10 Questions to Ask Before Investing in Precious Metals

Sprott

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Physical, Digital or Paper?

One rationale for investing in precious metals is ownership of an asset that is no one else's liability. Investing in physical precious metals (coins and bars), digital gold and physically-backed exchange-traded offerings often achieves this objective.

In contrast, forms of paper gold such as gold certificates and futures contracts are generally unbacked by physical metal, do not grant ownership title and cannot provide the ability for investors to exchange them for physical metal. In any instance of issuer default, paper gold investors will likely become unsecured creditors.

Tip: Only consider investing in physical precious metals, which grant direct ownership title, or fully-backed physical exchange-traded offerings, which provide beneficial ownership to the underlying metal and (preferably) the ability to redeem shares for physical metal.

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Allocated or Unallocated Metals?

There are many important implications in the difference between allocated and unallocated precious metals. Allocated precious metals provide the highest degree of investor safety. They are segregated, unencumbered and provide the holder ownership title. Allocated precious metals cannot be lent or leased to third parties. In contrast, unallocated precious metals begin to introduce counterparty risk, as ownership title is not secured by the holder. In certain situations, it becomes possible for gold investment vehicles to grant investor claims exceeding the total amount of underlying metal, if that metal is unallocated. In the event of issuer insolvency or bankruptcy, investors can become unsecured creditors.

Tip: Only consider investing in precious metals which are fully allocated, providing the security that the metals are not encumbered in any way and ownership claims do not exceed the value of the underlying metal.

3 Is There a Mark-Up to Spot Metals Prices?

The purchase of precious metals in coin and bar form generally involves mark-ups of 2% to 8% over reigning spot prices. For example, at the end of 2020, when gold was trading at approximately $1,898 per ounce in the spot market, sovereign one ounce gold coins were selling at premiums ranging from 5% to 10%, based on variables such as rarity, purity, volume and dealer inventories.

Exchange-traded funds (ETFs), are typically purchased and sold at prices very close to the spot price for the metal, but charge annual management fees to cover costs (trading, storage, insurance, trustee oversight and shareholder reporting) and provide a profit for the manager. Closed-end funds are a similar investment proposition to ETFs but can often trade at significant discounts to underlying spot-price of the related metal, unless they offer an option for investors to redeem shares for physical metal.

Tip: **If buying bars and coins from a dealer, compare the mark-ups among a number of them. If you intend to hold precious metals for only a few years, compare the total mark-up and mark-down costs versus the estimated management fees you will pay for owning an ETF or closed-end fund. For example, if you buy and sell an American Buffalo your total cost could be 13% of your investment. In comparison, it could take 20 years to pay the equivalent costs in management fees.**

4 Where are My Precious Metals Stored?

A key reason to own precious metals is to hedge against risk, so storing metal with a risky counterparty should be avoided. Many reputable storage providers offer insured storage. Most precious metals ETFs store underlying metal at bullion banks such as HSBC or JP Morgan. As demonstrated in 2008, even the largest financial institutions are exposed in a market calamity. In certain situations, bullion banks are also permitted to use sub-custodians for storage which introduces another layer of unquantifiable risk.

Tip: **Mitigate counterparty risk by selecting trustworthy and reputable storage facilities. For ETFs and closed-end funds, avoid storage custodians which are subsidiaries of levered financial institutions.**

5 Can I Take Delivery of My Precious Metals?

Direct investment in coins and bars is the easiest way to take physical delivery but there are trade-offs, such as mark-ups and the cumbersome nature of traveling to a dealer and then choosing the resting place for the metal, such as a safety deposit box. Most prominent bullion ETFs do not permit the average investor to take physical delivery of the underlying metal – this flexibility is reserved only for a limited number of Authorized Participants (mostly bullion banks) selected by the ETF to support creation of new units. Some closed-end funds allow investors to take physical delivery of the underlying metal.

Tip: **The option and ability for investors to take physical delivery of the underlying precious metal is an important feature of any bullion investment vehicle. Choose accordingly.**

6 What are the Ongoing Costs?

There are attendant costs to physical ownership of bars and coins, including insurance and storage. ETFs and closed-end funds charge annual management fees to cover costs and provide a profit to the management company.

Tip: **It's important to consider all of the initial and ongoing costs related to whether you choose to invest in coins, bars, ETFs or closed-end funds. For ETFs and closed-end funds, compare the management fees across different offerings, but also consider the differences in features and the associated risks with each offering to determine the overall value you receive.**

7 How Liquid is My Investment?

While many investors intend to invest in precious metals for the long term, there is always the possibility that a change in circumstances requires short-term liquidation. Selling coins and bars can be a cumbersome process. ETFs and closed-end funds, on the other hand, trade on an exchange (such as the New York and Toronto Stock Exchanges) and can be bought and sold throughout the trading day.

Tip: **ETFs and closed-end funds provide the most convenient way to sell your investment. The settlement period (when you receive the cash proceeds) is three business days after your sell order is executed.**

8 How are Precious Metals Taxed?

For U.S. investors, the IRS considers precious metals to be collectibles in the class of art, rare books and fine wine. The collectibles capital gains tax rate for precious metals investments held for longer than one year stands at 28%. The long-term 28% collectibles tax rate is significantly higher than applicable U.S. long-term capital gains tax rates for other investment assets, which range between 15% and 20%, depending on level of gross adjusted income and filing status. The tax rate on precious metals investments held for less than one year will always be the ordinary income rate for the taxpayer. ETFs holding precious metals are subject to the same tax treatment as ownership of precious metals coins or bars.

For some closed-end funds, special U.S. federal income tax rules apply because they are defined as Passive Foreign Investment Corporations (PFICs) by the IRS. If a U.S. non-corporate holder makes a timely QEF election each year by filing IRS form 8621 with his or her federal income tax return, it will generally mitigate the otherwise adverse U.S. federal income tax consequences of owning precious metals via coins, bullion or ETFs. Capital gains will be taxed between 15% and 20%, depending on the holder's specific personal situation.

Tip: **For non-corporate U.S. investors, consider closed-end funds that are classified as PFICs due to their potentially favorable tax advantages versus owning metals directly or precious metals ETFs.**

9 Which Precious Metals Should I Invest In?

Gold and silver are the most popular precious metals. However, there are also many other types of precious metals, such as platinum and palladium.

Throughout history, **gold** has been an unparalleled store of value. Gold is a monetary metal and alternative form of currency. It has minimal counterparty risk. Gold has also served as a safe-haven asset in times of geopolitical upheaval or economic downturn. Central banks hold roughly one-sixth of the global investable gold stock to diversify foreign currency reserves. Historically, gold has been an effective diversification tool for portfolios.

Silver is a hybrid metal – it has incredible physical properties which make it useful in technology and as a form of money. These properties lend silver to a wide spectrum of uses. Approximately 50% of the annual silver supply is consumed for industrial purposes. Silver is affordable relative to gold and has a reputation as the precious metal of the "common person." Like gold, silver is a tool for portfolio diversification, but its price is more volatile than gold.

Platinum and Palladium are the lesser known precious metals. They both have incredible properties that can make them very valuable. Platinum and palladium demand are both driven by the autocatalyst market but also jewelry. They are rarer than gold and silver and produced in only a few countries around the world, making their supply more sensitive to changes.

Tip: **To us, precious metals are a mandatory portfolio asset amid excessive debt levels and aggressive monetary debasement by global central banks.**

10 Can I Protect Myself from Counterfeit Precious Metals?

While gold and silver have always been the obvious victims of counterfeits, even platinum products are now being counterfeited with great skill and success. Counterfeit precious metals coins (and bars) are flooding the market at an astonishing rate, and are continually improving in quality and appearance. According to the Professional Numismatists Guild (April 30, 2020), "The current enormous demand and limited supply of silver and gold bullion coins and other precious metals items during the COVID-19 pandemic have created a breeding ground for the distribution of counterfeits that is costing unsuspecting investors millions of dollars, according to the nonprofit Anti-Counterfeiting Educational Foundation (www.ACEFonline.org)."[1]

Tip: **Only deal with well-known and reputable bullion dealers and national mints such as the U.S. Mint and the Royal Canadian Mint. Do not buy precious metals online from unknown sources. For ETFs and closed-end funds, check to see if they own London Bullion Market Association (LBMA) Good Delivery physical bullion. The good delivery rules include specific requirements regarding the fineness, weight, dimensions, appearance, marks and production of gold and silver bars. They also specify procedures for weighing, packing and delivery as well as policies for ensuring refiners' compliance with the specifications.**

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[1] Source: Counterfeits Gone Viral, Online Sales of Fake Gold and Silver Cost Public Millions, April 30, 2020. Visit https://acefonline.org/counterfeits-gone-viral-online-sales-of-fake-gold-and-silver-cost-public-millions/

* Subject to certain minimums.

** For more information, please see "Tax Considerations-U.S. Federal Income Tax Considerations" in the Prospectus and always consult your tax accountant regarding your particular situation.

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