

A Beginners Guide to Investing in Gold

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Buying precious metals, particularly gold and silver, are a very common investment strategy. Perhaps no other asset has had such widespread appeal as gold; and this appeal has increased due to the systemic risk facing our modern global financial system and economy.

Many beginner investors are eager to invest in gold; however, the high prices and multitude of investment options can be overwhelming. Typically investors buy gold for one of three reasons: a hedge against inflation, a safe haven during market downturns or a direct investment with historically solid returns over time.

Buying gold in the form of bullion or coins, trading for gold in the foreign exchange markets, or trading a variety of gold related stocks and mutual funds are all viable ways to invest in gold. Some of these methods can seem downright frightening for the new investors, but don't worry, the variety of options ensures that investors have a good deal of control over their investments.

Why Buy Gold as an Investment

Gold as a Hedge against Inflation and Currency Devaluation

Investors use hedges to offset losses in other asset on your portfolio. Many investors buy gold to hedge against the decline of a currency and the resultant inflation. For example, the price of gold more than doubled between 2002 and 2007 while the value of the US dollar was nearly cut in half during that same time period.

Gold as a Safe Haven From Market Downturns

Individuals have used gold as a safe haven for wealth and as insurance against market fluctuations which protects against losses on other risky investments in their portfolios. For example, during the 2008 financial crisis, gold prices continued to rise while many other investment options were devalued. Gold, on the other hand, is a unique blend of a nearly indestructible, finite and rare commodity which lends itself as a stable means of exchange or currency.

Gold as a Direct Investment

Other investors bought gold as a physical asset to take advantage of future price increases. Gold has been a form of direct investment for many individuals and governments throughout history. Gold itself is speculative making it risky for the average individual investor, however, gold is an important part of a diversified portfolio.

3 Ways to Invest in Gold

In general, individuals looking to invest in gold can purchase the physical asset (jewelry, bullion and coins), purchase an ETF that replicates the price of gold, or they can trade stocks and futures in the commodities market.

1. Gold Bullion, Gold Coins and Gold Jewelry

One of the most common ways to begin investing in gold is to have physical ownership of gold bullion (bars), coins or jewelry. The value of physical gold is based almost entirely on the market value for gold once it has been melted down and sold at the current prices.

Buying gold bullion, coins and jewelry is a direct investment. This is usually cost effective, but there are some hidden costs when it comes to storing and insuring physical gold, or paying transaction fees associated with buying, selling or melting it. And as a direct investment, the price you will receive is directly tied to the market and may quickly change the value of your portfolio.

2. Gold Mining Stocks

Gold stocks are not gold – Mining stocks (shares in a gold mining company) are a way to leverage higher gold prices through corporate operations. The cost of extracting an ounce of gold varies by country and company, but is generally well below the current trading prices. If the gold price rises, profits of a gold mining company should rise and as a result the share price should rise.

Gold shares may be regarded as a high-risk, speculative investment, however, they can result in higher returns; particularly good returns are expected from mid and large-cap gold mining companies with proven reserves, strong balance sheets with a strong earnings history and effective company management.

Remember that buying shares in a gold mining company (rather direct ownership of the metal itself) exposes an investor to operating risk and the possibility that management problems, corporate buyouts or some mining accidents will cause share prices to decline despite the market value of the gold itself.

3. Gold ETFs, Mutual Funds and Futures

One alternative to a direct investment in gold or buying stock in gold mining companies is to invest in one of the gold-backed exchange-traded funds (ETFs), gold-backed mutual funds or futures contracts on the price of gold.

- **Gold-Backed Exchange Traded Funds (ETF)**

Gold-based ETFs are a specialized instruments representing a fixed amount of gold (ie. one-tenth of an ounce) which are bought or sold in any brokerage or IRA account just like stocks. ETFs may be easier and more cost effective for beginners than direct gold investment, as the minimum investment is only the price of a single share of the ETF.

- **Gold-Based Mutual Funds**

Instead of direct ownership of physical gold, investors can participate in mutual funds which own gold bullion or shares of gold mining companies as part of their normal portfolios. Many mutual funds invest in a number of other commodities, so be sure ask your trusted broker or financial advisor for gold-based mutual funds.

Just as with the gold-backed ETFs, gold-based mutual funds are cost effective with low minimum investment requirements, as well as diversification across different companies. This allows the mutual fund to hedge against management issues or accidents affecting the value of any one mining company.

- **Gold Futures and Options**

Futures are contracts to buy or sell a given amount of a gold, on a particular date in the future – for gold or its market value in dollars. This is a highly speculative market, but investors continue to buy futures because the commissions are very low, and the margin requirements are much lower than in traditional investments.

Options on futures contracts allows the investor a chance to buy the futures contract within a certain time frame at a preset price which limits losses. Unlike a futures investment, which is based on the current value of gold, the futures options investor must pay a premium to the underlying value of the gold in order to own the option.

Because of the volatile nature of futures and options, they may be unsuitable for many novice investors. Even so, futures remain the cheapest way to buy or sell large amounts of gold. Success depends on the price movement of gold during the contract term. Investors in gold futures without protective stop-losses can quickly find themselves losing large sums of money.

Even beginners can benefit from investing in gold. Before jumping head first into gold and other commodities, learn more about the gold markets and industry. The more knowledgeable you are, the more successful you will be in your investments.

There is a level of comfort found in physical ownership of gold over shares and contracts, however, direct investment can come at a slight premium. There are other options out there for the savvy investor to hedge inflation and portfolio losses with gold. Speak with your financial advisor, stock brokers, and mutual fund managers to begin investing in gold.

If you need a referral to a great gold and silver broker, let me know. ---