

Finally Serious About Gold & Silver?

The Cheapest Way to Buy (and Sell) Precious Metals

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RMB Special Report

After years of being ignored, gold and silver are finally getting the attention of the mainstream press. Ads for bullion and coins are all over the place. But gold and silver's newfound popularity also comes with a downside: the more popular metals get, the bigger the mark-ups and premiums demanded by dealers. ***Big demand for silver coins recently pushed premiums on popular American Silver Eagle coins as high as \$5.00 per ounce or 13.5% more than the actual melt value of the metal.*** Premiums on gold Eagles have climbed as high as 5%.

Why would anyone buy gold retail at \$1,436 per ounce when they could buy it wholesale at \$1,400? Would you buy a stock or a bond that had to rise 5% or 13% percent just to break even? Of course not... Yet gold and silver investors do this all the time. You don't have to!

While there are plenty of ways to increase your exposure to gold and silver, perhaps the cheapest, safest and most flexible way to own precious metals is through exchange-traded futures contracts. Surprised? You have plenty of company; most individual precious metals investors run the other way when they hear the word "futures."

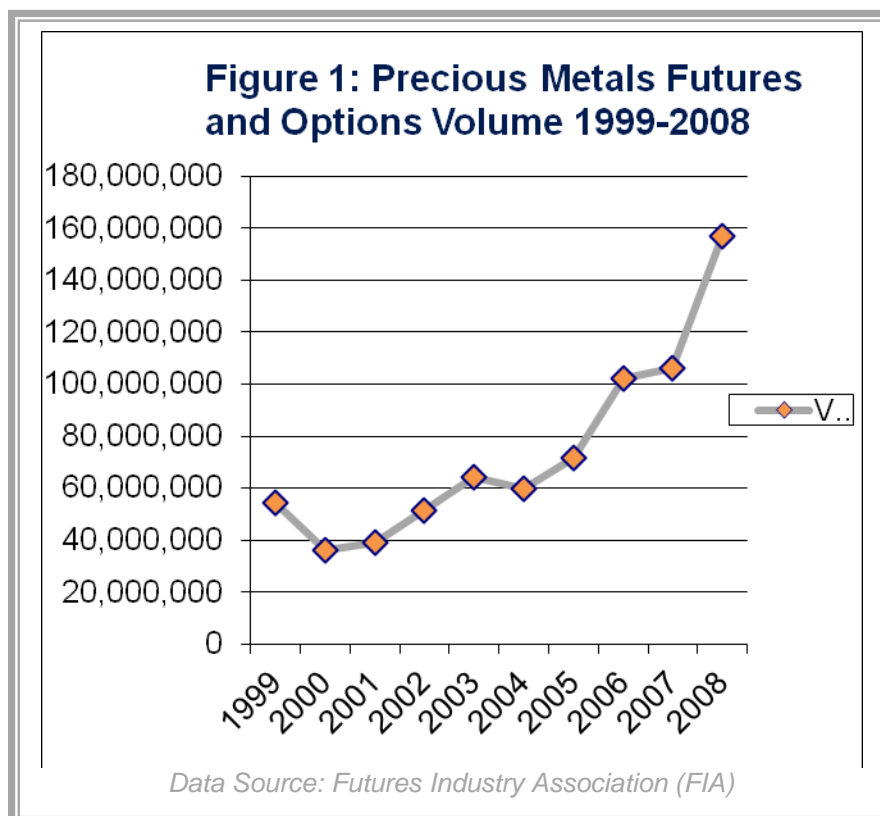
In fact, buying and selling physical metals like gold, silver, platinum and palladium using futures contracts is one of the best-kept secrets around.

Futures Advantages

- ✓ **Liquid, transparent market means tight bid /ask spreads** – no mark-up on the buy, no mark-down on the sale. No dealer commissions. \$25 flat rate to buy. \$25 flat rate to sell, no matter the price.
- ✓ **Highest purity and consistency available.** Regular audits by exchanges and other agencies.
- ✓ **Physical storage, transport and insurance are not required** – holders can choose to store their metal in the futures market itself, just like mints, refiners, investment banks, precious metal funds and fabricators do.
- ✓ **10-ounce gold and 1,000-ounce silver contracts are geared to individual investors** making them perfect substitutes for more expensive coins and bullion.
- ✓ **No Counterparty Risk for Exchange Traded Metal** – not one cent has ever been lost due to counterparty default, impurity or vault shortages.

Using Futures to Buy Metal “Wholesale”

Precious metals futures contracts are standardized, making them as easy to buy and sell as stocks. Unlike retail bullion or coins, there are no mark-ups or inflated premiums. This means buyers get their metal “wholesale.” Futures have a wild and woolly reputation because of margin. There are plenty of stocks (and mining shares) that are far more volatile on a percentage basis than precious metal futures. What gives futures this reputation is not the market itself, but the amount of leverage available to



traders in futures. ***Take the leverage away and the risk characteristics of futures are no greater than bullion and coins.*** Because futures let buyers get in the market wholesale, one could make the argument that the risk is actually less because the amount at risk is less.

So how do I take the leverage away? By opening an account and posting the entire value of the contract I am trading.

Let's say I buy a 10-ounce micro gold contract at \$1,400 per ounce. 10 ounces times \$1,400 gives this contract an underlying value of \$14,000. But the “margin” required to trade this contract is currently only \$610. If I only post the \$610 required and the value of my account drops significantly below \$610, I must post enough new cash to bring the initial margin back to \$610. A move of just \$25 per ounce could generate a margin call. This is where futures traders get into trouble and where futures get a bad rap; it's not the underlying markets themselves but the way margin is used and, unfortunately, abused.

But what if instead of posting the minimum margin required, I posted the entire \$14,000? I would never get a margin call. It would be like buying gold bullion and coins, only cheaper because now I don't have to pay the mark-ups charged by bullion and coin dealers. A 5% mark-up on \$1,400 gold is \$70 per ounce and a whopping \$700 for ten ounces. This is real money, not chump change.

The savings are even bigger in silver. Because it is a smaller market than gold, silver bullion and coins have bigger premiums -- ditto for platinum. (See Figure 2.)

Premiums for silver eagles are currently at 13.5%. With silver going for \$37.75 per ounce, 13.5% amounts to roughly \$5.06 per ounce. That means coin buyers need silver to rise to \$42.81 just to realize the melt value of their coins. Instead of buying coins, I could buy a 1,000-ounce mini-silver contract instead, deposit the entire \$37,750 contract value (\$37.75 per ounce times the 1,000 ounce contract size) in my account and, like our gold example, get into the market much more cheaply with no risk of a margin call. An equivalent amount of coins would set me back \$42,810 or \$42.81 per ounce. \$37.75 per ounce or \$42.81 per ounce, which would you choose?

Figure 2: Three Ways to Buy Metal

*Cost per ounce**

	<u>Spot Price</u>	<u>Eagle Coins</u>	<u>Retail Bullion</u>	<u>Futures**</u>
Gold	\$1,400.00	\$1,470.00	\$1,436.00	\$1,400.50
Silver	\$37.75	\$42.81	\$39.22	\$37.79
Platinum	\$1,760.00	\$1,960.00	\$1,816.00	\$1,761.00
Palladium	\$780.00	N/A	\$815.00	\$780.50

**Using quotes from typical cash dealers available on the web.*

***Largest spot futures contract with \$50 flat rate commission.*

But I don't have post the entire amount to have a nice cushion. Instead of posting the entire \$37,750 value of the mini-silver contract used in the example above, I could post half of that amount and have the balance of \$18,875 busy earning a return somewhere else. This enables me to put cash to work that would typically be sunk into the purchase of physical bullion or coins. Silver would have to drop \$19.50 per ounce to generate a margin call.

Not only do I now own gold and silver cheaper than I would otherwise, I don't have to tie up all my cash. I also get these other, important advantages:

1) When it comes time to exit my precious metal holdings, I simply pick up the phone, call my broker and sell, just like I would a stock. The cash will be deposited in my account immediately and can be withdrawn the next day.

2) I don't have to worry about storage, insurance and transportation. Storage and insurance costs are built into the contract itself and are much, much lower than those charged by retail metal custodians.

3) I also get certain tax advantages – especially if I hold my metal less than one year. **Futures contracts are taxed 60% long-term and 40% short-term no matter what the holding period.** (Tax laws do change so check with your accountant.)

4) Finally, and perhaps most importantly, I get the benefits of the Exchange Clearing Corporation. The exchange clearing corporation acts as buyer to all

sellers and seller to all buyers, guaranteeing *all* counterparties are made good on their trades.

Since the inception of the modern-day clearing corporation in 1925, not one penny has been lost due to a counterparty default; that means you don't need to worry about your dealer going out of business or refusing to buy back your holdings when it comes time to sell. There is always a market in which you can do business and your counterparty risk is virtually eliminated.

Buy (and Sell!) as Much Metal As You Want, When You Want...

We challenge anyone to come up with a cheaper, safer and more liquid way to buy or sell metal. We've listed some of the major advantages of buying metal via futures contracts above, but did you know they can mean the difference between owning and not owning metal? There were times during the recent run-up when dealers literally ran out of metal leaving potential buyers high and dry. Coin premiums, high already, soared due to increased demand. Investors who bought precious metals using exchange-traded futures contracts had no trouble buying as much gold, silver and platinum as they desired and because they used futures, they didn't have to worry about the expense of shipping and storing their metal.

The ability to buy and sell when you want can be even more important if the market is in the grips of a mania. When gold and silver prices peaked after the Hunt Brothers run-up in 1980, many metal investors decided to take profits. When they did, disarray in the dealer market meant legions of dealers were not willing to take the other side of the trade and buy without huge discounts because they were not capitalized to absorb the inventory risk of gyrating markets. Others, in spite of sales claims, never intended to buy anything back. There were notable exceptions, but the dealer network -- from "Mom and Pop" shops in small towns to high profile dealers spending millions in promotions -- essentially froze up, some literally taking their phones off the hook.

Spreads in the coin market were crushingly large as dealers, afraid of getting stuck with depreciating inventory, pulled their bids and backed away from the market. Thousands of precious metal holders wound up being right the market, but because they couldn't sell at a decent price, wound up stuck with their metal and losing fortunes anyway. If you were a bullion coin investor in the early 1980s, you know it wasn't pretty. Although the exact figures are impossible to know for sure, it is estimated that of the roughly 4,700 dealers and leverage houses doing business prior to the 1980 collapse, at least 2,000 disappeared in the ensuing three years. Unlike exchange transactions, which are guaranteed by the

Figure 3: Precious Metals Futures Contracts, Domestic

<u>Contract</u>	<u>Size</u>
Gold	100 oz.
Micro Gold	10 oz.
Mini Gold	33.2oz.
Silver	5,000 oz.
Mini Silver	1,000 oz.
Platinum	50 oz.
Palladium	100 oz.

Clearing Corporation, the dealer market is based purely on the good faith of the participants.

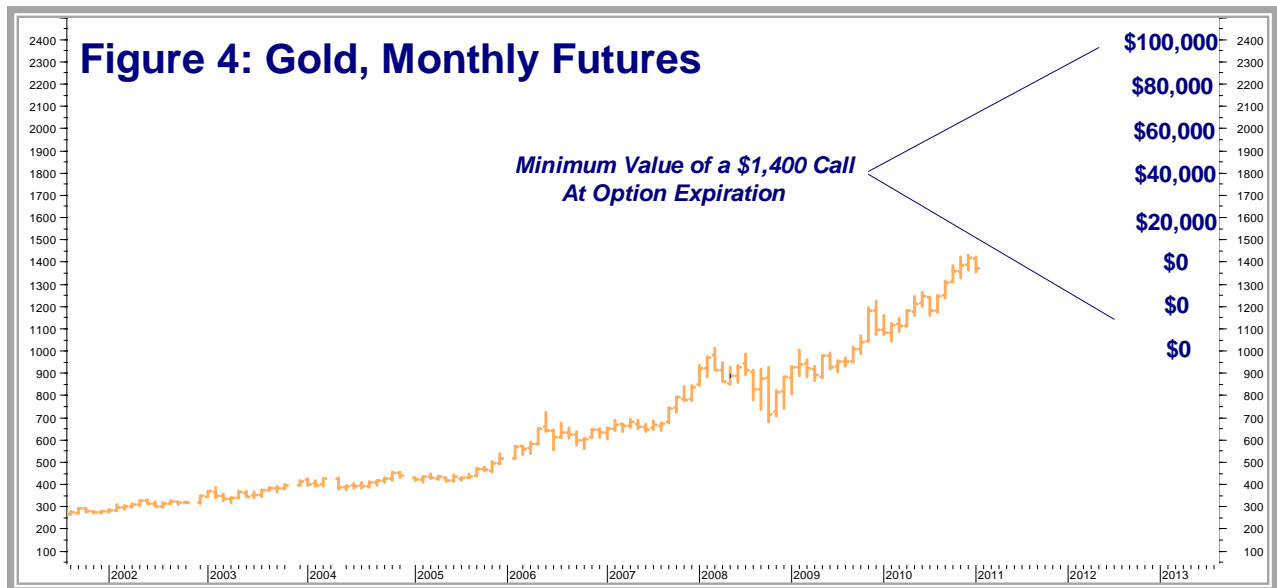
Think the Hunt fiasco can't happen again? Many of the same conditions leading up to the Hunt mania and crash are percolating in metals right now, including shortages of physical metal in the dealer market and rising premiums. The massive amount of metal backing ETFs could come flooding back onto the physical market a lot faster than it flowed out. There are some analysts who believe the mania stage is already in its early stages and that it won't end until the market goes vertical as late-to-the-party investors pay anything not to miss the rally. Markets like this can reverse on a dime, making the ability to sell with just one simple phone call critical.

Wait, Wait There's More... Using Leverage with Limited Risk

Since precious metals futures contracts can and often do result in delivery of bullion of the highest purity we can use options on futures contracts as a method of buying and selling metal. Buying a call gives the holder of that call the right, but not the obligation, to be long a futures contract at a specific price for a limited amount of time. Since the call buyer does not have the obligation to buy the underlying futures contract, all he or she would lose is the price of the option. Options typically cost a fraction of the price of the underlying metal.

Let's say I thought that gold was going to skyrocket to its inflation-adjusted high of \$2,285 per ounce in the next 12 months and wanted the exposure of 100 ounces of gold in my portfolio. However, I didn't want to tie up a large amount of capital up in the actual metal. So instead of buying the futures, I decide to buy an at-the-money \$1,400 gold call instead. This call gives me the right but *not the obligation* to own a 100-ounce futures contract between now and the expiration of this option 12 months from now. It currently costs \$10,300. If gold doesn't rise above \$1,400 prior to expiration of my option, I will lose the entire \$10,300 (plus any transaction costs) I paid but no more. However, during this period I can buy and sell this option -- to cut loses or takes profits -- the same as an exchange-listed stock. Since I don't have the obligation to buy, gold could go to zero and my loss will not exceed the net cost of my option.

But what if I am right and gold rallies to \$2,200 per ounce? I could exercise my right to be long a futures contract at \$1,400 per ounce and then turn right around and sell it at the going rate of \$2,200. The \$800 per ounce difference times the 100 ounce contract size equals \$80,000. Subtract the \$10,300 I paid for my call option and you get a net gain of \$69,700. Because I can go through this exercise procedure, chances are I won't have to. Any gains above the \$1,400 "strike price" will be reflected in the value of the option itself. Granted, \$10,300 is a lot to risk and \$2,200 per ounce is a very aggressive target but that's precisely when a speculator should consider options: when he or she expects the market to make an exaggerated move. The chart below shows the minimum value of a 100-ounce \$1,400 Comex call at a series of prices.



(Please Note: the chart above is for educational purposes only and in no way suggests that you will profit from any trading suggestion contained in this report.)

Getting Started

Want to learn more about buying your metals cheaply or gaining some limited risk leverage with options? The folks at the **RMB Group (Rutsen Meier Belmont Group LLC)** in Chicago can help you. You cannot trade the futures or options covered in this report in a stock account. You need a separate commodity account. The **RMB Group** has been trading precious metals futures and options since 1984. Call them toll-free at **800-345-7026** or **312-373-4970** direct. They'll send you everything you need to get started. You can also visit them on their website www.rmbgroup.com. Tell the **RMB Group** you read this report and receive the *IPS Short Course in Futures and Options*, a \$14.99 value, plus the next month of their trading publications and do-it-now "Alerts" absolutely free.

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