Physical Precious Metals: Tips to Avoid Tarnishing Your Portfolio

Precious metals are notorious for price movements that can pique investor interest during upswings and downswings alike. If you are thinking that now is the time to invest in physical precious metals such as silver, gold or maybe palladium or platinum, be aware of the risks involved. They include the potential for high-pressure sales tactics and even fraud.

Enforcement actions by the Commodity Futures Trading Commission (CFTC) and court decisions paint an ugly picture of sellers that charge high commissions and fees but ultimately fail to purchase or deliver the physical assets as promised. In one recent CFTC case, a federal court in Florida levied $2.5 million in monetary sanctions against a firm for illegal precious metals transactions. And in another court verdict, a firm selling precious metals was ordered to pay over $52 million in restitution to defrauded customers.

Precious metals can play a helpful role in building a diversified portfolio, but some investments are better than others. These five tips can help you avoid problems when it comes to investing in physical precious metals:

1. **Say “no” to pushy salespeople.**

   No reputable investment professional should push you into making an immediate investment decision, or tell you to “act now.” Even if no fraud is taking place, this type of pressuring is inappropriate. Be particularly wary of unsolicited telephone calls. Persuasion tactics—such as dangling the prospect of large profits (the “phantom riches” tactic) or implying that there are limited quantities of an investment available (playing the “scarcity” card)—are often used. Avoid unwanted calls by registering with the National Do Not Call Registry.
2. **Check out the salesperson’s background before you invest.**

   Although firms offering precious metals to retail customers do not have to be registered with a federal or private sector securities regulator if the metal is delivered within 28 days, a number of the sales professionals involved in enforcement actions were previously registered with the National Futures Association (NFA). Use the NFA’s [Background Affiliation Status Information Center (BASIC)](BASIC) to check whether the firm or individual is registered with the CFTC or an NFA member and whether the firm or individual was the subject of any disciplinary actions. It’s also a good idea to check an investment professional’s background using FINRA BrokerCheck and to do a general Internet search.

3. **Be on high alert when you hear “low risk.”**

   Don’t purchase physical quantities of precious metals based on a promise that the investments are “safe” or have minimal risk of loss. In particular, don’t fall for the pitch that investments in physical assets are not risky. Storage charges, price fluctuations and the use of investor loans to finance the purchase of metal bars, bullion or coins are just a few of the risks associated with an investment in physical precious metals. Ask to receive a risk disclosure statement from the salesperson **before** you send any money. And request the salesperson’s name, address and telephone number, as well as that of the firm. If the salesperson balks at the request, end the conversation.

4. **Look out for leverage risk.**

   Precious metals investments often involve the risky and expensive use of leverage, or borrowed money. You may pay a portion of the cost to invest in the precious metal in cash, but then pay for the rest of the investment (in some cases up to 80 percent of the metal’s purchase price) “on margin.” This margined portion is in fact a loan which carries interest and is subject to the risk of a margin call if the value of the investment declines. In the event of a margin call, you may be required to invest additional money to prevent your investment from being liquidated without your consent or prior notice.

5. **Get a full accounting of fees.**

   There is often an account opening fee with physical precious metals investments, which can be hundreds of dollars. Then there are commissions, which can be 15 percent or more of your investment, **including any leveraged portion.** Add in storage fees, management fees and ongoing interest on the loan for the leveraged portion of the precious metals purchase, and you may find that you would need to earn an unusually high return on your investment just to break even. It can be extremely difficult to make money on direct investments in physical precious metals.

   Investors also should be aware that direct investments in precious metals are not covered by the Securities Investor Protection Corporation, or SIPC. SIPC provides limited coverage to investors on their brokerage accounts if their brokerage firm becomes insolvent. But with precious metals, **SIPC protections** do not apply because the investments are not registered securities.
Investment Options Beyond Physical Precious Metals

While you may be tempted to invest in physical precious metals, doing so directly can be difficult and costly, which in turn can make it harder to diversify your portfolio.

Mutual funds or exchange traded funds (ETF) that invest in an array of precious metals companies or a variety of physical precious metals can help you avoid putting too many precious metal “eggs” in one basket. Unlike physical precious metals, mutual funds and ETFs are registered securities that provide legal protections and ongoing disclosure about the investments.

Furthermore, funds can provide a cost-effective way to diversify among different types of physical precious metals and companies involved in mining and other aspects of the precious metals business.

That said, all securities that offer exposure to commodities such as precious metals carry the risk that you could lose some or all of your investment. Commodity futures-linked securities in particular may employ complicated investment strategies for achieving their investment objectives and can be volatile.

When it comes to precious metals funds:

➤ Take the time to research fees and other expenses, as well as the fund’s management, structure, risk factors and how long a fund has been offered, as some have limited track records.

➤ Don’t over-concentrate your portfolio. Even if you’re investing through a fund, it’s a good idea to diversify both across, and within, assets classes. It can be risky to have a large portion of your holdings in a particular investment or asset class relative to your overall portfolio.

➤ If you plan to invest via a fund, understand the fund’s investment objectives and strategies.

While precious metals investing can open up growth and diversification opportunities, be aware of the additional risks that come with it, and be prepared to do your homework.
Investor Alert

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- FINRA Investor Alert, “Gold” Stocks—Some Investments Mine Your Pocketbook
- FINRA Investor Alert, Stock Spams and Scams
- Commodity Futures Trading Commission Fraud Advisory, Precious Metals Fraud
- United States Senate Special Committee on Aging, Exploring the Perils of the Precious Metals Market
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