a lot — and it's a lot — it's a lot better to have a goose that keeps laying eggs than a goose that just sits there and eats insurance and storage and a few things like that.

What does Warren Buffett say?

- In October 2010, Warren stated: “You could take all the gold that’s ever been mined, and it would fill a cube 67 feet in each direction. For what that’s worth at current gold prices, you could buy all – not some—all of the farmland in the United States. Plus, you could buy 10 Exxon Mobils, plus have \$1 trillion of walking-around money. Or you could have a big cube of metal. Which would you rather take? Which is going to produce more value?”

What does Warren Buffett say?

- In the February 27, 2012 issue of Fortune, Buffett wrote:

Today the world's gold stock is about 170,000 metric tons. If all of this gold were melded together, it would form a cube of about 68 feet per side. (Picture it fitting comfortably within a baseball infield.) At \$1,750 per ounce -- gold's price as I write this -- its value would be about \$9.6 trillion. Call this cube pile A.

What does Warren Buffett say?

- Let's now create a pile B costing an equal amount. For that, we could buy *all* U.S. cropland (400 million acres with output of about \$200 billion annually), plus 16 Exxon Mobils (the world's most profitable company, one earning more than \$40 billion annually). After these purchases, we would have about \$1 trillion left over for walking-around money (no sense feeling strapped after this buying binge). Can you imagine an investor with \$9.6 trillion selecting pile A over pile B?

What does Warren Buffett say?

- Beyond the staggering valuation given the existing stock of gold, current prices make today's annual production of gold command about \$160 billion. Buyers -- whether jewelry and industrial users, frightened individuals, or speculators -- must continually absorb this additional supply to merely maintain an equilibrium at present prices.

What does Warren Buffett say?

- A century from now the 400 million acres of farmland will have produced staggering amounts of corn, wheat, cotton, and other crops -- and will continue to produce that valuable bounty, whatever the currency may be. Exxon Mobil ([XOM](#)) will probably have delivered trillions of dollars in dividends to its owners and will also hold assets worth many more trillions (and, remember, you get 16 Exxons). The 170,000 tons of gold will be unchanged in size and still incapable of producing anything. You can fondle the cube, but it will not respond.

What does Warren Buffett say?

- Admittedly, when people a century from now are fearful, it's likely many will still rush to gold. I'm confident, however, that the \$9.6 trillion current valuation of pile A will compound over the century at a rate far inferior to that achieved by pile B.

What does Warren Buffett say?

Our first two categories enjoy maximum popularity at peaks of fear: Terror over economic collapse drives individuals to currency-based assets, most particularly U.S. obligations, and fear of currency collapse fosters movement to sterile assets such as gold. We heard "cash is king" in late 2008, just when cash should have been deployed rather than held. Similarly, we heard "cash is trash" in the early 1980s just when fixed-dollar investments were at their most attractive level in memory. On those occasions, investors who required a supportive crowd paid dearly for that comfort.

Is Buffett Right?

- Why did Warren Buffett write the Fortune article?
- Does he care about the American public?
- Does he have an agenda?

Who is the Investor?

- Their area of competence?
- What do they know about the factors that affect the price of precious metals?
- How much time do they spend studying?

Ways in Invest in Gold

- Physical form vs. Paper form
- Physical form includes bullion bars, bullion coins, and numismatic coins
- Remember the commercial featuring G. Gordon Liddy?

Ways in Invest in Gold

- Paper form include:
- Gold ETFs
- Gold indexes
- Mining company stocks – Majors & Juniors
- Options on stocks
- Futures
- Options on futures

Ways in Invest in Gold

- Bullion bars vs. Bullion coins
- Gold coins are preferred over bars because of their liquidity! An investor will pay a premium for the coins but they get liquidity
- Bullion bars are less liquid because any buyer will get them tested or analyzed for their purity

Bullion Coins

- There are different coins including:
- U.S. one-ounce Eagles and American Buffalo Gold Bullion Coins, the first 24-karat gold coins produced by the U.S. mint starting in 2006.
- \$20 Double Eagles
- Austrian Philharmonics
- Canadian Maple Leafs – 5 different sizes (1 troy ounce, 1/2, 1/4, 1/10 & 1/20)
- Krugerrands

Bullion Coins

- Physical ownership means the owner must store and protect their investment
- Home safe
- Bank safe deposit box
- Third party storage facility – storage agreement and certificate
- Expense of shipping, insurance, storage
- BRINKS Global Services USA, Inc.
- Peace of mind

Silver

- Silver is more volatile than gold.
- Many view silver as “2nd tier” behind gold.
- Silver has industrial uses so demand for it should increase as economic activity increases but it is not attractive in a recession.
- Silver can be purchased like gold.

Silver

- Another play: Silver Wheaton – it provides financing to silver mines in exchange for silver at a low fixed price; it locks in the spread between that price and then current market prices. From its web site:
- Silver Wheaton is the largest metals streaming company in the world, and derives more than 95% of its revenue from the sale of silver. The company has entered into fourteen silver purchase agreements and two precious metals agreements with nine operating partners, including Barrick Gold Corporation and Goldcorp Inc.
- Silver Wheaton shares are listed on both the Toronto Stock Exchange and the New York Stock Exchange under the symbol 'SLW'.

Investing in Palladium

Article: The Ins and Outs of Palladium Investing

The precious metal could get a boost from stronger auto sales and other industrial demand

BY [ED MCCARTHY, CFP](#)

November 18, 2011

Conclusion

- Before investing, especially in a new area, investors should study long & hard
- Don't make emotional decisions
- What is your view of the future and what is happening around the world?

Questions?

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