Investments: Investing in Gold

What Are The Reasons For Investing in Gold?

The traditional assets that people invest in are typically stocks, bonds, cash and sometimes real estate. There are also mutual funds related to all of these asset classes. Where does gold fit into this picture? Gold traditionally was only used to hedge against inflation or when there was economic crisis in the world. The last time when gold had a large increase in price before now was in the 1970's. This period was characterized by world turmoil, high debt and high inflation.

Gold is thought of as a metal which is used in jewelry and ornaments, but this is only a part of the picture. These uses are an attempt to classify gold by what it physically does versus what it represents. The reason why gold is used to hedge inflation or economic events is because gold is money. If you need proof of this, understand that the biggest buyers of gold have been central banks. (1) They are not using gold to make jewelry, but to backstop their respective currencies. Lately, they have been net buyers after many years of being net sellers. If gold is out of date as a currency, the central bankers would not be interested in gold today.

Gold is the one of the longest running currencies in the history of commerce, and it was used in many cultures to represent wealth. (2)(3) This concept is still true today, but it has been obscured by the fact that the US dollar is now a representative currency or reserve currency for that wealth. You have no doubt heard of the "gold standard". There was once a time when all of the currencies of the world were exchanged at a fixed rate to gold. (4) Gold was essentially the base currency for the world, and then all of the other currencies like the pound, yen, dollar and franc were compared to the value of gold. Only recently was the US dollar used as a proxy for gold. This was done at first because the US government had a sufficient amount of gold to back up the representative value of the currency. This is like saying that the US dollar was a receipt that represented real gold stored in a government vault. When the dollar was taken off the gold standard, the receipt now had no gold backing it up. Instead, the power of the US treasury to tax people or generate value is where the dollars' worth comes from. Implicit in this idea was simply a matter of trust that the government, or whoever issued the currency would always create value that the currency unit represented. At the time that the gold standard was disabled, the national debt and deficit were not as large as today. At the present time, the debt has grown so large that there is talk about government bankruptcy. (5)(6)(7)

What does this have to do with your investing? Gold should not be treated like any other industrial metal, but more like currency. Like other currencies, what gold will buy in your dollars will change every day, similar to how many Euros you can buy with your dollar. This is one reason why gold is volatile, and it has risks like any other investment. What would affect the price of this gold? There are always many factors, but in terms of a currency, its purchasing power is the key variable in understanding the gold price. Since currencies are relative to other currencies, the way to look at gold is – how much of it is there compared to the other currencies of the world? Since all of the other currencies are based on trust, and currencies can be issued in any quantity at any time, this is a clue as to how to proceed. Gold is expanding every year due to mine production, but this is relatively slow compared to the issuance of other currencies, which are essentially issuing new debt.

I understand the story – how do I invest in it?

The gold I have been talking about up until now is the metal itself. There are many ways to invest in gold – gold stocks, gold indices, and buying gold directly – either in gold bullion (bars or wafers), coins or buying access to physical metals through gold dealers or funds. If you understand the idea that gold is a currency, the most straightforward way to capture that trend is to buy gold as a metal.

If you buy access to gold metal through a fund, you want to find something that tracks the price of gold as closely as possible. There will likely be small differences between the fund and the gold price due to fees, issuing fund units, or short term trading patterns which usually balance out in the long run. A gold fund can be an exchange traded fund that imitates gold, or a gold trust that actually buys the gold and holds it for you. The other way to buy gold directly is to buy gold physically. This would be done through a gold coin dealer, gold bullion dealer or a currency dealer if they deal in physical gold. Many of these dealers have sprung up in the last few years so make sure whoever you go to has history and a good reputation. The risk of buying gold bullion lies in where to store it, and the possibility of loss or theft. You can put gold in a safety deposit box at your bank or have someone store it for you for a fee, but then you need to trust whoever you store the gold with. There can also be expensive fees to buy gold so you need to shop around like everything else that you buy.

If you want to invest in gold through shares, you are looking for companies that can actually produce gold and take advantage of a very high price, or shortages of supply due to more demand for gold. This means that gold explorers and small minors may not serve the purpose too well, unless you are investing in gold and the company as well. The risks in buying a gold stock are different than buying gold bullion due to market factors like company management, gold reserves, geopolitical risk in mining locations, issuing new shares, company expenses and so forth.

You can also buy a mutual fund of gold shares. The risk and reward of this strategy is very similar to buying individual shares, but you can diversify across more gold companies. The downside is that the management fees for a mutual fund are typically higher than buying stocks directly.

The key takeaway here is that gold can be viewed as a currency rather just another metal, and investment should be adjusted accordingly.

Contact me, Joe Barbieri by email at joetheinvestor.today@gmail.com, or by telephone at 647-286-8020 for an independent consultation on what these options are. **Note: This article is intended for people who want to learn about the world of investments and how to research for themselves. If you would like to buy or sell investment products, or specific advice on investment products, tax or legal issues, please consult your investment advisor, accountant or legal counsel.**

Sources:

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