THE MONEY MORNING GUIDE TO GOLD AND SILVER INVESTING









From: *Money Morning* Research Staff

The Money Morning Guide to Gold and Silver Investing

Smart investors know that few assets have held their value longer throughout history than gold and silver.

That's one of the reasons gold and silver are universally regarded as the best safe-haven investments. They are hard, tangible assets that cannot



suddenly become worthless due to trading manipulation or panic-driven overselling.

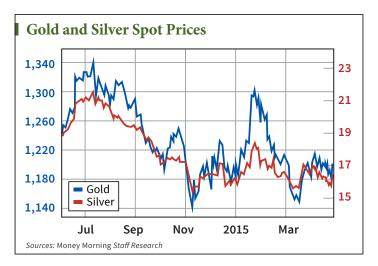
Gold and silver investments aren't meant to be played for quick or explosive gains. They go hand in hand with other precious metal investments as a way

"I believe holding precious metals is no longer optional. It's a requirement for every investor."

~ **Money Morning** Chief Investment Strategist Keith Fitz-Gerald

to diversify and provide an asset uncorrelated to the broader market movements.

While a massive market correction can drive down all share prices, gold and silver prices are driven by factors such as geopolitical events, central bank activities, and interest rates. Gold prices are also influenced by fluctuations in demand caused by purchase of the yellow metal for weddings and cultural celebrations in India and China, such as Diwali and the Chinese New Year.



While there are technical indicators that point to a price rise or drop in gold and silver, the best investing approach is still to think of them as a fixture in your portfolio – there to act as insurance against shocks.

There are many vehicles through which you can own gold and silver, and we'll take a look at all of them in this guide. These include:

- Coins, bars, or other means of physically holding the metals
- Pooled accounts or certificates that offer unallocated ownership of physical gold and silver
- Futures contracts
- Publicly traded vehicles, like stocks and exchange-traded funds (ETFs)

Many gold and silver enthusiasts like the tangibility factor in owning physical gold and silver. Physical ownership isn't for everyone – it does come with risks and liquidity or logistic issues, which we'll detail here. Then you can decide which precious metal investments are right for you.

Let's take a look at the gold and silver investments to choose from today...

Owning Physical Gold and Silver

Bullion and Coins

Possessing gold and silver coins or bars is the oldest and most direct form of ownership for these metals. In fact, in some cultures, people keep their entire savings in physical gold and silver.

Owning physical gold and silver also lets you side-step credit risk, which "I have physical silver... I might have bought some at the top, but I don't care what the price goes to; I will not sell that physical silver. It's there for a reason – just like I have insurance on my car, I have insurance in case of a disaster."

~ **Money Morning** Defense & Tech Specialist Michael A. Robinson

is an inherent problem to holding contracts. We'll get more into that later.

Storing a large amount of gold or silver will come with overhead costs, whether you choose to let bank vaults act as custodian or you buy your own secure safe to keep at home. As noted by JMBullion, a precious metals dealer, safes can cost anywhere from \$100 to several thousand dollars.

You can, however, generally offset some costs of premiums by buying in bulk, as opposed to buying say, a single Silver Eagle coin. This is referred to as "value density," according to *Money Morning* Resource Specialist Peter Krauth.

Banks can also store your gold or silver, but there are concerns about accessibility and security. The federal government has seized bank stocks before, and if this were to happen again, you could be deprived of your hard-earned investment.

There are a variety of options available to you for the purchase of physical gold and silver:

• **Gold coins:** American Eagles are the most trusted form of physical gold products on the market. They offer a convenient

and cost-effective way to add physical gold to your portfolio in several denominations of your choosing: 1/10th-oz., 1/4-oz., 1/2oz., or full 1-oz. coins. American Buffalos are 1-oz., 24-karat coins that provide a simple way for investors to own gold bullion that's also a form of legal tender (\$50 coins). Investors pay a small premium to cover coining and distribution costs associated with this newer asset class (since 2006).

- Gold bars: These are available in a variety of weights, ranging from as small as one ounce to over 100 ounces. It's important to have a safe place to store your new asset and factor in the cost of storage to the purchase.
- Silver coins: Because silver is so much cheaper than gold on a per-ounce basis, a single coin is within everyone's reach. Coins typically come in 1-oz. sizes. The Silver American Eagle (0.999 fineness) currently sells for about \$20, and the Canadian Silver Maple Leaf (0.9999 fineness) typically sells for a similar price to its American counterpart.
- Silver bars: Like gold bars, buying silver in bar form will get you more silver for your money. Silver bars are available in a number of sizes. Try to stick to recognized "Good Delivery List" bars, which will be easier to sell and bring top dollar should you do so.



Investors can purchase coins directly from the U.S. Mint or privately owned specialty mints, such as the Franklin Mint and the Bradford Exchange, which produce specially designed commemorative and collectible coins. However, these generally have high markups over the spot price of gold and silver. What's more, there isn't much of an aftermarket, and – in many cases – the actual bullion content of the coins isn't enough to make them a true investment.

A way around that is to find an established dealer with a strong reputation and shop around. Bullion dealers are one of the most straightforward ways for most investors to buy gold or silver. But buyers also need to be aware that vendors will charge a premium on top of the spot price when selling physical gold or silver.

These retailers have to pay overhead to store and secure physical products, and premiums are a means of pricing these costs in. The total premium is determined by the quality and the silver or gold content of a product. Do some homework to check them out before you purchase. Under normal circumstances, expect to pay 3% to 6% premiums above the spot price for physical gold or silver.

When economic conditions are driving investors to safe havens, like in the heat of the financial crisis, premiums can go up three to five times higher, with some dealers charging 10% to 15% above spot. Obviously, you're better off waiting for price dips and calmer circumstances.

Here are five reputable dealers to consider:

- **Kitco Inc.** (kitco.com) With offices in New York, Montreal, and Hong Kong, Kitco offers fair premiums, and their selection is usually good.
- **David Hall Rare Coins** (davidhall.com) In business since 1977, DHRC deals in gem-quality coins, including gold rarities. They can help build collections that take you well beyond hedging, too.
- Camino Coin Co. (caminocompany.com) Based in Burlingame, Calif., Camino has been in business for more than a century.
- American Precious Metals Exchange (apmex.com) Based in Oklahoma City, Okla., APMEX carries a wide range of pre-1933 classic U.S. gold coins.

Pools and Certificates

Another option is to acquire gold or silver through pools or certificates. These programs are more affordable than purchasing physical

gold and silver because the gold and silver is generally kept in what is called unallocated storage. This means that you don't actually own the gold or silver, in the strict sense of the word, but you are invested with many other investors in a large, privately owned pool of it.

These are cheaper than owning physical gold or silver because they also have more inherent risk. In this case, if the bullion bank where the pool is being stored goes under, they will reclaim the precious metals and you lose out.

Some options are considered less risky, because the gold and silver is not only locked away in a vault, but it is also insured. Perth Mint Certificates (PMC), for example, are government-backed bullion storage certificates, with the State of Western Australia standing firmly behind them.

Investors need to commit at least \$10,000 to get started in PMCs. And, there are small, but reasonable, fees to obtain your certificate and trade your holdings. But, it's also a great way to gain some international diversification for your gold investments, by owning it outside of your home country. Dealers

such as Kitco offer PMCs.

"Gold will take off in any global panic."

Pool accounts are attractive to investors who want to be able to acquire the physical metal at a time of their

~ **Money Morning** Capital Wave Strategist Shah Gilani

choosing. Investing in gold or silver stocks or exchange-traded funds will not usually offer that advantage. Otherwise, however, the same strategies that attract investors to pools and certificates can be employed through ETF investing.

Trading Futures Contracts

A futures contract is a legal obligation that promises the delivery of gold or silver in the future at a set price. There is a standard time and

place for delivery, amount of gold or silver, and quality that is put into place on the futures exchange. The only factor that changes is the price of the contract.

Gold and silver futures contracts are traded on the COMEX and the eCBOT exchanges and require that you set up a margin account and plunk down a portion of the cost of the product.

Futures contracts are typically traded for very specific investment strategies, such as hedging a physical position. Because the price of a futures contract is correlated to the spot price of the underlying gold or silver, a loss in one can be offset by a gain in the other.

If, for example, a prospective investor in physical gold is concerned about a likely increase in gold prices, he or she could buy a futures contract now, at a set price. If the price of gold goes down, the investor will lose on the contract, but still be able to buy gold at a cheaper

"Futures contracts are a great way to gain leverage on the price of gold or silver. Investors control many more ounces through leverage by requiring only about a small margin of the value of the ounces under contract."

~ **Money Morning** Resource Specialist Peter Krauth

price. On the other hand, if the price of gold goes up, he or she would be making money on the gain in the futures contract, which would then go toward purchasing the physical gold at the higher price.

Just as gold and silver themselves are used as a hedge or a kind of insurance against the risk of a potential economic downturn, futures contracts are a way of managing risk related to physical commodities like gold and silver.

While they can also serve as a way for investors to eliminate the middle man and trade gold and silver without some of the complications or costs of physical ownership, futures trading is complex and risky and should only be engaged in by traders who really know what they're doing.

For example, one contract promises the future delivery of 5,000 ounces of silver, generally at a warehouse or storage facility outlined in the contract. As a casual investor, you will likely not be able to reasonably afford and store that much silver, which is why you will only be trading the contract representing it.

If the price of silver moves up, you can look for someone willing to buy that contract at a higher price and pocket gains. If the price goes down, you'll see the futures contract decline in price. If it declines enough that your account dips below the margin requirement, you'll be forced to put down more money into the account. And exchanges can adjust these requirements, demanding contract holders to put up more funds or sell.

And that's not the only risk...

Futures contracts are only held for a certain period of time, and you will need to roll over your position into another futures contract for a later month. Otherwise you'll have to take delivery of the product and foot the astronomical bill of, for example, 5,000 ounces of silver (at the time of writing this, that's more than \$80,000).

There is also the kind of credit risk we mentioned earlier, which can be avoided by owning physical gold or silver. As Peter Krauth explains, "It's only paper, and I fear at some point a futures exchange could default if too many contract holders ask for delivery at the same time."

That may be seem unlikely, but it's a risk. And this taken together with the other risks that futures trading entails should give investors pause.

Gold and Silver ETFs

For investors who want to benefit from the advantages of gold and silver investing while eliminating the burden of storage, gold and silver ETFs are a great option. These funds allow investors to take advantage of the unique characteristics of these metals without having to buy an ounce of physical coins or bullion.

ETFs may well be the easiest, most cost-effective way to get exposure to gold and silver, and they are great for conservative investors. One example is the **SPDR Gold Trust** (NYSE Arca: GLD). This ETF seeks to replicate the price of gold and is the largest ETF backed by physical gold – you cannot take delivery, but if you aren't concerned about owning physical gold, this makes perfect sense. It is also highly liquid and easily bought and sold.

The most popular silver ETF is the **iShares Silver Trust ETF** (NYSE Arca: SLV). The fund backs its shares with about \$6 billion in physical silver in **JP Morgan Chase & Co.** (NYSE: JPM) vaults in London and New York. Each share represents the price of about one ounce of silver.

There are many ETFs you can look into, each trying to find advantage through varying degrees of innovation in how they track the performance of silver or gold. Here are a few that have been highlighted by *Money Morning* experts in the past...



Central Fund of Canada

Ltd. (NYSEMKT: CEF) holds a mix of gold and silver bullion and is traded on the Toronto Stock Exchange in addition to the New York Stock Exchange. There are no transaction fees other than your broker's commission.

Sprott Physical Silver Trust (NYSE Arca: PSLV) holds silver bullion that is fully allocated and stored at a secure third-party location in Canada, subject to periodic inspection and audits. The only problem is that PSLV makes you pay a premium above the spot price of silver as well. And that premium can be extremely volatile.

The **ETFS Silver Trust** (NYSE Arca: SIVR) is less popular than SLV, but it has SLV beat in cost efficiency. Management fees peg SLV's expense ratio at 0.5, while SIVR's is lower at 0.3.

Merk Gold Trust (NYSE Arca: OUNZ) is one of a small handful of gold ETFs that *do* allow investors the opportunity to turn in their shares for the delivery of actual physical gold bullion, like bars and coins. Should investors want to take physical delivery of gold tied to the ETF, they can redeem it in the form of London bars. Smaller amounts can be redeemed, too: 1-oz. American Gold Eagles or American Gold Buffalos, Australian bars (either 1 oz. or 10 oz.), Australian Gold Kangaroo coins, or Canadian Gold Maple Leaf coins.

If you're looking to try for some larger gains by taking on a riskier approach than just buying up shares in the standard ETFs, you might look at leveraged ETFs like **ProShares Ultra Gold** (NYSE Arca: UGL) or **ProShares Ultra Silver** (NYSE Arca: AGQ). Funds like UGL and AGQ seek to double the performance of spot gold or silver.

This could magnify gains, though of course the risk is such that it can also magnify your losses. And what's more, it thrusts the conservative precious metals investor into the thick of the financial system, which is often what gold and silver investors are looking to avoid.

ETFs like UGL and AGQ can't double the performance of silver simply by sitting on the physical product and holding it in vaults. These funds generally hold financial instruments like futures contracts rather than investing directly in the physical metals or related stocks. They seek to capture gains trading derivatives. If you're (understandably) wary of the often confusing derivatives market – especially given the above-mentioned risks related to futures trading – you're better off buying into the safer ETFs that only look to follow gold or silver's movements...

ETFs allow investors to get precious metals exposure via a variety of funds that either track futures contracts – like UGL and AGQ – or own physical bullion. But it's important to remember that, for all intents and purposes, these are essentially stocks. In the same way you can't redeem a company's hard assets by buying shares, you can't redeem physical gold and silver from ETFs – unless you hold one of the rare funds like OUNZ that specifically allow you to redeem shares.

Beyond ETFs that just represent physical gold and silver, or derivatives, there is another approach to investing in these metals through stocks that can also be very advantageous.

Owning Gold Stocks

The other option for gold and silver investors who may not be interested in owning the metals directly is investing in gold and silver mining companies. As prices for precious metals shoot up, so, inevitably, will profits for the companies that produce them.

As with the other vehicles we've outlined, you have a multitude of options. The most important thing to remember is that with stocks come leverage *and* volatility – that's great when gold and silver go up, but it can be less than pleasant on the way down.

As for individual stocks, there are four main categories: major producers, intermediate producers, junior producers, and finally junior explorers.

Major gold producers churn out at least 1 million ounces a year and include the world's largest gold miner, **Barrick Gold Corp.** (NYSE: ABX). With 138 million ounces of resources and producing 7.8 million ounces annually, this is the undisputed leader.

• **Intermediate producers** are the next tier. They produce in the 200,000 to 1 million ounces range. With intermediates look for good geopolitical characteristics and a decent anticipated growth

profile. Many have multiple mines and reliable cash flow.

"Bullion doesn't throw off cash. But mining stocks can."

Junior producers
 have less than

 Zeroutive Editor
 Bill Patalon

200,000 ounces of annual production, often sourced from a single mine. Here you'll want to aim for the potential to grow the company's production and resources over time through existing or new projects.

• Junior explorers are among the most volatile stocks around, but they come with moon-shot potential. Some have gold assets in the ground, while others are still looking. Their shares tend to trade on relatively low volume, which



adds to their risk. But they also account for many discoveries of new deposits. Once sufficient gold has been found, some aim to become producers, while others look to sell that asset to a major and then go on exploring.

• Gold and silver streaming companies are a new segment of the industry. And they're already making tidy profits for their investors. Streaming companies lend up-front capital to miners. And as payment, they take a percentage of the gold found in the mines.

A silver or gold "stream" is a contract that allows the owner to purchase, in exchange for an upfront payment, all or a portion of the byproduct silver or gold produced by a mine it neither owns nor operates. This strategy allows streaming companies to avoid the risks and unexpected costs associated with mining operations. And it provides incredible upside as prices rise.

Silver mining royalty company **Silver Wheaton Corp.** (NYSE: SLW) is the largest precious metals streaming company in the world (at the time of writing). Silver Wheaton pays about \$4 per ounce of silver and \$400 per ounce of gold.

Here are a few other indexes and funds to keep an eye on...

The most common way to track gold stocks as a whole is through the **NYSE Gold Bugs Index** (INDEXNYSEGIS: HUI). This is an index of large miners operating around the world.

Market Vectors Gold Miners ETF (NYSE Arca: GDX) is an ETF that holds a basket of the largest mining stocks. Many of these companies

may be phenomenally cheap, but owning an individual miner is very risky – it's a cash-intensive operation that relies somewhat on luck. With this ETF, you diversify your risk across all 100 of the holdings. It also pays a small dividend.

The Gold and Precious Metals Fund (MUTF: USERX) is offered by U.S. Global Investors. This is a five-star-rated, no-load gold fund focusing on senior producers with the largest market caps in the precious metals mining sector. As a side note, the most conservative approach may be to invest in a precious metals mutual fund. By law, mutual funds have to earn at least 90% of their income from securities. That means up to 10% of the portfolio is also allocated in physical metals.

For a little more octane, consider looking at the **U.S. Global Investors World Precious Minerals Fund** (UNWPX), of which 80% is invested in producers and 20% in junior miners.

Now that you know what to buy, let's take a look at how much to buy...

The Best Strategy to Increase Gold and Silver Holdings

The conventional thinking is that holding between 5% and 10% of overall assets in something like gold can provide meaningful diversification and a hedge against inflation. But despite what you see on late-night television commercials, gold and silver have never been proven to be a significant inflation hedge.

They have, however, been proven to be a great *crisis hedge* and one that is more perfectly correlated to interest rates, which are, in turn, driven by inflationary pressures and global risk, especially lately. So, according to *Money Morning* Chief Investment Strategist Keith Fitz-Gerald, owning \$1 of gold for every \$10 you have in bonds is the best way to hedge your risk in today's volatile global markets.

In practical terms, let's say you have \$10,000 in bonds. Using the 1:10 ratio, this would mean you'd also have \$1,000 in gold or silver

socked away using exchange-traded funds, bullion, or something like Perth Mint Certificates.

As we've shown, it's likely that gold and silver prices will become increasingly volatile, so you don't just want to set it and forget it.

Instead, Keith suggests rebalancing the gold/bond relationship at least annually. Pick a day like your birthday or the start of the New Year and lock it into your calendar so you don't forget. Rebalancing should take you all of 20 minutes.

You can do this by selling enough of what's risen and buying a corresponding amount of what's fallen. Or you can simply add new money to your holdings and purchase enough of what's fallen to maintain the ratio.

Most people love or hate gold and silver depending on whether or not they "love" the idea that it's real money or "fear" the demise of the dollar and fiat currency. So they make decisions based on how unsettled they feel. In effect, they're trying to time the markets, which is almost always a bad idea because it reduces performance over time.

As with any long-term investment, but especially those that are intended to hedge other investments, consider dollar-cost averaging into your position – meaning you split your capital into chunks and buy equally over time.

That way you're going to capture the best of today's volatile gold prices without inadvertently concentrating your risk. And, at the same time, you'll be positioned ahead of time when gold comes into its own again.

It's also important to find the optimal entry points into gold and silver positions. Keep an eye on measures like the gold-to-silver ratio, as well as ratios that compare the metals with a range of currencies. Even though the best approach to gold and silver investing is not to try and "time" short-term gains, you'll still want to find the best opportunities to get in, so as to get the most out of your investment...

Investing in gold and silver is all about maximizing performance, minimizing risk, and strengthening your portfolio with an enduring, stable store of value. This is what gold and silver offer to investors.

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MM0116-512 WEB