

John Cummuta White Paper

Precious Metals

Investing in gold and other precious metals has been attracting a lot of attention lately. You may have heard ads proclaiming “gold has never been worth zero.” These ads would have us believe there will come a time when our money won’t be worth the paper it’s printed on. Although I’m not in that camp, based on what has happened to the world’s economies over the past few years, their argument is gaining credibility and popularity.

Gold is a popular, even mythical metal, and it attracts most of the attention, but it isn’t the only metal worthy of your consideration. The three other major investment metals are platinum, palladium, and silver. All four have risen in price over the past several years as demand has increased around the world. While many people associate precious metals with jewelry and coins, these metals are also used in manufacturing. The emergence of China and India as major participants in global manufacturing has contributed to higher demand for industrial purposes.

Gold is a critical element in the electronics industry as an integral part of many high technology components. It’s an excellent electrical

conductor, it's corrosion-resistant, it's chemically stable, and it's a superior heat shield. NASA has built many a space gadget around these golden virtues.

Platinum is used in medical equipment, computers, and automotive parts. Palladium is softer than platinum, and is a key element in catalytic converters due to its ability to resist oxidation and endure high temperatures. It's highly conductive so it's sometimes used instead of gold in electronics. Palladium's other applications include raw material processing, photo processing, water purification, fuel cells, and the refining and purification of oil and natural gas.

Why Buy Precious Metals?

The value of the U.S. Dollar declined more than 30% from 2001 through 2004, plunging 5% in just a few weeks. For a long list of reasons, including massive increases in U.S. government deficits totaling trillions of dollars, the cost of a prolonged war against terrorism, and a massive trade imbalance, this trend may be just the beginning. This means U.S. dollars could now be worth less and less every day. Which also means that investments pegged to the U.S. dollar could be worth less and less every day.

We're all aware that the U. S. government took dramatic action to combat the Great Recession. The benefits of the government gushing hundreds of billions of dollars into bailouts and stimulus have been mixed, but the effect on the national debt is obvious. At the same time the government was taking this fiscal action, the Federal Reserve was rapidly inflating the money supply. At some point this stimulus will have to be withdrawn and our record low interest rates will have to increase to hold off retail inflation. How successful this strategy will be, and how it will affect future economic growth, are questionable.

So many people around the world are asking, "If the U.S. dollar fades in value because the government has simply diluted the nation's Gross Domestic Product with too many dollars, what asset category will hold value?"

The answer for many has been, "Precious metals."

How Can You Invest in Precious Metals?

There are five common ways to invest in gold and other precious metals:

1. Tangible coins and bars
2. Precious metals mutual funds and ETFs
3. Stock in mining companies
4. Certificates

5. Gold and metals futures

Mutual Funds

Let's start with mutual funds. An example of a broad precious metals fund with a mining component is Vanguard Precious Metals and Mining ([VGPMX](#)). For a more diversified metals fund, look at Oppenheimer Gold & Special Minerals ([OPGSX](#)), which usually keeps a fair amount of assets in platinum-group metals. For a more gold-centric fund, check out American Century Global Gold ([BGEIX](#)).

ETFs

The most popular precious metal Exchange Traded Funds are [GLD](#) (gold), [SLV](#) (silver), [PALL](#) (palladium), and [PPLT](#) (platinum). Because ETFs trade on an exchange, each transaction is generally subject to a brokerage commission. Commissions depend on the brokerage company and which volume plan is chosen by the customer. For example, a typical flat fee schedule from an online brokerage firm in the United States ranges from \$10 to \$20, but the cost can be as low as \$0 with discount brokers.

Due to this commission cost, the amount invested has a great bearing; someone who wishes to invest \$100 per month may have a significant percentage of their investment destroyed immediately, while for

someone making a \$200,000 investment, the commission cost may be negligible. Generally, mutual funds obtained directly from the fund company itself do not charge a brokerage fee. But when low or no-cost brokerage transactions are available, ETFs become very competitive.

ETFs have a lower expense ratio than comparable mutual funds. ETFs are almost always in the 0.1% to 1% range. Mutual funds can charge one to three percent. Not only does an ETF have lower shareholder-related expenses, but because it does not have to maintain a cash reserve for redemptions, it saves on brokerage expenses. Over the long term, these cost differences can compound into a noticeable difference.

The cost difference is more evident when compared with mutual funds that charge a front-end or back-end load. ETFs do not have loads at all. The redemption fee and short-term trading fees are examples of other fees associated with mutual funds that do not exist with ETFs.

Precious Metals Futures

I do not recommend non-professional investors messing with any kind of futures contracts, so I'm not even going into the subject.

Hold Your Gold

If you're interested primarily in safety against troubled times, you'll want to focus on tangible coins and bars. This means you're looking at bullion and numismatics. Gold bullion (or bars) is pure or almost pure gold. Numismatics are minted coins, which often commemorate special occasions. The same applies to silver.

Don't just buy from the first place you feel comfortable with. Shop around, because the markup on coins and bars will vary. One popular choice for coins is the one-troy-ounce size because they're easy to buy, sell, and store. But educate yourself about the numismatics market. Like many valuable assets, the values in numismatics are based on more than just quantity. The design and condition of a coin can affect its price as much as the precious metal content itself.

Newly minted coins:

- Gold: American Eagle, Canadian Maple Leaf, South African Krugerrand, British Sovereign, Vienna Philharmonic, Mexican Gold 50 Pesos, and U.S. Mint 24K Gold Buffalo
- Platinum: American Eagle, Australian Koala, and Canadian Maple Leaf
- Palladium: Palladium Canadian Maple Leaf

- Silver: Canadian Silver Maple Leaf, Silver American Eagle, and Austrian Vienna Philharmonic

Bullion Bars are produced by some government mints, as well as private companies:

- [Johnson Matthey](#)
- [Wall Street Mint](#)
- Credit Suisse ([CS](#))
- Engelhard (no longer in production but available on the market)
- [Ohio Precious Metals](#)
- [Academy Group](#)
- [Pan American Silver](#)

When you begin looking for precious metals, search for both online and brick-and-mortar precious metals dealers. Find out how long the dealer has been in business, whether he or she specializes in one segment of the market, and who the typical client is. If you know someone who is satisfactorily investing with a precious metals dealer, that would be your best endorsement.

One dealer that seems to be popular with TV and radio talk show hosts is www.goldline.com.

Storing Your Bullion and Coins

Numerous options are available for you to store your precious metals. The first important step in making this decision is defining your risk tolerance and your level of trust.

The simplest method is to purchase through a dealer that also offers **storage at a “secure” facility**. Here’s where you’d have to trust that your metal actually exists in someone’s vault. Your metals are registered, numbered and stored for a fee. Fees are generally defined by the amount you have in storage. Here are a couple web sites of dealers offering both purchase and storage:

www.bullionvault.com/

www.goldline.com

Of course the downside to this type of ownership is that you never see the physical metal. It’s entrusted into another’s care. While I am not aware of anyone losing their investment with this option, there are those who entertain worst-case financial meltdown scenarios that would much prefer access to their assets if they’re needed. Also, in any possible government confiscation situation, storage with a secure facility virtually assures a paper trail with your name on it.

Safe deposit box option: Cost is dependent on the size of the box, but you can expect costs to be in the neighborhood of one hundred dollars a year. Safe deposit boxes are generally located inside a bank. If you're thinking about this option, it's a good idea to walk into your bank and ask the bank manager for their policy regarding access to your safe deposit box in the event of a bank closure or a run on the bank. Will safe deposit box customers be given access to the inside of the bank? I did this little exercise and was surprised to find that the bank manager didn't know the bank's policy...or if there even was a policy. And the contents of your safe deposit box are not insured so no protection exists in the event of robbery.

Storage at home: While I am sure it would be fun to sit at your kitchen table and stroke your gold bars, you might feel more vulnerable with this option. If you intend to purchase over ten thousand dollars in precious metals and you want to store it at home, it would be a good idea to purchase a large safe and have it bolted to the floor in an out-of-sight location. By adding a home security system you would limit intruders to a short window of time to dislodge a securely attached safe weighing several hundred pounds.

- Advantages: you are in possession of your savings if they are needed. With a safe you can also store other important artifacts or documents.
- Disadvantages: you may feel your assets are more vulnerable than with other storage options.

Certificates

If you don't want to worry about safely storing your precious metal investments, choose certificates. A certificate represents ownership of a certain quantity of a specific precious metal. Certificates offer investors all the benefits of physical gold ownership minus the hassle of transportation and storage. That said, if you're looking for insurance in a real disaster, certificates are just paper. Don't expect anyone to take them in exchange for anything of value. For information on buying certificates, just search the Web with terms like "gold certificates" or "precious metal certificates."

Be Careful

Because of their volatility, precious metals should represent only a small portion of your portfolio. I recommend ten percent at the most. The most conservative way to invest in precious metals is through a mutual fund

or ETF. They're professionally managed, diversified and particularly well-suited to new investors.

The drawback to precious metals is that they increase in value only when the price per ounce goes up. By contrast, stocks and bonds can pay dividends even when their market price is declining. If conditions for gold are poor, your stash can sit for years doing virtually nothing. However, in this climate of out-of-control government spending, it seems prudent to build a hedge against potential runaway inflation...or worse.

There's no doubt that the demand for metals is on the rise, but this doesn't necessarily translate into immediate price increases since the supply is constantly changing due to active mining and sales by large holders. Before buying precious metals, **do your own research**. If you decide to buy coins or bullion, you will need a safe place to store them. Be prepared for volatility in the price, and unless you are an experienced trader, it's important to keep a long-term perspective.