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How to Buy, Sell & Store Precious Metals

by Vincent Malherbe





HOW TO BUY, SELL & STORE PRECIOUS METALS

GUIDE 1.0

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THE CASE FOR GOLD IN ONE CHART	6
THE FIVE-STEP APPROACH TO PURCHASING PHYSICAL BULLION	7
Step 1- Choose your metal	8
Step 2- Know the spot price of your metal	9
Step 3- Choose the characteristics of your metal	10
Step 4- Know the purchase premium	13
Step 5- Decide on the final allocation to specific products	15
STORAGE OPTIONS FOR PHYSICAL BULLION	16
OTHER GOLD INVESTMENT SOLUTIONS (WITHOUT DIRECT OWNERSHIP OF BULLION)	24
CONCLUSION	32
APPENDIX 1: A WORD ON THE LONDON BULLION MARKET ... AND WHY THE WISE INVESTOR SHOULD STAY AWAY FROM IT	34
APPENDIX 2: MAJOR BRANDS AND BAR SIZES	37
ABOUT THE AUTHOR	38

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2,014 BC



Gold lunula (a crescent-shaped collar) and two small gold discs dating from the Early Bronze Age c. 2300-1800 BC (found in current Ireland).

14 AD



Roman gold coin minted under Augustus in 13-14 AD in current France.

2,014 AD



Investment grade gold bullion from the Perth Mint, Australia

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INTRODUCTION

“The process [of debauching the currency] engages all the hidden forces of economic law on the side of destruction, and does it in a manner which not one man in a million is able to diagnose.”

—John Maynard Keynes

The liberty-minded individual is turning to precious metals as a safe haven in these economically troubled times. He knows that gold has acted as a stable store of value for thousands of years while the value of world currencies has steadily declined. He understands the need to own tangible and liquid assets, even more so in an environment of ever-expanding fiat money and government debt. He has decided to partially opt-out of the current financial system by directly owning tangible wealth. This report will refer to this liberty-minded individual as the Wise Investor, who has decided to take control of his wealth.

Today's financial system is fraught with counterparty risks, and precious metals stand out in the investment universe



because they are no one's liability and have no counterparty. Financial institutions are highly leveraged to the point that the failure of a significant player would result in a systemic collapse. The term "too big to fail" has been coined to reflect this reality. Banks are holding record amounts of derivatives products that only add to the risk of the whole system.

On top of that, major global institutions have been caught perpetrating frauds and manipulating all markets. **In these days of unprecedented financial experiment, the Wise Investor has made up his mind to diversify part of his portfolio with physical precious metals.**

There are many options available to the Wise Investor who wants to invest in gold. This guide reviews the various options that exist (including ones which don't involve ownership of bullion). The case will be made that the best way to hold bullion for wealth protection is to have legal title to bullion bars or coins either in your possession or with a trusted supplier. Because the most cited rationale for investing in precious metals is wealth preservation, it is indispensable that a precious metals investment performs that wealth preservation function in times of economic distress when counterparties collapse.

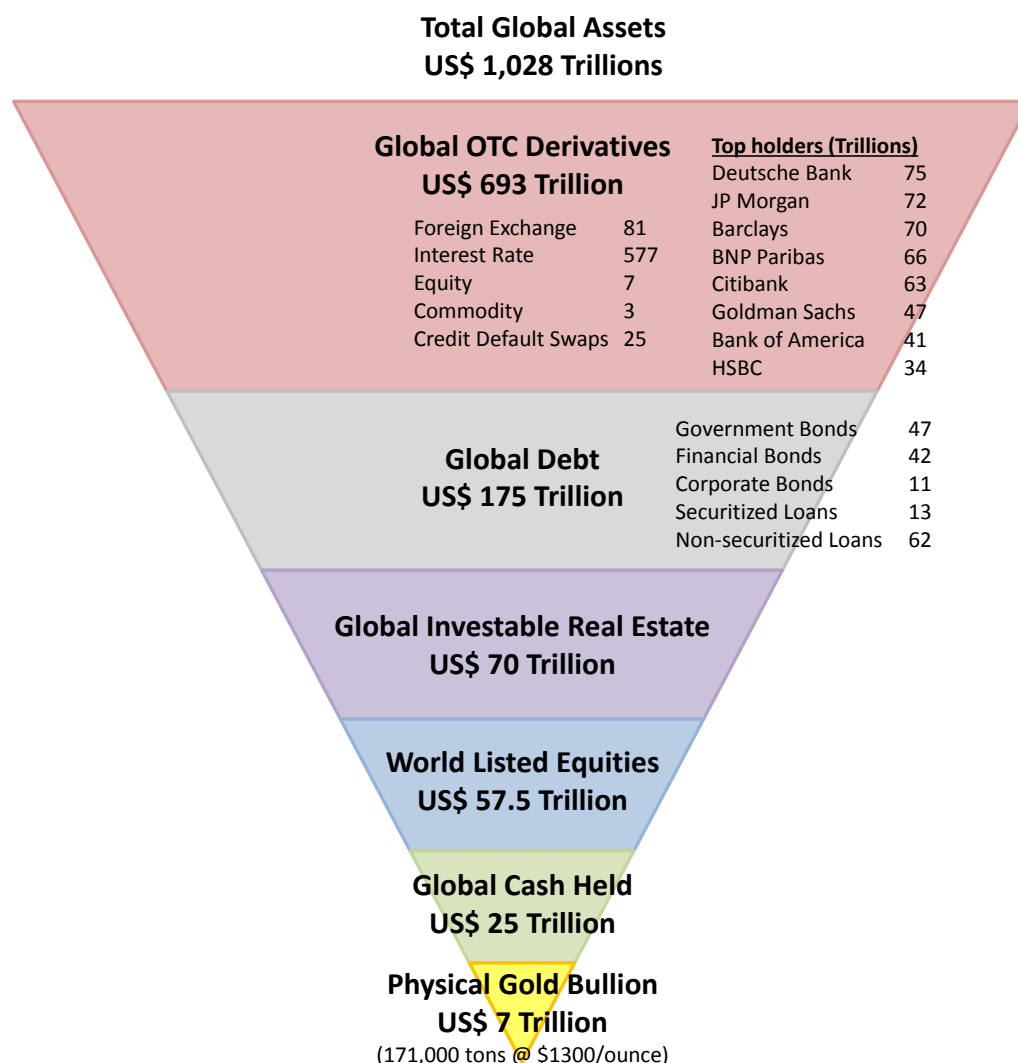


This short guide aims to lay out the options available to the liberty-minded individual who wishes to buy and hold precious metals for long-term wealth protection.

THE CASE FOR GOLD IN ONE CHART

The purpose of this guide is not to make the case for investing in precious metals (plenty has already been written on this topic), but rather to lay out the options available to the investor who has made up his mind to do so.

Before going into any great detail, let's pause for a moment to take a helicopter view of our financial system in order to better understand gold's position in it. Most people are well aware





that gold is a scarce resource but are usually not aware of the sheer volume of other financial products which currently exist. The above chart provides an overview of our financial system and lays the case for gold quite succinctly.

A financial meltdown would see the upper layers of the pyramid being liquidated in a panic.

A financial meltdown would see the upper layers of the pyramid being liquidated in a panic that would likely involve the opaque over-the-counter derivatives markets. A few of the world's largest banks hold the bulk of all derivative contracts, which have notional amounts in the 10s of times their assets and 100s of times their market capitalizations.



Whilst the upper layers evaporate as the market for most IOUs simply stops existing, capital will seek refuge in the “most marketable good” or the most liquid asset further down the pyramid. Many people holding assets located at the top of the pyramid will lose parts of their capital on the way down in the flight to liquid and to less-risky assets. After most of their wealth literally has evaporated, they will finally come to the conclusion that gold is the ultimate store of value.

A look at recent history reminds us of the intrinsic value of paper money, which is the paper that it is printed on. One picture in support of this case is certainly worth a thousand words.

“Paper money eventually returns to its intrinsic value – zero.”

—Voltaire

THE FIVE-STEP APPROACH TO PURCHASING PHYSICAL BULLION

The Wise Investor understands that the direct ownership of unencumbered physical bullion is the best and only way to invest in metals. Once he has made up his mind to buy precious met-



als, he faces the challenge of choosing the specific bars that he should buy. Some bullion dealers carry tens of products across the four precious metals and it can be daunting to examine them all.

This section outlines a five-step approach that the Wise Investor can follow to acquire physical bullion.

The direct ownership of unencumbered physical bullion is the best and only way to invest in metals.

Step 1- Choose your metal

The four precious metals are gold, silver, platinum, and palladium. Most people are very familiar with gold, which has stood as the monetary metal of choice for millennia. Most people overlook gold's close cousin, silver – which has a long history of being used as a monetary metal on top of being a ubiquitous industrial metal (used in the electronics, energy, and medical industries).

Without going into great detail, silver generally follows gold's price movements in a much more volatile way. It has been described as gold on steroids and produces magnified gains when the metals appreciate (and magnified losses when the metals go down). An investor with a solid risk appetite and who thinks that gold will appreciate should therefore have an allocation to silver.

Silver is roughly 65 times cheaper (at current prices) than gold, which makes it far more affordable than gold but also greatly increases its transaction costs (since transaction related costs are spread on an item of much lower value). Silver's lower value would make it appropriate for transacting everyday items in a scenario of economic chaos. An ounce of gold is far too powerful for such purpose.

Platinum and palladium make up the platinum group metals (PGMs) that are rare precious metals with unique physical properties. The largest use for both metals is in the production of catalytic converters used in the automotive industry to reduce harmful emissions. The second largest use for both metals is the jewelry industry. In addition to catalytic converters and jewelry, both metals are used in diverse industrial applications in the electronics, medical and petroleum industries.



The use of platinum and palladium for coinage and monetary purposes is generally limited. The demand for both metals is therefore much linked to the continued expansion of the automotive industry and the regulatory push for more stringent vehicle emis-

sion standards. The investment case for PGMs lies more with the limited global supply of both metals: more than 80% of world palladium production is concentrated in just two countries – Russia and South Africa. Russia alone accounts for nearly half of total palladium supply. Continued growth of the automotive industry coupled with supply disruptions could therefore constitute a strong investment case for both metals.

The Wise Investor should always be aware of the spot price prior to making a purchase.

Step 2- Know the spot price of your metal

The price of metals quoted by dealers always involves two components: the international spot price and the purchase premium. **Because the spot price makes up the bulk of the purchase price and is easily found, the Wise Investor should always be aware of the spot price prior to making a purchase.** He should also be able easily to convert the spot price per ounce into the weight of the bar contemplated.

The spot price refers to the price that is determined on key markets where metal is traded. The spot price is quoted around the clock and refers to the price determined in the London Bullion Market during European trading hours and on the futures markets, thereafter, in New York, Sydney, and Hong Kong. This price fluctuates every moment and determines the bulk of the purchase price of the metal.

The chart below shows the spot price for gold on May 1st 2014. Intraday price swings of one percent are common in the gold market. This reinforces the need for the Wise Investor to know the latest spot price when making a purchase.



Knowing the spot price, the investor can determine the quantity of bullion that he can afford with his budget. For example, an investor willing to invest US\$200,000 in gold bullion can easily determine that he can afford about 153 ounces of gold (at a spot price of US\$1,300 per ounce).

Step 3- Choose the characteristics of your metal

ITS FORM

Physical metal comes in the form of bullion (bars purposely made for investment purposes) or coins which are minted by national mints and refiners worldwide. A distinction can be made between bullion coins and numismatic coins, which are collectible items commanding a higher price and which should only be considered by connoisseurs.

Bullion derives its value from its pure-metal content and its weight. There are two types of bullion bars:

- **Cast bars** that have rough finish and are produced by pouring molten precious metal directly into a mold;



- **Minted bars** that are made from gold blanks that have been cut to the required dimensions from a flat piece of gold with the marking applied by presses.

As a general rule (there are exceptions), bars have a lower premium than coins, with cast bars having a lower premium than minted bars. This report will focus to a large extent on bullion products, which are the cheapest way to purchase precious metals.



100 gram cast gold bar by Pamp SA. 100 gram minted gold bar by Pamp SA.

ITS WEIGHT

Bullion comes in bars of different weights, with the standard unit being the troy ounce (31.1 grams) for precious metals. Bullion bars are available in weight denominations ranging from 1 gram to 400 ounces (12.4 kilos) for gold and 1,000 ounces (31 kilos) for silver. The investor has a wide range of weights and sizes from which to choose, which can be confusing at first. Most people are not accustomed to dealing with troy ounces as a unit of weight. A troy ounce is approximately 31.1 grams, which renders conversion into grams and kilos rather difficult. As a simple rule, there are 32.151 gross ounces in a kilo. Keeping that number in mind allows us easily to calculate the number of ounces contained in bars which are denominated in grams.

For example, with a spot price of \$1,300, the spot value of a gold bar weighing 100 grams with a purity of 999.9 is US\$4,179 ($1300 \times 3.2151 \times 99.99\%$).



ITS FINENESS

All bullion bars and coins have a specific fineness, which is the ratio of the precious metal it contains to any impurities. It is traditionally expressed as parts per 1,000 (or on a scale of 24 karats for jewelry). Most bullion products have a fineness of at least 999.5 (which equates to 99.95% pure metal) for gold and 999 (99.9%) for silver.

ITS BRAND

Mined gold is brought in rough and impure form to refiners that mold it into standard bars recognized by the international market. The brand of a bar is the refiner and it is always marked on the bar. The quality of a bar is therefore dependent on the reputation of its refiner. It would be difficult for individual investors to track the reputation of each refiner they encounter prior to making a purchase.

Fortunately, a trade association called the London Bullion Market Association (LBMA) has defined the standards that gold and silver products must meet to be traded on exchanges. The LBMA has set up an accreditation process for refiners that meet their stringent quality criteria, as well as regular production checks. Such LBMA accredited status is being held by about 70 refiners worldwide for gold and 80 refiners for silver. The list of accredited refiners is called the Good Delivery List and is available on the LBMA website (<http://www.lbma.org.uk>). The London Platinum and Palladium Market association performs a similar role for platinum and palladium.

It is essential to purchase metal that is manufactured by a refiner that is on the Good Delivery List because the quality of the bar (the accuracy of the weight and fineness indicated on the bar) is widely recognized. Bars fabricated by little-known refineries might be hard to resell, and the buyer must also contend with counterfeit risk. There are some very reliable refiners that are not on that Good Delivery List but it is generally advisable to hold the most widely recognized form of bullion.

It is essential to purchase metal that is manufactured by a refiner that is on the Good Delivery List.



Step 4- Know the purchase premium

The spot price applies to metal that may or may not exist in physical form at the moment of trading and that is not readily available for the purchaser in a particular place. An extra layer of cost needs to be added to that spot price for an actual piece of bullion to be produced and shipped to the right location, and that is the purchase premium.

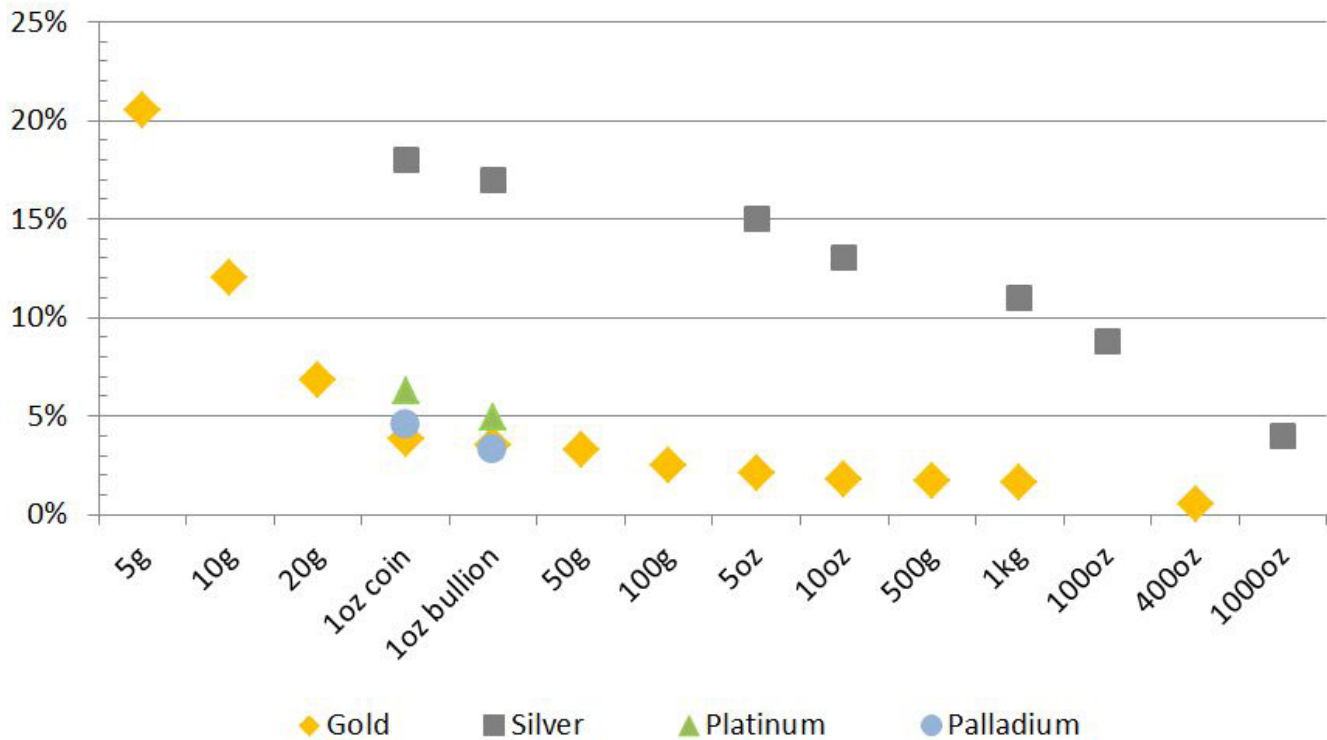
The purchase premium is typically between decimals of a percentage point to a few percentage points of the spot price for gold (it is a lot higher for silver, which has a much lower value per weight). The premium covers all the costs related to the physical aspect of the bullion, such as the manufacturing cost of a bar, its insured transportation to the desired location, its insured storage along the way, and the margin of the bullion dealer selling it. **The purchase premium includes the compensation of all the parties involved in making the bar and transporting it securely to the buyer.**

The first question that should be asked when considering the purchase of a particular bar is, “What is the premium?” The spot price is transparent and the buyer should be aware of it at the time of purchase. The dealer has no way to impact or cheat on that component of the price. He only has control on the premium and should be transparent about it. It sometimes takes a lot of effort for a customer in a physical or online shop to figure out the magnitude of that premium. A dealer should be transparent about the premium he charges and should clearly indicate it in percentage points for each bullion product. Moreover, he should always quote the price his metal in U.S. dollars, with a local currency equivalent if the settlement currency is not the U.S. dollar.

The premium includes the manufacturing cost of the bar, which is more or less similar irrespective of the size of the bar. The refiner needs to perform a similar amount of work to pour the gold needed to make a 100-gram cast bar, a 400-ounce bar, or a 1-kilo silver cast bar. As a result, the premium in percentage points is the highest for smaller value products. The chart below provides an indication of the premium for the four metals and for the most common sizes of bullion.



Typical premium per metal & bullion size



Some dealers (not all) buy back metal from customers. Independently from the requirement to test the bars at the cost of the seller, the dealer usually will buy back bullion products at a discount off the spot price. This is so that he can make a spread on the subsequent sale of the bar to another customer or, should he be unable to find another customer, to cover the cost to ship the bar and sell it to another dealer or refiner (who buys back at a discount).

A note should be made here that gold, as a rule, is never available at a discount off its spot price. Gold is an extremely liquid asset recognized globally. Gold at a discount would be akin to being offered US Dollars at a discount, which would seem suspicious for anyone. In most cases, such schemes to buy gold at a discount are scams run by con artists who try to lure and confuse investors with complex gold acquisition procedures that always involve a down payment to secure the sought after bullion. The exceptions to the rule and the genuine cases where gold is available at a discount are: the clueless seller who doesn't know how gold is priced or a seller trying to get rid of gold acquired illegally (from theft, illegal mining or from politically exposed persons).



Step 5- Decide on the final allocation to specific products

The new investor should remind himself that precious metals are commodities and that bullion derives its value solely from its fine metal content. A Wise Investor will try to get the maximum amount of fine metal at the cheapest price. He should look for the product that meets his budget and has the lowest premium. He should also take into consideration his need for future liquidity on his investment (selling part of his holdings to pay for living expenses) and his expectation to need his bullion to transact in case of severe economic distress (to buy food with metal for example).

A Wise Investor will try to get the maximum amount of fine metal at the cheapest price.

Let's take a concrete example. An individual has decided to invest US\$200,000 in physical bullion. He can follow this simple three-step approach to determine what products to consider:

- 1. The item with the lowest premium is the kilo bar. Slightly exceeding his budget, he can buy 5 kilo bars.**
- 2. He expects that he might need to free up US\$60,000 over the next few years to pay for living expenses (should his current income decrease). He wishes to have that liquidity in smaller tranches of US\$5,000. He therefore allocates the budget of 2 kilo bars to smaller bars of 100 grams worth approximately US\$4,200 each. He allocates to his portfolio 14 gold bars of 100 grams, which have a value of US\$58,800.**
- 3. He fears that he might someday need to transact with his bullion in a situation of economic disorder. Given the high value of gold, he decides to allocate US\$20,000 to buy silver bullion. He purchases 1,000 silver bars of 1 ounce (each worth about US\$20). He forgoes 5 bars of 100 grams to purchase his silver allocation.**



At a spot price of \$1,300 per ounce for gold and \$20 for silver, the investor will have the following allocation:

1. **3 kilo gold bars with a premium of 1% for a total cost of \$125,377.**
2. **9 gold bars of 100 grams with a premium of 2.5% for a cost of \$38,553.**
3. **1,000 ounces of 1 ounce silver ingots with a premium of 17% for a cost of \$23,400.**

The total cost of the investment is \$187,330 and the investor can allocate the balance amount to the product of his choice.



STORAGE OPTIONS FOR PHYSICAL BULLION

Now that our Wise Investor has decided on the type of bars that he wants to purchase, he needs to find out how and where store them. There are many options and one easily can be overwhelmed by the various ways to invest in gold. This guide attempts to review the various options that exist (even the ones not involving ownership of any bullion, in the next section) and make the case for the only way to hold bullion for wealth protection that is to have the legal title to bullion bars or coins either in your possession or with a trusted supplier.



HOME STORAGE

The investor can visit a gold shop armed with his calculator and a well-stocked wallet and go home discretely making sure that nobody followed him. This works perfectly for small purchases and can constitute a smart regular saving routine. However, not many people would feel comfortable doing so for larger amounts, such as kilo bars worth US\$42,000 each.

Let's assume that our adventurous investor made it home safely with a few kilo gold bars. He can choose to store his bars in a safe located in his home but he should be aware that this brings an additional risk to the safety of his family should this fact be known by other people. Home insurance also is not much of an option in most countries and if it is, its cost would be prohibitive.

Burying the gold secretly in the garden is a great option for those who have a garden but the secrecy is difficult to maintain for the investor who wants to adequately plan for the transfer of his wealth to his heirs in case of an unfortunate event. Countless quantities of bullion are likely still resting below the ground since their owner passed away.

SAFE DEPOSIT BOXES

Safe deposit boxes managed by professional institutions are the best option for the storage of a few gold bars. However, there are limitations to the solutions provided:

- **The boxes are usually small and have a maximum weight capacity** which is quickly reached with bullion. The storage of silver is also out of the question, given the bulky nature of the metal.
- **Most providers of such boxes are banks.** While they do not have access to the content (we hope), they are involved in granting access to the box. This means that the investor wouldn't be able to access his box in the case of a bank holiday, which is when he needs it the most. Another detail is that he would need (in most cases) to open a bank account with the bank, which might involve some level of government disclosure and indicate that he has assets in that bank.



- **Most bank safe deposit boxes do not offer the option to insure their contents**, which might raise the question of what happens if the contents of the box disappear. And cases of items missing from deposit boxes are legion.
- **Another major problem with any safe deposit box is the loss of integrity of the gold that is stored in it.** Bars that are kept at all times in vaults recognized by the gold bullion dealing community remain within what is called the “chain of integrity.” Within that community, a record is made of every movement of a bar between recognized vaults and such bar can be sold easily and quickly without the need to assay it.

There are non-financial institutions that provide safe deposit boxes service with insurance. Being non-financial firms, they wouldn't be impacted by a bank holiday and would not have the same disclosure regulations as banks. These firms are a far better option.

ALLOCATED METAL ACCOUNTS

Once the Wise Investor's gold holding outgrows his safe deposit box, the next step is to consider the most secure storage of all: a private, precious-metal vaulting facility that takes care of the storage and insurance. **The client retains total ownership of his metal and enters into a service agreement with the provider who acts as a bailee and cannot make any use of the assets whatsoever.**

Such a solution is best for the storage of large amounts of bullion that do not fit in a deposit box or for the overseas storage of metal as part of a geographical diversification strategy (because it doesn't require you to be there personally to move the bars). The greatest advantage of such a solution is the increased liquidity of the metal held, because it has remained in the custody of a trusted vault operator who can provide a guarantee to a potential buyer that the bars never left its custody and remained in the chain of integrity. Such a provider can, in some cases, assist in the purchase or sale of metal and arrange the transportation of the goods to other locations upon instructions by the client. Such arrangement, of course, necessitates a fair amount of trust in the provider, who should have an impeccable reputation.



With an allocated gold account, the client is the direct owner of the metal, and the metal does not appear on the balance sheet of the provider. The provider is merely acting as custodian and the investor pays a storage fee that usually includes insurance. The storage fee varies with the volume stored and the storage location.

There are two types of allocated accounts: pooled allocated accounts and segregated allocated accounts.

POOLED ALLOCATED ACCOUNTS

Such accounts allow investors to purchase a fractional interest in a pool of gold that most often consists of Good Delivery 400 oz bars. The gold must be purchased through the provider, which doesn't allow for outside bullion to be deposited in its storage. Those accounts are entirely backed by physical gold, but the specific bars are not allocated to investors, who hold a collective claim on the metal, along with all other investors. These suppliers offer fully insured and unencumbered ownership in the pool of metal that is stored with non-bank custodians at very attractive rates.

Because the gold pool is not allocated and segregated on a client basis, several issues arise:

- **Clients cannot inspect their holdings.**
- **Withdrawal of large 400 oz bars is the only affordable option.**
- **Withdrawal of smaller bars involves swapping large bars with smaller bars with a refiner and involves hefty additional charges.**

While these pooled accounts represent an easy way to own bullion, owning a fraction of a large bar will not be of much help should many investors ask for physical delivery at the same time. Swapping large bars with smaller ones or getting them refined into small bars might not be possible in a scenario of economic panic. Should the refineries be operating at full capacity during that period, the bullion would be locked for a while due to its collective ownership. Such ac-



counts offer the investor the option to “register” his bars and have them physically segregated but often at a prohibitive cost.

SEGREGATED ALLOCATED ACCOUNTS

With such an account the investor owns metal that is identified by bar type, unique serial number, gross weight, the assay or fineness of each bar, and its fine weight. Credits or debits to the holding are linked to the physical movements of bars, to or from the client’s physical holding. The investor outright owns specific bars that have been fabricated and are sitting insured in a vault segregated from holdings of other clients.

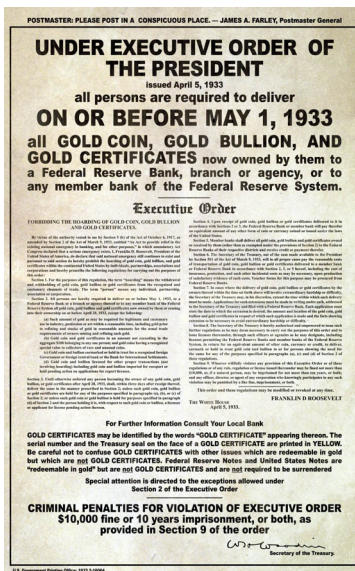
There are several types of providers of such accounts:

1. **Bullion banks** provide allocated accounts and charge a yearly storage fee ranging between 0.1% and 0.6% of the value of the metal, depending on the size of the investment and the relationship with the client. A feature of the London Bullion Market is that the clearing members act as sub-custodian for each other. This means that in the case of bullion held in an allocated account with a bullion bank, the property will exist but its location will be a bit of a secret. One clearer’s allocated collection (comprising individually identified 400 oz bullion bars) is most likely distributed across multiple vaults.
2. **Most wholesale bullion dealers** offer a storage solution since the vast majority of their clients need to store the quantities they purchased. Such dealers work with top tier vaulting companies with whom they get a wholesale deal on the storage due to the volumes they bring. Clients are often better off going through these intermediaries. Moreover, most professional vaulting companies are not too keen in dealing with private clients (and some simply refuse to). Lastly, the bullion dealer acts as a front for its clients to the vaulting company, which adds another layer of confidentiality for the cautious investor.
3. **Most of the bullion companies that offer allocated pooled accounts** (explained above) give the option to pay for the fabrication of the bars and have their segregated storage. The bar fabrication fees are usually prohibitive.



GEOGRAPHICAL DIVERSIFICATION AND OFFSHORE STORAGE

If history is any guide, gold has been the object of confiscation because it represents an obvious concentration of wealth. Such confiscation can take the form of theft if done by private individuals, or public policy if done by governments. Governments can unfortunately reach out to the safest private storage facilities and insurance does not cover government confiscation.



When choosing a jurisdiction in which to store a large amount of wealth, it is crucial that:

- It is governed under the rule of law and has an efficient legal system.
- It has a low motivation to expropriate assets (which is usually an inverse function of its solvency).
- It has balanced finances.

Unfortunately, these criteria already rule out most of the Western world as viable options. Investors are very concerned about the Western banking system and the risks of bail-ins, deposit confiscations and capital controls.

As a result, the world's growing middle classes and the wealthy are moving their gold away from increasing financial repression in the Western world to the Asian capitals of **Hong Kong** and Asia's emerging precious metals trade hub, Singapore. Switzerland remains a favorite destination for many western and international investors, both retail and institutional. Let us review the jurisdictions that are considered the safest.

SWITZERLAND

Switzerland is in our opinion one of the safest countries for gold storage and is said to concentrate the greatest amount of art and valuables of any storage location in the world. Since Switzerland gained independence in 1648, it has remained neutral and has not been engaged in any foreign conflicts. The country has a long tradition of safekeeping wealth.



However, the country is locked by European countries and increasingly submitting to the regulatory pressure by the European Union. Switzerland is still a safe option and certainly the most viable historically, but investors should stay informed of the potential future changes that might affect their holdings held in Switzerland

HONG KONG

Hong Kong is one of the most stable, vibrant, and economically free regions of the world. It has maintained a business friendly and low-tax environment which inspires confidence with global investors. Its legal system is based on British law with which most investors are familiar and comfortable and a robust financial infrastructure has been put in place over the years.



Hong Kong is also a logistics hub for bullion that contains the whole ecosystem required for trading and storing metals. It is home to two refineries accredited by the LBMA and the most reputable logistics companies are all present. It is the import gateway for precious metals into China, which have soared in recent years. Goods can move freely in and out of the city with minimal government interference.

The proximity and influence of China can be seen as a risk for some investors. However, it appears rather unlikely that China would go after private holdings of bullion, given that the country is sitting on considerable quantities of gold that it has mined or imported in recent years.

SINGAPORE

Singapore is well positioned to accommodate the growing demand for physical precious metals because of its well-earned reputation as a financial and wealth



management hub. The island-state is well positioned to develop a flourishing precious metals hub because it combines all the necessary ingredients:

- **Political and economic stability:** Singapore is a young nation but it has seen impressive economic growth due to its efficient legal system, absence of corruption, and a business friendly government



- **A favorable tax treatment of precious metals:** Singapore abolished VAT/GST on investment grade precious metals in 2012.
- **A Freeport** dedicated to the storage of precious metals and valuables. It was launched in 2010, is located next to the airport, and has 25,000 square meters of space. It is operated as a high security, state-of-the-art, duty-free zone facility and offers a highly confidential and attractive international free trade zone that makes for ideal storage premises for precious metals.
- **Government support and sponsorship:** The Singapore government and its major partners like the Singapore Economic Development Board (EDB), International Enterprise Singapore (IE), and the Singapore Bullion Market Association (SBMA) are contributing to and supporting a bid to rival London, New York, and Zurich as a hub for the trading and storage of physical gold, silver, platinum, and palladium.



- **Refining capacity:** Swiss refinery Metalor recently has completed the set-up of a refinery in Singapore and is now able to supply bullion to the local market and to provide refining services.
- **The precious metal ecosystem** is growing fast with several of the top logistics companies already present and bullion dealers setting up shop in the country to satisfy the growing demand for bullion to be stored locally.

OTHER GOLD INVESTMENT SOLUTIONS (WITHOUT DIRECT OWNERSHIP OF BULLION)

UNALLOCATED METAL ACCOUNTS

Most of the world's gold is held in unallocated accounts provided by financial institutions and large bullion dealers. While those accounts are described as the most convenient, cheapest, and most common ways to gain exposure to bullion, specific bars are not set aside for the client and the account is backed by the credit worthiness of the institution.

“Unallocated” storage means you own part of a pool of gold with no title to any particular bar. Precious metals held in this form do not entitle the holder to specific bars and the holder only ranks as an unsecured creditor of the dealer or bank in the event of an insolvency or bankruptcy. This bullion can be considered part of the general pool of metal held by the dealer or bank, and may be lent out or sold without the owner's knowledge or consent. As a result, storage fees are much lower than for full custodial storage and are not paid until the account is closed or the bullion delivered.

The London Bullion Market Association clearly mentions that with such account, “The client is an unsecured creditor.”

The reality behind these accounts is that they are an investment structure whereby the investor provides free capital to the supplier (and sometimes pays a small



fee to do so) and risks the loss of his capital should the supplier become insolvent. As an investor in unallocated gold, your metal is on the balance sheet of the supplier as a liability and you remain exposed to its insolvency. The actual metal doesn't necessarily need to exist, pursuant to the terms and conditions of the unallocated storage contract.

These accounts typically charge no storage fee or a small fee and do not allow for physical delivery to clients. Unallocated accounts usually have an option to convert into allocated at the investor's option and additional cost.

With an unallocated account, the client does not own bullion, but is merely an unsecured creditor of the bank. The bank may or may not have physical gold to back its liability to the client.

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The units of these accounts are typically 1 fine ounce of gold and 1 ounce of silver, based upon a London Good Delivery gold bar of a purity of at least .995 and a .999-fine London Good Delivery silver bar, respectively. There are several types of unallocated accounts offered by different suppliers:

1. **Bullion banks** (such as JP Morgan, HSBC, Bank of Nova Scotia, Barclays, UBS, Deutsche Bank) offer unallocated accounts that are available to investment companies or high-net-worth individuals through their private bank account. Those banks are members of the London Bullion Market Association and conduct most of the trading in the London gold market. Please read the section on the London Bullion Market to understand the nuances of that market.
2. **Large refineries** offer unallocated accounts to their client. Of all unallocated accounts, those offered by reputed refineries are probably the safest option because they have a natural flow of gold to refine. This is also the least available to the common investor and only reserved for professional dealers (with the exception of the Perth Mint, where unallocated storage is available to retail clients).
3. **Large bullion dealers** offer unallocated accounts that are backed by the rolling inventory of the company. Those accounts work in a similar way



as described above and are usually put in place for the dealer to finance its inventory required for its operations. The cost of conversion from unallocated to allocated is usually prohibitive, involving a bar fabrication cost and a storage fee. This artificially high rate achieves its primary purpose of keeping the gold unallocated. Physical delivery is possible only after conversion from an unallocated to an allocated account.

4. **Retail bank metal accounts** work similarly to a bank account, with the currency of account the gold gram. As an indication of the fee involved with retail gold accounts, a Singaporean bank charges 0.25% per annum of the value of the account (despite there being no gold to store and the deposit being an interest rate free loan to the bank) and there is a bid/ask spread of 1.5%.
5. **Gold certificates** are typically unallocated gold with an option to convert into allocated gold at the request of the investor and after paying the fabrication fees.

Unallocated gold generally is not insured (because there is not always metal to insure) and you would not necessarily have suffered a loss if it were stolen (the liability of the supplier remains). If the account documentation mentions insurance, chances are high that this is not an unallocated account, but rather an allocated account.

It is interesting to note that most investors holding an unallocated account are not aware of the true nature of such account. This is evidenced by several lawsuits that have been brought against bullion banks in recent years:

- **A class action lawsuit was filed in 2011 against UBS, alleging that the bank sold physical silver to investors while charging them a storage fee, without ever buying or storing physical silver. In fact, all the bank did was to provide a position in the metal by means of unallocated storage.**
- **A similar lawsuit was filed in 2007 against Morgan Stanley, where small investors claimed they had been defrauded into participating in unallocated metals storage. It appeared that clients had been paying storage fees for metal that did not exist. Morgan Stanley eventually settled for a multi-million dollar payout, but it continued to deny liability.**



Investors should find out the type of account that they are holding and be aware of the considerable risks associated with it if it is an unallocated account.

GOLD FUNDS

Several vehicles allow investors to own bullion indirectly. The investor owns shares in a vehicle that is the direct owner of bullion. The most popular such vehicles are exchange traded funds (ETF) that hold assets and issue shares that are traded on the stock exchange. Large broker dealers (the Authorized Participants) act as market makers and make sure the shares trade at the net asset value. Other vehicles are mutual fund structures with a distinction as to who provides the custody of the metal: a bank or a non-bank custodian.

THE ETFs

Gold ETFs offer a convenient way to add tactical gold exposure to a portfolio. With an annual fee ostensibly ranging from 0.25% to 0.4% for most ETFs, this convenience comes with a price given the many drawbacks of these products.

For the purpose of this guide, I will examine the workings of the largest gold ETF (which will remain nameless in this report) which currently holds over US\$30 billion worth of gold bullion. In such structure, investors hold units issued by the trust, with each unit representing an undivided interest in the assets of the trust.

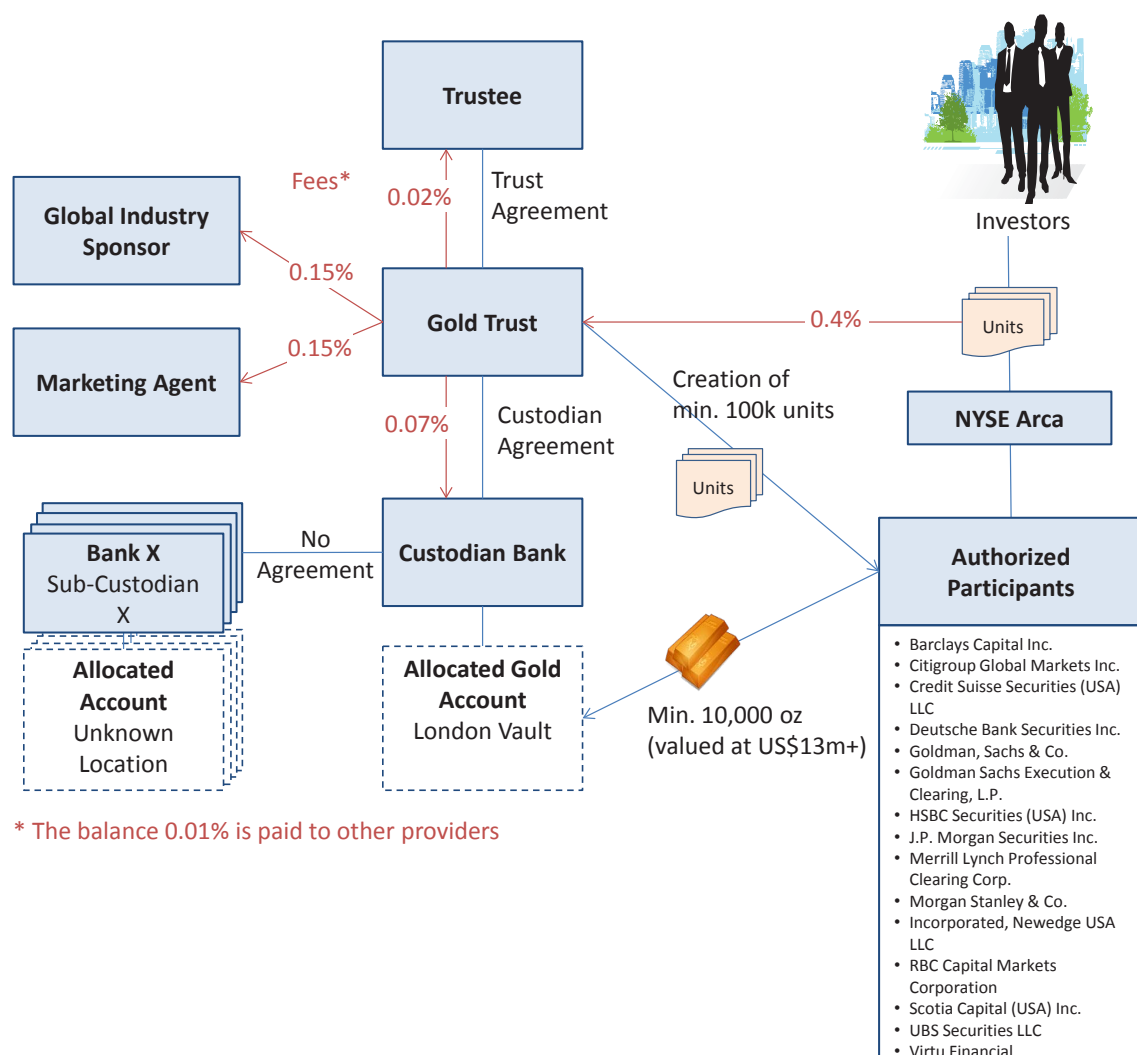
What makes an ETF different from another type of fund is that investors cannot interact with the trust directly for the purpose of creating or redeeming shares. This process is intermediated by Authorised Participants, who are for the most part large banks and only they can instruct the trust to create or redeem shares in baskets of 100,000 shares (representing about 10,000 oz of gold, worth US\$13 million). There is no legal obligation for the Trust or the Authorized Participants to deliver 10,000 oz of physical gold upon presentation of 100,000 shares by an investor (only the Authorised Participants may). Most ETFs are therefore paper gold instruments for investors because the physical redemption feature is only available to Authorized Participants.

Furthermore, the gold bullion is in an allocated account held with a bullion bank in London for the account of the trust. While this seems fine, the prospectus



authorises the custodian to use undisclosed sub-custodians holding the bullion in undisclosed locations. The prospectus also places several limitations to the liability of the custodian and sub-custodians, to the ability of the trustee to audit the holdings of the trust and the quality of the bullion held.

Conflicts of interests also have been pointed out between the custodians of such ETFs and their investors. Custodians of the two major gold and silver exchange traded funds, HSBC and JPMorgan Chase, hold great quantities of bullion on behalf of unit holders while at the same time holding significant over-the-counter derivatives in both gold and silver and significant short positions in both gold and silver on the COMEX.



Many investors are lured by the seemingly low cost of holding an ETF, but they should realize that a management fee of 0.4% is not justified for such a large



institutional structure. It is also obvious that the bulk of the management fee (0.3%) is not used to run the product, but to pay the fees of the sponsor and the marketing agent.

Investors also should factor in the brokerage fee they need to pay to their stock broker to acquire the units, and these can be substantial, depending on the provider used. While the brokerage fee may seem to have nothing to do with the ETF, it adds to the total cost to get in or out of the investment and must be taken into consideration when making comparisons to the other options available (such as the purchase of physical bullion).

Most metal ETFs can be regarded as products created by the banks and for the profit of the banks. Their workings are intricately intertwined with the London Bullion Market and should be avoided by the wise long term precious metals investor (please read the Appendix for a more detailed analysis on the London Bullion Market).

THE ETNs

An exchange traded note (ETN) works in a similar way to an ETF with the difference that the investor does not own a share in the trust, but owns title to a debt which is secured by bullion owned by the trust. The investor is therefore a creditor and is one more step away from the ownership of bullion. In fact, he does not own bullion at all, not even indirectly.

BANKS' SPONSORED FUNDS

Many banks have sponsored their own fund and act as fund manager and gold custodian. Many such funds have been established by Swiss banks which hold the gold in their own vault, often located in the basement of their main building. Such investment funds are clearly superior to ETFs but present some evident drawbacks:

- 1. Investors can face high fees to subscribe or redeem units of the fund, depending on the particular distribution channel into which they fall. This is not applicable to the funds that are listed, but brokerage fees and larger spreads for relatively low liquidity stocks might prove very expensive.**



2. Those funds are holding large bank bars of 400 oz, which are worth more than US\$500,000. Physical redemption is possible, but only for such bars and therefore is only available to large investors.
3. The bank acts as the provider of many services needed by the fund, including custody of the gold. This might create conflicts of interest in situations of distress for the institution in question.
4. Rules and regulations are changing fast in European countries and the conditions for the redemption of units for physical metal might change in the future and be out of the control of the provider.

FUNDS WITH NON-BANK CUSTODY

Funds such as the Sprott Physical Trust or the Central Fund of Canada have long earned the best-in-class reputation of all precious metals funds. They are closed-ended funds that acquire metal after each round of share offering and store the metal with non-bank custodians. Their shares can easily be acquired on stock exchanges in Canada and the USA. While superior to the bank sponsored funds, they suffer from a few drawbacks as well:

1. Acquiring the shares can be pricey, depending on the investor's brokerage arrangement and the liquidity and spread of the stock.
2. The funds are backed by large bars which then constitute the minimum holding required to request physical delivery.
3. Being closed-ended funds, their shares can trade sometimes at a significant premium or discount to the Net Asset Value, adding another layer of volatility to an already volatile asset.

FUTURES AND OPTIONS TRADING

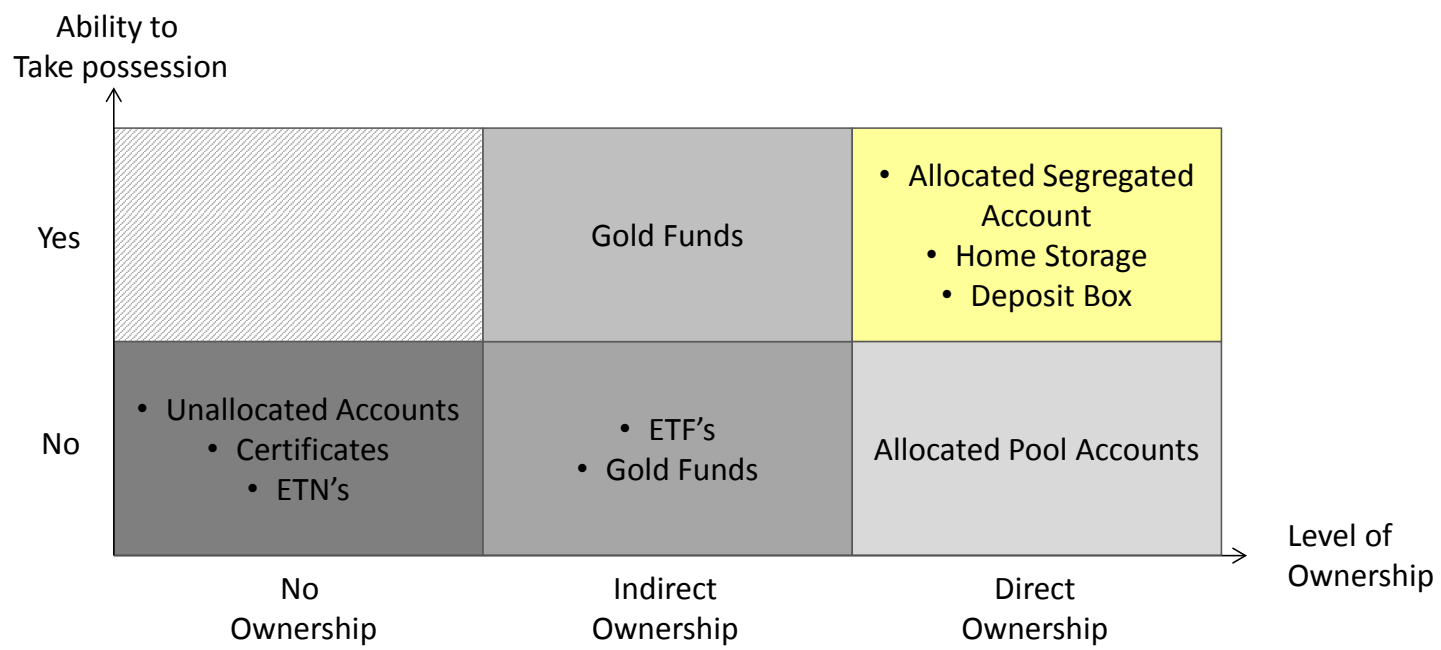
Futures contracts constitute an efficient way to purchase and take delivery of metal in lots of 100 ounces for gold and 5,000 ounces for silver. It is one of the cheapest ways to acquire and take delivery of metal for investors who have access to a broker that allows for physical delivery (most brokers do not).



Buying futures contracts and rolling them over does not, however, constitute a viable alternative to holding bullion. The investor who acquires his bullion in this way also should have sufficient capital on margin, given the high volatility of precious metals prices. The Wise Investor can acquire his metal on the futures markets and get it delivered to his allocated account held with a non-bank professional vaulting company.

The main commodity exchanges for gold and silver are COMEX in New York, TOCOM in Tokyo, and MCX in India. Gold also can be traded on other commodity exchanges, including the Chicago Board of Trade, Istanbul Gold Exchange, Chinese Gold and Silver Exchange Society, the Shanghai Gold Exchange, and Dubai Commodity Exchange. Only a small percentage of the futures market turnover ever comes to physical delivery of the gold or silver represented by the contracts traded.

SUMMARY



The chart below summarizes the various ways of holding bullion. Please note that taking possession of metal located in an unallocated or pool account is possible, but only after switching to an allocated segregated account.



CONCLUSION

Investors who own only a limited quantity of metal simply can store it at home hidden and in secret.

For larger quantities, the services of private storage facilities should be sought. Wise precious metals investors only should consider an allocated and segregated storage solution that presents the following characteristics:

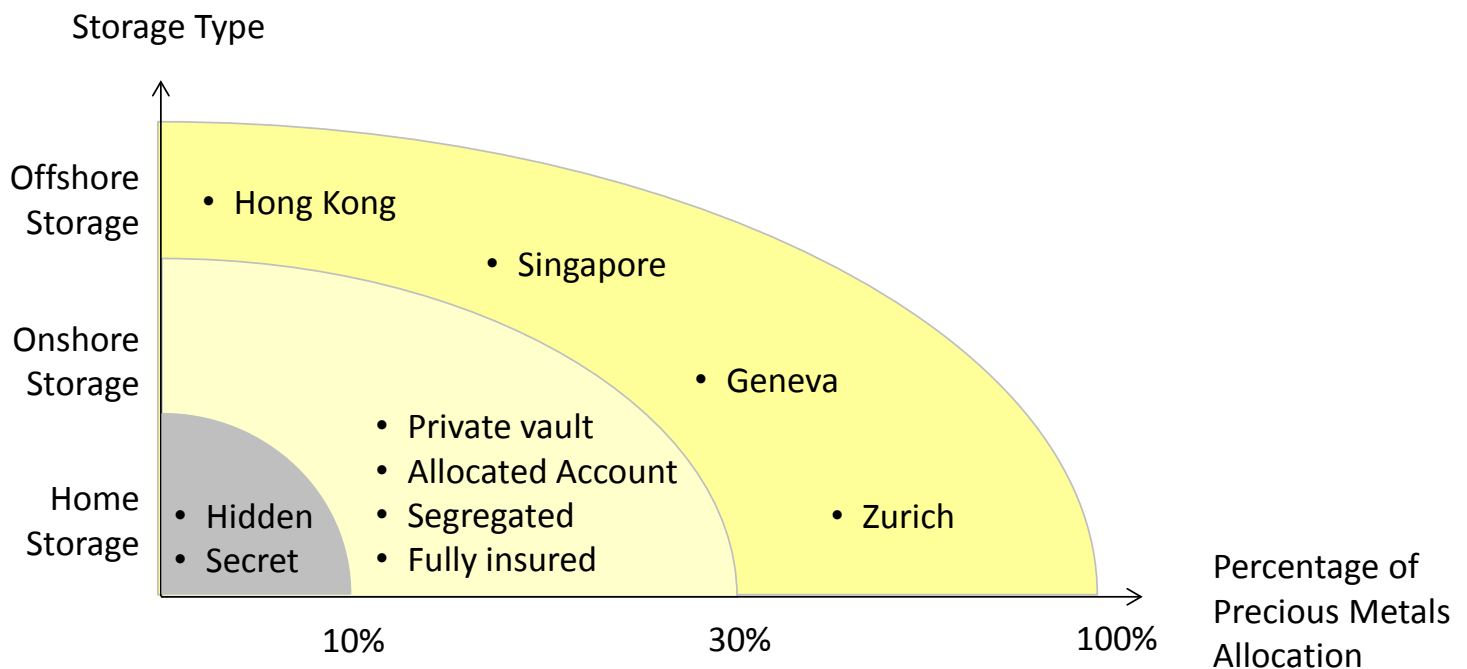
1. **Established in a stable jurisdiction** known for efficient commercial law and property rights enforcement.
2. **Offered by a reputable provider**, preferably being part of a reputable group of companies and with the directors clearly identified and accountable.
3. **Full insurance coverage** up to the replacement value of the metal, at no additional cost.
4. **Documentation clearly evidencing the title in the property by the investor.** This is usually accomplished with a sale invoice by the company. In the case of storage being provided by the company, this is sometimes complemented by a warehouse receipt and a certificate of ownership. These two documents have little legal value, but reinforce the fact that the ownership lies with the investor.
5. **A storage agreement that clearly limits what the supplier can do** with the investor's metal and outlines his role as a mere service provider.
6. **Documentation and statements setting forth the exact weight, manufacturer, fineness, and bar number** of your property. Failure to do this by the provider means that you are involved in an unallocated storage scheme.
7. **Regular audits** by independent third-party auditors.
8. **Competitive storage and administrative fees.** Such fees should never exceed 1% of the value of the metal per annum and should be closer to half a percent (including insurance).
9. **Ability to sell your holdings back to the supplier** in a convenient and fast way.



10. Ability to pick up your bullion at the storage facility with minimum notice to the provider (48 hours maximum).

Investors can structure the geographical distribution of their precious metals assets in the following way:

- 1. Small quantities of bullion can be held at home so that they are available in case of emergency.**
- 2. Larger quantities can be held in private storage in the investor's country of residence so that it can be reached within a few hours' drive should the emergency persist.**
- 3. The rest of the allocation should be held overseas in allocated, segregated, and insured storage located in stable jurisdictions.**





APPENDIX 1: A WORD ON THE LONDON BULLION MARKET ... AND WHY THE WISE INVESTOR SHOULD STAY AWAY FROM IT

Anyone even remotely interested in gold or silver often encounters the name of the London Bullion Market Association (LBMA). The LBMA is an international trade association that represents the wholesale market for gold and silver bullion, and it has two main roles:

- 1. It governs the London bullion market, where most of the world's physical gold trades. The London market is the focus of the over the counter (OTC) market for physical bullion, with a client base that includes producers, refiners, fabricators, and the majority of the world's central banks.**
- 2. The association sets the industry standards in terms of manufacturing, assaying, and vaulting of the gold in the London market. The LBMA publishes a list of accredited refiners (called the Good Delivery List) whose standards of production and assaying meet the requirements set out in the LBMA's rules. Bars produced by such refiners and conforming to size and purity standards are called Good Delivery bars. Only bullion conforming to these standards is acceptable in settlement against transactions conducted between participants in the bullion market.**

Unlike other commodity exchanges, the London Bullion Market does not operate as a commodities exchange with a clearing house as a central counterparty, but instead operates on an Over-the-Counter (OTC) or principal-to-principal basis. What this means is that buyers and sellers choose each other, and do not necessarily find the best price on an exchange floor purely through price competition among different players.

It is important to understand the structure of this market to see the concentration and control that some of the largest banks maintain over it.

- There are eleven market-making firms in the London Bullion Market that provide two-way price quotations during London bullion trading hours. These members are Barclays Bank, Goldman Sachs, Credit Suisse, Deutsche Bank, HSBC, JP Morgan, Merrill Lynch, Mitsui, Société Générale, UBS AG and the Bank of Nova Scotia (Scotia Mocatta).**



- **There are six clearing members of the London Bullion Market (Barclays, Deutsche, HSBC, JPMorgan, Scotiabank and UBS) that together own and operate London Precious Metal Clearing Limited (LPMCL). Note that the two biggest players from a clearing perspective are JP Morgan and HSBC.**
- **There are five banks that are market-making members and responsible for setting the price twice daily. They are Scotiabank, Barclays Bank Plc, Deutsche Bank AG, HSBC Bank USA and Société Générale.**
- **The clearing members maintain secure vaulting facilities, but only three of them have their own vaults (Barclays, HSBC, and JP Morgan). The other clearing members use the services of three security carriers, also LBMA members (Brinks, Malca Amit and ViaMat) and of the Bank of England.**
- **In addition to the clearers, there is the Bank of England, which clears the net gold positions among the clearers each day by making book entry transfers into unallocated accounts in respect of each clearer's trades. The balances of the clearers at the Bank of England represent their entitlement to the bank's bullion, and within the rules of the LBMA the clearers can treat it as if it were physical reserve (even though nobody outside the bank ever gets to look at the actual metal itself).**

The London market operates in absolute confidentiality due to the fact that trading between LBMA market makers and their clients is on an OTC basis. Moreover, since the passage of the Financial Services and Markets Act 2000, spot and forward trading in bullion in the UK have not been regulated activities. This results in the London bullion market being one of the most opaque markets ... despite being one of the largest markets in the world.

As per the LBMA website, last year clearing¹ statistics were nothing short of astounding:

*“In 2013 the daily average amount of gold cleared through London was 21.95 million ounces with an average daily value of \$31 billion.”*² It also later clarifies that “these are net figures; the gross turnover of gold and silver is expected to be considerably higher).”

It's constantly a source of amazement to the gold world that these LBMA average daily clearing statistics are so large. For example, 21.95 million troy ounces is equivalent to 668 metric tons of gold being cleared each day through the London Market. As admitted on their website, the gross turnover is “considerably higher.”

¹ Clearing statistics represent the net volume of loco London gold and silver transfers settled between clearing members of the LBMA.

² <http://www.lbma.org.uk/clearing>



In 2011, the LBMA surveyed trading activity amongst its trading members in an attempt to gauge the liquidity of the market.³ Despite the fact that only 36 of the 56 full members involved in trading gold submitted returns, the report states: “there is an approximately ten to one ratio between the turnover figures and the clearing statistics.” So this means that 2013 saw an average of 219.5 million ounces of gold being traded each day in the London Market. This equates to 6,826 metric tons of gold changing hands daily in 2013, with a value of US\$310 billion (and this is a low estimate of actual trading volume per the LBMA’s own admission).

Bearing in mind that global gold mine production is circa 2,800 tons per annum (or 7.7 tons per day), we can see that the volume of gold traded in London every day is 890 times the annual output of the world’s gold mines – and 4% of the quantity of gold that ever has been mined.

The LBMA website further states that: “In total there is approximately 9,000 tons of gold held in London vaults, of which about two thirds is stored in the Bank of England.”⁴ Well, it appears that those 9,000 tons must change hands every day and half or so, given a trading volume of 6,826 tons per day ... unless, of course, most of the activity in the London Bullion Market has little to do with physical gold.

In April 2013, the LBMA with HM Revenue and Customs (HMRC) drafted a document clarifying the treatment of VAT for the London precious metals markets.⁵ The consideration of whether physical goods or services are sold is central to a discussion on VAT. The report revealed that 95% of the trades in the London precious metals market are unallocated metal: “95% of transactions are in unallocated metal: therefore, because they are treated as services, the location of the underlying metal is not relevant.”

So let’s recap what we now know about the London Bullion Market:

1. It is essential to purchase physical bullion that is Good Delivery or has been manufactured by a refinery accredited by the LBMA because it is a sign of quality recognized globally and it facilitates future liquidity of the metal.
2. The London Bullion Market is at least 95% a paper market, consisting of gold denominated debts issued by over-leveraged bullion banks. Assuming that the 9,000 tons held in London vaults represents 5% of the total London Bullion Market,⁶ it means that 175,000 tons of paper gold with no backing whatsoever are currently being held by (mostly) unsuspecting investors. And this is,

³ Loco London Liquidity Survey, LBMA Gold Turnover Survey for Q1 2011, By Stewart Murray, Chief Executive, LBMA (available at http://www.lbma.org.uk/assets/Loco_London_Liquidity_Surveyrv.pdf)

⁴ <http://www.lbma.org.uk/vaulting>

⁵ Memorandum of Understanding between HM Revenue & Customs and The London Bullion Market Association and London Platinum and Palladium Market on the transactions effected by their members and the VAT issues arising, 2013 (available at http://www.lppm.com/lppm_memorandum-of-understanding.pdf)

⁶ To be fair, the clearing members of the LBMA may be holding bullion in vaults located outside of London and those quantities are not known.



of course, a low estimate because it assumes that those 9,000 tons have not been re-hypothecated several times. One hundred seventy-five thousand tons is more than all the gold ever mined and represents a value of approximately US\$7.3 trillion.

3. Given these alarming figures, a run on the London Bullion Market is likely to happen at some point. Investors desiring to hold precious metals for the long term as a crisis protection should stay away from the London Market and from any product involving its financial participants.

APPENDIX 2: MAJOR BRANDS AND BAR SIZES

The bars shown below are at scale if printed on A4 paper. Their dimensions are indicated in millimeters.



Pamp 1 kilo Cast Bar
(116 x 51 x 8.67)



Heraeus 500g Cast Bar (91.0 x 41 x 7.6)



Perth Mint 10oz Cast Bar (47 x 21 x 15)



Argor Heraeus 250g Cast bar (50 x 30.5 x 9)



Metalor 100g Cast Bar (45 x 25 x 5)



Tanaka 50g Mint Bar (40 x 25 x 2.6)



VINCENT MALHERBE



Vincent Malherbe is a Director at Global Precious Metals Pte Ltd, a wholesale bullion trading & custody company established in Singapore. Vincent moved to Singapore in 2003 where he started his career as a management consultant for Arthur D. Little, focusing on mergers and acquisitions in South East Asia, India and the Middle East. Vincent worked in the investment team of a single family office prior to setting up Global Precious Metals in 2012 with the Singapore-based family office Nimoi Holdings Pte Ltd. Vincent holds a Master's degree in Financial Management from the Vlerick Business School in Belgium.

To learn about Global Precious Metals' services for buying, selling and storing precious metals around the world, visit <http://www.global-precious-metals.com>.