Getting Real: Overcoming the Five Myths of Precious Metals Investing

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Look across the traditional investment landscape.

In many cases, the usual mix of stocks and bonds – the core of the “Efficient Frontier” and Modern Portfolio Theory – has proven to be more correlative than not in the new global economy.

Yesterday’s portfolios may no longer be up to today’s challenges.

In their quest for portfolios that can withstand the rigors of today’s marketplace, financial advisors and investors are increasingly looking for alternative solutions. For some, even holding securities is not enough. They are turning in greater numbers to the benefits of ownership in actual collateral, real assets – like precious metals.

This enduring asset class can play as prudent a role in a well-rounded investment program as it did 2500 years ago with the introduction of the first gold coins. To access the benefits of precious metals, brokers, advisors and investors, however, should first overcome a few of the popular myths surrounding precious metals investing:

- **Myth #1:** You have to be a gold bug or a survivalist to care about gold
- **Myth #2:** Precious metals are just too risky (and strange)
- **Myth #3:** Precious metals don’t really fit into an asset allocation strategy
- **Myth #4:** Precious metals are illiquid
- **Myth #5:** Keeping precious metals safe from thieves is a constant worry

**Myth #1: You have to be a gold bug or a survivalist to care about gold**

The term gold bug is frequently used to describe those that criticize the use of fiat currency and support a return to the use of the Gold Standard. Whether you believe in the eventual collapse of the currency or not, gold can play a vital role in a modern portfolio.

**FACT:** While war and political upheaval will continue to drive up the demand for gold on short notice, there are other reasons, like asset allocation, to invest in mankind’s first asset class: precious metals

Financial advisors and investors don’t have to be frightened by world events to benefit from investments in gold and other precious metals. Given its historic role in the global monetary system, gold has consistently exhibited a negative correlation to the U.S. dollar, offering protection against losses in purchasing power.

There are good reasons to consider precious metals during unusual market conditions and periods of global conflict, but, more importantly, they represent a long-term element in a prudent asset allocation strategy. A proven alternative asset class, precious metals have facilitated commerce and wealth generation for 2,500 years.
Myth #2: Precious metals are just too risky (and strange)

For those unconvinced that fiat currency is on its last legs, precious metal investments might seem a little scary. The truth is just the opposite.

**FACT**
- Despite a “lost decade” for equities in the 2000s, one asset class delivered outstanding returns to investors over the same time period: *gold*
- While no investment is without risk, *gold outperformed equities in four of five bear markets from 1973 to 2010*

<table>
<thead>
<tr>
<th>Peak</th>
<th>Trough</th>
<th>Return</th>
<th>Gold Return</th>
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<tbody>
<tr>
<td>1/5/73</td>
<td>10/3/74</td>
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<td>139%</td>
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<td>10/9/07</td>
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Sources: Standard & Poor’s, NBER, Dow Jones & Company, J.P. Morgan Asset Management. Data are as of 11/21/13.

**FACT**
- **Not so strange:** Investors report increasing comfort with precious metals

According to a Nataxis Survey in 2013, 28% of investors polled said they planned to increase their investments in precious metals over the next 12 months, surpassing the number of those who planned to increase their U.S. stock allocation.²

Investors also said they are turning to their financial advisors for more ideas about how alternative investments, including precious metals, can play a role in their portfolios. Fully 85% of investors said they would invest in alternatives if they understood them better.
A survey conducted by EverBank\(^3\) last year supported similar conclusions: 52\% of investors said they were looking outside of traditional U.S. equities for performance in 2013. Of these, 21\% were eying investment opportunities in precious metals.

**FACT: Investment Advisors Also Warming to the Appeal of Precious Metals**

Commodities and precious metals have graduated to the mainstream of investment asset classes, according to a survey of brokerage representatives and independent advisers undertaken by *Investment News*\(^4\) in 2013. According to participant Tom Lydon, president of Global Trends Investments, “This survey confirms that many advisers are using commodities and precious metals in diversified portfolios, and indeed, these alternative investments have cemented themselves as mainstream asset classes.”

About a third surveyed noted that they were using precious metals as part of their clients’ asset allocation strategies, while more than 20\% included precious metals in tactical investing approaches.

**FACT: Alternatives Are a Favorite Choice for Many Major Institutions**

Investors concerned that precious metals may represent too great a departure from conservative money management principles should read Wealth Daily’s “Who Owns Most of the World’s Gold?”\(^5\) It’s no surprise that governments, central banks, and investment funds head the list as the world’s largest holders of gold reserves:

1. Topping the list is the United States with holdings of 261.6 million ounces worth approximately $433 billion\(^6\).
2. The Deutsche Bundesbank, the most influential member of the European System of Central Banks, has 109.4 million ounces of gold valued at about $181 billion\(^6\).
3. The International Monetary Fund that oversees the global financial system by following the macroeconomic policies of its 185 member countries holds 90.5 million ounces valued at $150 billion\(^6\).
4. China’s reserves are estimated at 87 million ounces valued at $144 billion\(^7\).
5. The Italian National Bank, Banca D’Italia, has reserves of 78.8 million ounces worth approximately $131 billion\(^6\).
6. The Banque De France is close behind Italy with reserves in the vicinity of 78.3 million ounces worth $130 billion\(^6\).
Myth #3 Precious metals don’t fit into an asset allocation strategy

Relying on a traditional portfolio of only stocks, bonds and cash may prove more risky than adding alternative assets like gold.

**FACT:** A diversified blend of precious metals and traditional investments in a portfolio may outperform a traditional portfolio while lowering risk

The exhibit illustrates a comparison between a portfolio that combined traditional investments with alternatives (which included precious metals) and a portfolio composed of only traditional investments.

In the case of the portfolio with alternatives, the risk profile of the hypothetical investment was reduced while the return was improved.

The advantages of including gold in an equity portfolio, as represented by the S&P 500 Index, is also dramatic. Adding more gold greatly reduces risk while delivering increased overall return.

**Annualized Portfolio Returns**

*Ten Year Period Ending October 2013*

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Myth #4: Precious metals are illiquid

FACT: By diversifying into precious metals, investors gain a real asset growth vehicle that is fully liquid.

Not only have gold and other precious metals long been considered one of the few ways to protect assets from high inflation and economic uncertainty, but precious metals are liquid assets and readily convertible into cash. Gold is traded 24/7 around the world. With narrow bid/ask spreads, gold is easily bought and sold for investors through a broad based network of dealers.

Myth #5: Keeping precious metals safe from thieves is a constant worry

The movies are rich with stories of major gold heists. However, the real world is very different than Hollywood.

FACT: A passive custodian like Equity Institutional provides world class storage and security for precious metals through one of the nation’s largest precious metals depositories.

Not only is gold securely stored in an insured, physically segregated account, but coins are also identified by type and year to allow for accurate reporting. The depository maintains many layers of physical and electronic security, as well as metal detection, proprietary systems, internal controls, legal protections and extensive “all risk” precious metals storage and shipping insurance coverage. For privacy protection, the depository is never provided with an account holder’s personal information.

CONCLUSION

Thousands of years ago, precious metals set a standard for wealth that endures today.

Once the myths of precious metals investing are overcome, the case becomes clear: Some allocation to precious metals in a portfolio, whether it is protective, conservative, balanced, growth-oriented, or aggressive in objective, has the capability of providing an attractive, competitive level of risk-adjusted total return.

Instead of being fear-based or unfamiliar, precious metals have as much to offer the modern investor as the introduction of gold coins to the ancient world 2,500 years ago.
ABOUT THE AUTHOR
Jon Potts is the Managing Director of Delaware Depository™. Mr. Potts, a graduate of California State University, has been a precious metals professional since 1981. He has held various trading, marketing, sales, and management positions within the refining, manufacturing, brokerage, and banking sectors of the industry. Prior to forming Delaware Depository™, Jon worked at Johnson Matthey Limited, an internationally recognized refiner, Wilmington Trust, a major trust and wealth management firm, as well as other financial service firms. Jon currently serves as a Director of the International Precious Metals Institute, Director and Past President of the Silver Users Association, and member of London Bullion Market Association, Industry Council for Tangible Assets and Retirement Industry Trust Association.

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