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The Ultimate Guide To Buying Gold

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The Ultimate Guide To Buying Gold

Introduction

The Ancient Greek philosopher Aristotle (384 BC – 322 BC) cited five key attributes of money: durability, portability, homogeneity, and divisibility. It must also be hard to counterfeit. To which we can add one more factor, scarcity, to arrive at six key attributes of "good" money:

i) Durability
ii) Portability
iii) Divisibility
iv) Scarcity
v) Homogeneity
vi) Difficult to falsify

Why are these desirable in money? And why is gold "good money"?

Durability is an easy concept to grasp, and it's not hard to see why it should be regarded as a good monetary attribute. Physical money — coins and notes — is only as good as long as it's recognisable tender. Coins that damage easily will eventually fall out of circulation, because traders will be unwilling to accept them as payment. Durability in money has declined in importance with the rise of electronic payments, but to the extent we still use physical currency or physical backing of currency, it is important.

Gold has incredible durability. It does not rust, tarnish, or corrode, and no substance that appears commonly in nature can destroy it — special acids are the only way of dissolving it. Gold is also the most malleable and ductile metal known to man; one single ounce can be beaten into a 300-square foot sheet. This makes it easy to shape into coins and bars.

Physical currency also needs to be portable. What after all, is currency used for? As a means of paying for goods and services, which is considerably harder if you're using, say, a herd of cattle as the means of payment. This is why notes and coins are the only form of physical money in developed economies.

This leads into Aristotle's third requirement: divisibility. This is why you can't use fine art as money, as it would be rather hard to chop the Mona Lisa into lots of smaller parts, and still claim that added together, the different part of the portrait were all worth the same amount as the old (whole) portrait.

Scarcity is the reason why elements such as iron or aluminium do not make good money. Aluminium occurs at a rate of 82,300.00 parts per million in the Earth's crust. By contrast, silver — the most common of all elements in the periodic table deemed "precious metals" — occurs at a rate of just 0.075 parts per million. The equivalent figure for gold — though it is not the most scarce precious metal — is just 0.004.

Crude oil is divisible, durable, portable and very useful. On top of this, easily extractable oil deposits have been increasingly hard to find over the last half century. So why don't we use barrels of the black stuff as money?

Because, whereas gold — which sits at number 79 on the periodic table — is a uniform grade and has fixed properties, oil, corn, wheat, soybeans and other such commodities come in many different grades, which makes their use as money far more complicated. Gold's homogenous nature supports its use as money. And, as with other commodities, the space needed to store $10,000 worth of crude oil is much greater than the space needed to store $10,000 worth of gold — a storability issue. The gold/silver ratio currently stands at around 55. This means that if you want to store an equal amount of gold and silver in US dollar terms, it will take you 55-times as much space to store the silver than the gold.

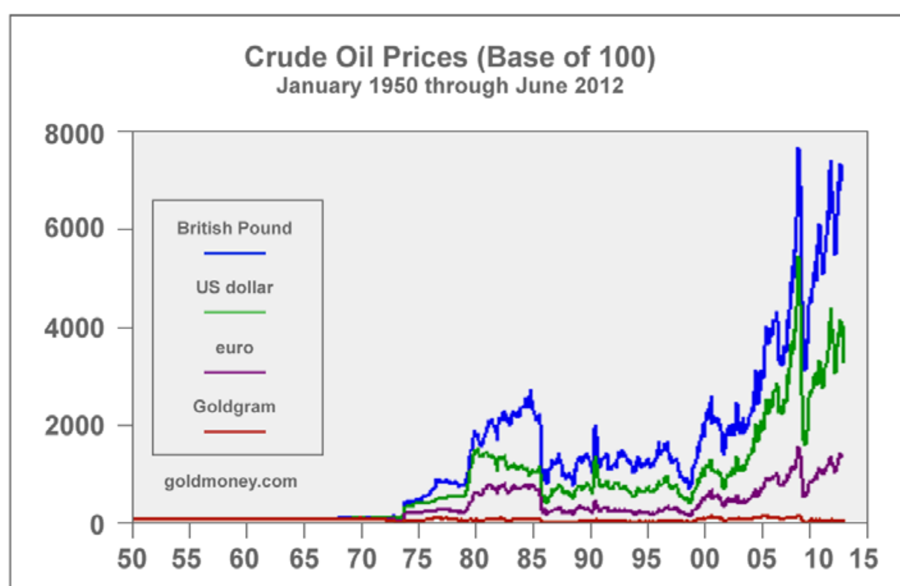
Aristotle's last attribute of good money — that it is hard to falsify — is another point in favour of gold money. Alchemists have famously expounded much time and effort trying to replicate gold, but to no avail. The only way to add to the total stock of aboveground gold is by mining more of it. There are many different types of tests that bullion dealers can use when assessing gold products — such as visual checks of the product using microscopes; weight, size and sound tests; as well as magnet tests and ones involving nitric acid (where the phrase "the acid test" comes from). All of these and other such tests can easily tell fools' gold from the real deal. For more information about this topic, be sure to have a look at the GoldMoney Laboratory, which provides information on precious metal production, processing and quality assessment testing.

All of these physical characteristics have led many people to conclude that as far as commodity money is concerned, gold is king. In the words of J.P. Morgan: "gold is money and nothing else". This is a slight exaggeration given that gold also has some important industrial uses. But Morgan's sentiment captures gold's suitability as money — a suitability that is above and beyond that of any other asset or commodity.

Preserving Your Purchasing Power — Why Buying Gold Works

In 2011, just 2,818 tonnes of new gold was mined, which is around 1.7% of the total aboveground gold stock at the end of 2010. Since 1492, the year of Columbus's first voyage to the Americas, the aboveground stock has never increased by more than 5%. As of July 2012, the World Gold Council records the world's total aboveground gold stock at 171,300 tonnes. This is just 2.9% of the entire weight of the Hoover Dam. Or imagine a cube where each side measures roughly 20 metres (60 feet); to put this in perspective, 60 feet is the length from a tennis court net to the back fence. Or imagine this gold cube placed adjacent to the Washington Memorial or in the Capitol Reflecting Pool:

Gold's scarcity and the relative consistency in the increases in aboveground stock have important implications when considering its use as money. A gram of gold has bought roughly the same amount of wheat since the Middle Ages, and has maintained its purchasing power well when compared with national currencies, as the following crude oil price chart shows (note that the Deutschmark is used as euro proxy prior to 2002):



This phenomenon is best described in Roy Jastram's book *The Golden Constant: The English and American Experience 1560-2007,* which examines the consistency in gold's purchasing power from 1560 in England, and 1800 in the USA.

This doesn't mean steadiness, as a key theme of the book is the sometimes "long swings upward and downward" in gold's purchasing power. Sometimes these trends away from the mean can be short and sharp, such as during America's Civil War, when wholesale goods priced in gold soared. But these war years were followed by a long stretch from 1864 to 1897 when gold steadily increased in value relative to wholesale products. The "Retrieval Phenomenon" always applies in the end. The author comments: "Whether ascending for a time, or falling away for substantial intervals, commodity prices turned back toward the steady level of gold prices."

How Can I Buy Gold?

Broadly speaking, there are two ways of playing gold. By buying physical gold, or by buying "paper gold". The latter may mean futures or options contracts, which can allow people to make big money by leveraging gains in the gold price. Mining shares are a third category of gold asset.

This guide will discuss the various options relating to gold ownership — coins, bars, ETFs, closed-end funds, certificates, and bailment products. But what about gold futures and the shares of gold mining companies? Are they also neat ways of taking a stake in the yellow metal?

Futures

Gold futures and options are traded primarily at the Commodity Exchange in New York (Comex), a subsidiary of Chicago-based CME Group Inc. The great attraction of futures is that they offer the tantalising prospect of leveraging gains in the gold price. The real amount of money that you have to put up to enter a position is a fraction of the notional value of the contract — probably around 5%. So using 5% as an example, to enter a "long" position on a standard 100oz Comex gold contract — which at a gold price of $1,650/oz has a notional value of $165,000 — you would only need to stump up $8,250.

Cash settlement on futures positions occurs on a daily basis. This is a necessary function of delaying delivery for a commodity, as without daily settlement people who entered into deals that subsequently went against them might choose to walk away from their obligations. If the price of your $165,000 contract goes up by 2%, then $3,300 is credited to your trading account. So a mere 2% up move translates into a 40% gain on your initial outlay ($8,250). Not bad.

Of course, the reverse is also true, and the nub of why futures trading is inappropriate for most people who are looking to buy gold. A 2% loss on your long position would mean you had to pay the person on the other side of your trade — in futures parlance, the "short" — $3,300, meaning that you would only have $4,950 of your initial $8,250 investment left. If the price declined by 4% the following day, then you would owe another $6,468 — which would wipe out your stake entirely. At this point you would either be forced to add more money to you account to meet the exchange's maintenance margin — and run the risk of losing even more than $8,250 if the price action goes against you for a third day in a row — or if you did not do that, your broker would close your position, and you will have lost all of your money with no chance of gaining it back. You may also be liable for more broker fees and outstanding losses.

Those with sufficient trading savvy can make a lot of money very quickly from futures. But most people lose money trading futures, and they are simply not suitable for anyone who is just looking to take a buy and hold position in gold that they do not need to pay much attention to.

Mining Shares

In contrast, mining shares offer the opportunity of leveraging gains in the gold price, and can be suitable as buy and hold investments that you needn't pay too much attention to on a day-by-day basis. This is particularly true if you just buy a fund or ETF that invests in many different companies, meaning you reduce risk via diversification across lots of different producers. Two of the popular gold producers' indexes are the AMEX Gold BUGS (Basket of Un-hedged gold Stocks) Index (symbol: HUI), and the Philadelphia Gold and Silver Sector Index (symbol: XAU).

Dramatic run-ups in the gold price usually translate into good gains in the stock prices of many miners, as gold gains relative to their production costs. A 10% increase in the gold price could mean a 40% increase in a mining entity's profits. This is particularly true for smaller producers and exploration companies; the gains in many of the latter can be truly astonishing during gold bull markets. To give one example, the shares of Vancouver-based Glamis Gold languished for much of the 1990s under $2 a share. But in January 2001, its low-cost Marigold mine in Nevada began producing, and investors woke up to the company's potential. Over the following six years, Glamis's stock price soared from $1.50 to $40, before the major Canadian producer Goldcorp bought the company in 2006.

So when things go well for investors in the mining sector, big money can be made — as with futures, more than if you'd simply bought and held the actual metal. But the downsides of gold mining investments also need to be considered. The most obvious of these is that when you buy mining shares, you are buying a stake in a human enterprise, and are thus exposed to any number of things that could and often do go wrong.

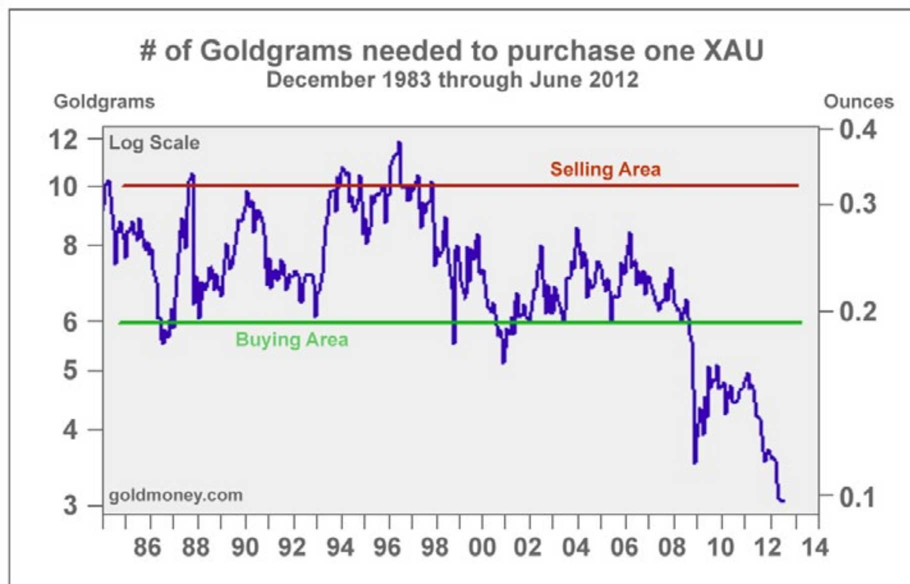
Collapsing mineshafts and other onsite accidents can instantly wipe billions off the market capitalisation of even well established senior producers. Miners face political risk as well: whether it is in the form of "windfall" taxes, or, in worst-case scenarios, nationalisations and expropriation of investors' assets.

On top of this — as has been painfully apparent to many mining investors in recent years — despite the theoretical promise of leveraging gains in the gold price, miners often do not outperform bullion. Consider that in July 2002, the HUI averaged 107.35, while the gold price averaged $314/oz according to the London PM fixes that month. 107.35 divided by 314 gives a "HUI/Gold Ratio" of 0.354. But in July 2012, despite the gold price going from the low $300s to $1,600 over the previous decade, the HUI/Gold ratio stands at 0.275. So the HUI, a modified equal dollar weighted index of 15 of the largest gold producers, has actually underperformed gold over a 10-year span of the metal's latest bull market.

This underperformance is even more striking when you consider that the HUI represents *unhedged producers* — companies who are not engaging in forward sales of gold based on conservative price predictions. During a bull market, unhedged miners should be far more profitable than those that hedge, as they sell gold at the market price. This should mean rising profit margins and, as many have been led to believe, outperformance relative to percentage gains in the gold price.

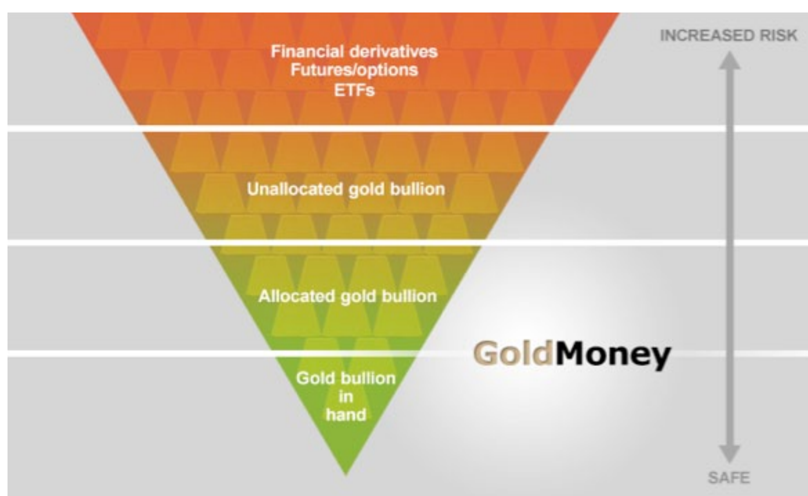
The recent underperformance of gold shares relative to bullion is even starker when comparing the XAU Index — which includes hedged producers — to gold.

But past performance is no predictor of the future. Mining shares may outperform gold over the next decade; the fundamentals for these companies are certainly bullish enough. Careful research and diversification across different producers is the order of the day if you choose to go down this road.



Physical Gold

This guide focuses on the pros and cons associated with various gold bullion ownership methods — be they coins, bars, certificates or bailment operations. Some of these products are "physical gold" in the true sense of giving you title or direct ownership of gold. Others are better described as "paper gold" products offering exposure to gold rather than ownership. Consider the risk pyramid below. Gold is insurance and a means of protecting capital. The higher up the pyramid you go, the greater the liquidity and the greater the ease of trading gold. But this comes at the cost of greater insecurity. In the words of Franco-Nevada Chairman Pierre Lassonde: "Bullion doesn't pay interest or dividends, nor does it grow or expand by itself. That's the price you pay for tranquillity."

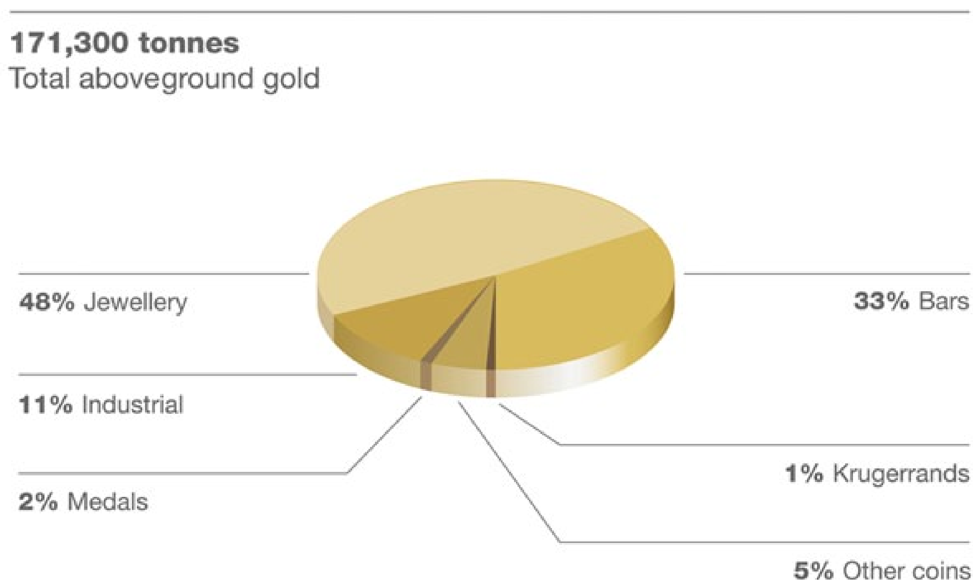


Coins

Before the dawn of the internet era, coins and bars were one of the only ways that ordinary investors could own physical gold. And as any visit to eBay will show you, there is still a thriving market in gold coins — both in terms of famous brands such as Krugerrands, Canadian Maple Leafs and American Eagles, as well as in rarer “numismatic” or collectable coins. Some of the most popular coins are listed below:

South African Krugerrand
Canadian Maple Leaf
Vienna Philharmonic
American Gold Eagle
American Buffalo
French Napoleon
Chinese Gold Panda
UK Gold Sovereign
UK Britannia
Australian Gold Nugget

Most people interested in holding gold coins for their monetary value as opposed to aesthetic reasons tend to favour coins produced by national mints. This is on account of their name recognition and the greater liquidity of the market in these when compared with numismatics. The Krugerrand has proven particularly popular, with a total circulation of around 55 million ounces. But still, this is only about 2.6% of all gold that exists in investable form as coins and bars, which gives some idea of the variety of bullion products — as well showing how little aboveground gold exists in the form of coins.



Krugerrands are embedded with a copper alloy that makes them more durable and harder to scratch, making them more suitable for barter (though it reduces their gold purity slightly). You will always find someone who’s willing to buy or trade such coins — in contrast to collectable coins, which you may find harder to trade in an emergency.

Gold coins are often designated as legal tender in the country in which they were minted (as is the case with Krugerrands in South Africa) — though the face or legal value of the coin is always far below that of its actual market value. Governments often apply tax breaks to coins minted in their jurisdiction that are deemed legal tender; so for example in the UK, capital gains tax does not apply to the proceeds generated from sales of gold Britannias and Sovereigns, but it does apply to sales of "non-British" gold coins. Similarly, sales tax (or VAT) may not apply to coins that tax authorities deem "investment bullion" — which usually covers all of the popular gold coins — but may apply to numismatic coins.

It may be wise, however, not to place too high a priority on tax issues. In a monetary crisis, the gold coins that will be of most use are the ones that are most accepted, and this may not coincide with those coins that attract tax breaks or legal tender recognition in your country of residence.

And if you spend a lot of time travelling or are planning on emigrating, you need to be sure that traders in all the jurisdictions that you frequent readily accept the gold coins you choose to hold. This also means that you are better off buying the most well-known and durable coins on the market.

Bars

Gold bars can vary in size from tiny 1-gram ingots (sometimes called "wafers") all the way up to the "London Good Delivery" 400oz bricks held in central bank vaults around the world. Though Good Delivery bars are described as weighing 400oz, they are permitted to vary in gold content weight between 350oz and 430oz — but they must have a purity of at least 99.5%. The world's largest gold bar (image to the right) sits in the Toi Gold Museum in Japan, weighing 250kg (551.150lb).

Wealthier investors may favour holding bars on account of the ease with which they allow large amounts of gold to be stored in one place. Larger bars also offer a cost advantage over coins, in that larger amounts of gold have smaller percentage premiums attached to the price. This means wealthy investors can save significant amounts of money by buying bars as opposed to coins.

Premiums on coins and bars are an important consideration. You will always pay slightly over the spot price for any precious metal, as this is how dealers make money. Generally, the smaller bullion is and the harder it is to produce, the larger the percentage premium (it costs the same amount of money to produce a ¼-ounce coin as it does a one-ounce coin). Rare bullion will also attract higher premiums; some intricately designed coins and bars can command premiums worth millions of dollars above their metal content value.

Popular bullion typically attracts premiums ranging from 4% to 8% above spot — with larger gold purchases attracting lower premiums. They can go higher, though. During the 2008 financial panic, premiums in the US on some popular one-ounce coins reached as much as 15%. Likewise, when you sell bullion back to dealers, you can usually expect a discount of 4-8% depending on the amount you are selling.

Security is something else to consider with coins and bars you take possession of.

Obviously there is no issue with counterparty or performance risk as far as coins and bars are concerned. Once you have bought them and they are in your possession they are indisputably yours, and do not constitute a liability as far as anyone else is concerned. This is the most important point in favour of physical possession of bullion: that there is no one standing between you and your gold.

However, security from theft and burglary is another matter. You may be tempted to store metal in a safe, but you'll then have the problem of hiding it, as in the event of your house being burgled it may be possible for a group of strong thieves to steal it. Buying a safe adds to your expenses, as do insurance costs. The more gold you keep at home, the more these costs become a factor — something especially relevant to owners of large gold bars.

Perhaps the biggest drawback of owning gold in the form of coins and bars is the lack of liquidity when compared with third-party storage on an internet platform. If you ever need to sell your gold in order to raise cash for whatever reason, it's more time consuming to do this by selling to an actual high street dealer than it is if you have a web-based ownership platform. Some people may be able to negotiate sales of coins and bars through internet dealers, but others will not have this luxury — perhaps because of the availability of such services in their country of residence. Also, you will have to pay delivery costs when selling large amounts of gold back to dealers. For small coins this may not amount to much, but for large bars the charges will be higher.

If you are only holding gold as insurance against some sort of manmade or ecological disaster, then liquidity will not be an issue for you; but if you are holding gold because you anticipate making a profit on it and selling it to a higher bidder at some point in the future, then coins and bars may be a less suitable means of holding gold. In addition, there may come a time when online gold payments for goods and services become common place, in which case choosing to buy gold online could be the wiser choice.

Coins & Bars: Pros and Cons

Pros	Cons
Actual physical possession of your gold	Security and insurance issues associated with storing large amounts of gold at home
No counterparty or performance risk	Lack of liquidity in comparison with internet-based ownership
Plenty of recognisable and easily tradable products to choose from	Risk of paying over-the-odds for bullion, on account of excessive dealer premiums

Gold Certificates

The rules governing gold certificate schemes vary according to national law and the legal designs of products. Nevertheless, a few general points can be made that investors need to consider before buying these products.

First, the basic nature of any certificate is that of the promise of payment. Back in the days when the United States and other countries were still on gold standards, their currencies were basically gold certificates. Notes issued by various banks were promises to pay the bearer a certain quantity of gold on demand.

Today, when you buy a gold certificate you become the unsecured general creditor of the bank, mint or trading firm that issued the certificate. This is similar to the process that occurs when you deposit money at your bank. In both cases, your asset — be it a certificate of cash deposit or a gold certificate — is your asset, but sits as a liability on the balance sheet of the entity that issued it.

This is an important distinction to grasp, as in contrast to physical gold ownership this introduces an element of counterparty risk. Counterparty risk is the risk you take when you accept someone's promise. The person or firm extending the promise is your counterparty, and the gold you place with them becomes a liability on their balance sheet that is owed to you. In other words, title as well as possession of your property transfers to the counterparty, meaning that you become their creditor. So their financial strength is important to the safety of your gold. Their financial capacity determines the prospect that your gold will be returned to you after asking your counterparty to make good on their commitment.

In the words of GoldMoney founder James Turk: “a certificate is not a vault receipt… many people do not understand this difference.” It pays to be wary of the distinction between “allocated” and “unallocated” gold.

Allocated gold is when you are the direct owner of a specific quantity of metal. You are the defined and recorded owner — and crucially, the manager of the vault where you store your metal has no claim on it. Companies that offer allocated storage typically charge 0-1% of the value of the gold as a storage fee, and should also offer insurance and third-party verification that they are in fact safely storing the amount of gold they claim to hold for their customers.

But with unallocated gold, because your bullion shows up on the vault operator’s balance sheet as an asset — with your claim to it a corresponding liability for them — then in the event of their bankruptcy, any of their creditors would have first claim to these assets. This could leave the entity’s customers with no access to the metal (liabilities) promised to them. So it pays to be careful with regards certificate programmes, or any other kind of “paper gold” product where a third-party stands between you and your bullion.

It is however true that certain certificate programmes offer physical redemption opportunities and assurances that the gold they hold on behalf of customers will not be lent out. It is also the case that reputable certificates can offer a cheaper means of staking a claim on large amounts of metal when compared with buying physical metal, and can also offer people a good means of diversifying their financial assets and mitigating political risks such as the threat of confiscation.

Gold Certificates: Pros and Cons

Pros	Cons
Can offer a cheap way of staking a claim to large amounts of gold in comparison with buying coins and bars	There is counterparty risk Most of these programmes offer unallocated gold
May offer geographical diversification opportunities	Possibly no physical redemption options or limited to the stock available

Exchange-Traded Funds

An exchange-traded fund (ETF) is a portfolio of stocks, bonds, options, and/or other instruments that trades on an exchange. They are designed to closely track a particular index, sector or group. As with ordinary shares, they can be bought and sold at the click of a computer mouse, and can be sold short, owned on margin, and incorporated into tax-free investment shelters. You can also set limit and stop-loss orders with ETFs in order to protect yourself during times of market volatility.

Combine this flexibility with low management fees — most ETFs charge less than 1% per annum — and the ability to place bets on any sector of the market (non-commodity ETFs allow you to diversify your risk among tens if not hundreds of companies) and it's hardly surprising that ETFs have proliferated in popularity over the last two decades. According to Wikipedia, as of September 2010 there were 916 ETFs registered on US stock exchanges, with $882 billion in assets — an increase of $189bn over just the previous 12 months. Many more will surely have sprung into existence since then.

Gold ETFs of course track the gold price, though as a consequence of the operating expenses you pay on them, they will always underperform the actual metal price slightly. This is referred to as "tracking risk".

ETFs are financial products rather than physical gold. They offer exposure to the gold price, but not title to a specific quantity of gold. With this in mind, it's important to ask yourself why you are buying gold in the first place. If it's because you want to trade gold frequently, then ETFs may well be the right option for you. The convenience of being able to "buy gold" through your existing stockbroker is a plus — especially in comparison with the effort it takes to deal in coins and bars with high street bullion dealers.

As with Comex futures and options, gold ETFs also offer the opportunity of playing both sides of the gold game, as it's possible to be "short" gold ETFs — meaning you profit when the gold price declines. How does this work? When you short something — be it a stock, commodity or bond — you borrow it from an owner and sell it, in the hope of being able to buy it back at a cheaper price than you sold it for, returning the asset to the person you borrowed it from having made a nice profit on the difference between your sell price and your buy price.

These strategies can be used effectively by seasoned traders, but are less suitable for the majority of investors, as in contrast to going "long" on an asset, your losses from short-selling anything are potentially infinite. It's doubtful that a stockbroker will even let you dabble with short selling unless they are satisfied that you are experienced enough to handle these products.

As far as most retail investors are concerned, gold ETFs start and end with simple buy and sell orders on the actual stock. Convenience is a major selling point for ETFs, but retail investors should remember that most ETFs are paper gold products, that rely on a functioning financial system to work properly. If you are buying gold as a hedge against problems in the financial system, ETFs are less suitable. They offer no practical way for average investors to take physical delivery of gold, and the custodial arrangements they use for the gold they store can be opaque. Some ETF managers contract out storage to custodians (banks hired to store the ETF gold) who in turn arrange for smaller sub-custodians to deal with storage.

However, some prospectus may absolve the custodian from any liabilities arising from sub-custodian solvency, while the funds may absolve themselves of the responsibility to monitor sub-custodians, despite these being the people entrusted with the fund's gold. Indeed, ETF trustees may have extremely limited legal rights in terms of oversight of sub-custodians. There is a wider legal point that people need to consider here, in that the web of ETF custodians and sub-custodians can spread across many different countries. In the event of problems, courts in various jurisdictions may take years to arrive at a solution.

As with certificates, gold ETFs rely on a third-party — in the case of ETFs, the banks that have been assigned as custodians — to make good on a promise. This is not the same thing as owning physical gold. It pays to read the prospectuses of these products, as individual funds will differ from one another. If you are only interested in owning gold as a trading vehicle, then ETFs may make sense. But if you are buying gold as a means of escaping counterparty risk, then you may think the issues raised here can be deal breakers.

Gold ETFs: Pros and Cons

Pros	Cons
Low management costs	Does your ETF actually own the gold it claims to own?
Ease of buying and selling online through regular stock brokers	Lack of physical redemption opportunities in big or small bars
The ability to short-sell gold, use stop-loss orders, buy options, etc	Counterparty risk resulting from chains of custodians and sub-custodians

Closed-End Funds

On the surface, closed-end funds (CEFs) looks identical to ETFs. Both trade on stock exchanges just like ordinary shares, and both represent shares backed by other assets. In the case of closed-end gold funds and gold ETFs, it is the amount of gold they claim that gives these entities' stock value.

However, these superficial similarities mask important differences. For starters, CEFs have a fixed number of shares outstanding. This is in contrast to ETFs, which are passively managed by fund companies that issue and redeem shares on demand from investors. With CEFs — barring occasional share buybacks and secondary offerings — investors may only trade their shares on the secondary market. As far as gold CEFs are concerned, this means that the amount of gold they own is fixed for long periods of time — until such a point when the fund decides to buy more bullion and issue more shares.

Because of this fact, gold CEFs trade on the basis of supply and demand for the fund as a professional entity, rather than just on the basis of the total value of the gold they hold. This means that the share price of a CEF can trade at significant premiums and discounts to their net asset value. Net asset value represents each share's portion of the total value of the fund's gold holdings.

This can work to your advantage, as the premium on shares issued by the best-known and most reputable gold CEFs may increase as more investors look to invest large amounts of money in well-regarded gold assets. That some of these funds also offer physical redemption options is an added bonus, though usually you will have to own large amounts of gold (400oz+) in order to take delivery. The flip side to this is that you will likely be paying a significant premium for a given amount of gold. This disadvantage might be outweighed for some by the prospect of an increasing premium, and the fact that CEF gold is — unlike ETF gold — allocated and subjected to periodic inspections and audits.

Managers of CEFs are responsible for gauging demand for the underlying assets they've invested in, and for deciding whether or not to make secondary offerings or buyback shares. It is this management that to a large extent determine whether or not CEFs trade at a premium to net asset value or not, as investors will be far more willing to entrust their money with managers who have proven track records. Bear in mind, however, that active management means higher management fees than would be the case with passively managed funds.

Closed End Funds: Pros and Cons

Pros	Cons
Offers the flexibility associated with stock trading	Management fees
Usually allocated, audited gold, with physical delivery options	Premiums over net asset value can mean you get "less gold for your buck" than with other ownership methods
Possible profits from increasing premiums over net asset value	
Allows you to diversify your gold holdings into different jurisdictions	

Bailment Gold

Bailment gold operations — sometimes referred to as "allocated gold", or "vaulted gold" — offer their customers a forum for buying and selling gold over the internet, with storage outsourced to specialist vault operators. They are similar to some of the other ownership methods discussed above. However, bailment is a legal agreement between two parties whereby the customer (the bailor) retains the full rights to his or her gold, while the bailment company (the bailee) keeps the metal for safekeeping. Unlike other forms of gold ownership where those storing the metal are legally entitled to lend other people's metal out in order to earn money, bailees are generally not permitted to do this.

This is the closest thing to physical ownership people can get without actually holding the metal themselves. While you are obviously dependent on the storage provider for security promises, your metal is not their property in terms of legal ownership. This means that in the event of their bankruptcy, their creditors will not have a claim on your gold.

Bailment programmes of all shapes and sizes make their money through fees on storage and buying — and with some companies selling — metal. So why not just store the metal yourself and cut out the middleman and his fees?

Because these companies are buying and selling metal in bulk on behalf of thousands of customers in the form of large bars, premiums are low owing to economies of scale. In addition, you can place buy and sell orders for metal at anytime of your choosing, because metal ownership is through a web-based customer interface. This offers an obvious advantage over coins and bars for people who are looking to make regular purchases of gold. It's easy to set up a standing order from your bank to buy a certain amount or cash value of gold each month, and far more convenient than going down to your local coin shop to buy. And if you are a frequent traveller or spend a lot of your time in multiple jurisdictions, internet-based ownership that can be linked to one or more bank accounts in different countries has advantages over other ownership methods.

Gold bailments also offer great opportunities in terms of diversification. No one can say with any certainty what the future will hold for gold holders in terms of taxation, regulation and even confiscation of their bullion. For that reason, it makes sense to diversify your gold holdings. Bailment operations that offer storage in multiple countries are a way of doing this.

The more countries and continents you can choose from, the better you can diversify yourself. At GoldMoney, we offer customers storage at VIA MAT vaults in the United Kingdom, Switzerland and Hong Kong, as well as G4S storage in Hong Kong, and an additional gold vault operated by Rhenus Freight Logistics at Zurich Airport in Switzerland. Customers can buy gold online, as well as silver, platinum and palladium using nine major currencies. Top-quality governance and audit procedures provide assurances that the metal recorded in customers' Holdings is backed one-to-one by metal in the vaults.

Those who choose such gold products do not have to worry about counterparty risk, but they do have performance risk — namely that the representations made by the company are accurate and that it is fulfilling the terms of its customer agreement. To mitigate this risk, companies should provide regular audits of the gold stored on behalf of customers, as well as for other important aspects of their businesses. It is this independent third-party verification from reputable auditing firms that confirms your precious metals are safe.

These audits should be available to every customer. Ultrasound scanning of gold bars and comprehensive governance procedures are likewise essential guarantees.

Of course, the acid test of a bailment company's commitment to physical gold are its physical delivery options. Bailment programmes usually offer their customers this service — even for those with small amounts of gold — though terms and conditions will vary between companies; GoldMoney offers Baird & Co. 100-gram and 1-kilo gold bars for delivery in certain countries, and can also arrange delivery of larger amounts of gold and silver as well.

This is in contrast to closed-end funds and other web-based ownership vehicles, where only wealthy investors may take physical delivery of gold. This is another plus point in terms of flexibility and asset diversification.

Bailment Gold: Pros and Cons

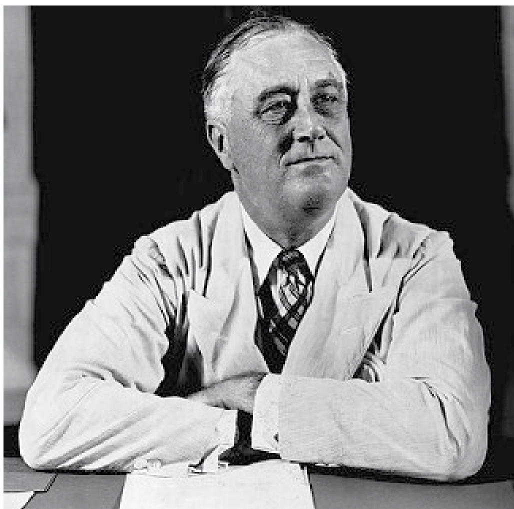
Pros	Cons
Ownership of physical gold	Storage fees?
Allows diversification for where you store your gold	Do you have the option of diversifying between metal in your possession and metal stored elsewhere? Some dealers may not offer delivery options for smaller investors or to certain countries
Provides a convenient internet-based platform for buying and selling, with low fees in comparison with premiums on coins and bars	
Physical delivery options	

Conclusion

How you choose to own gold is just as important as your initial decision to buy. Get the means of ownership wrong and you could end up in just as much financial difficulty as those people who never even attempted to buy in the first place.

Diversification is key. Putting all of your eggs in one basket in terms of gold ownership isn't a good idea. But what should you diversify between? If safety is your paramount concern, then coins and bars, allocated storage schemes and closed end funds are the best options.

The threat of government confiscation and/or moves to curtail gold dealing also needs to be considered by all gold owners, but especially by those who have chosen to store all their gold in just one country. There are historical precedents for such confiscations and restrictions — most famously President Franklin D. Roosevelt's decision to confiscate US citizens' gold in 1933. Americans weren't allowed to own gold again until 1975. It makes sense to diversify your assets — both in terms of what you own and where you own it — in order to mitigate such risk.



Roosevelt: his gold confiscation still holds warnings for investors

Gold offers a simple and time-proven method of protecting capital during periods of economic and geopolitical uncertainty. In the words of gold analyst Jim Sinclair, the yellow metal is "a barometer of fear and confidence" and an insurance tool. And as he rightly points out, you don't trade insurance. So if you're looking to gold as a safe-haven play, it makes sense to stick to the most conservative ownership options. When you buy gold as insurance, you are looking to at a minimum preserve your purchasing power — and hopefully increase it relative to many other consumer goods and services.

How much risk do you perceive there to be in the financial world? This is the crucial question to ask when assessing the desirability of different gold investment products.

Thanks for taking the time to read The Ultimate Guide To Buying Gold. If you have enjoyed it, you might want to share it on Twitter using the following button link:

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