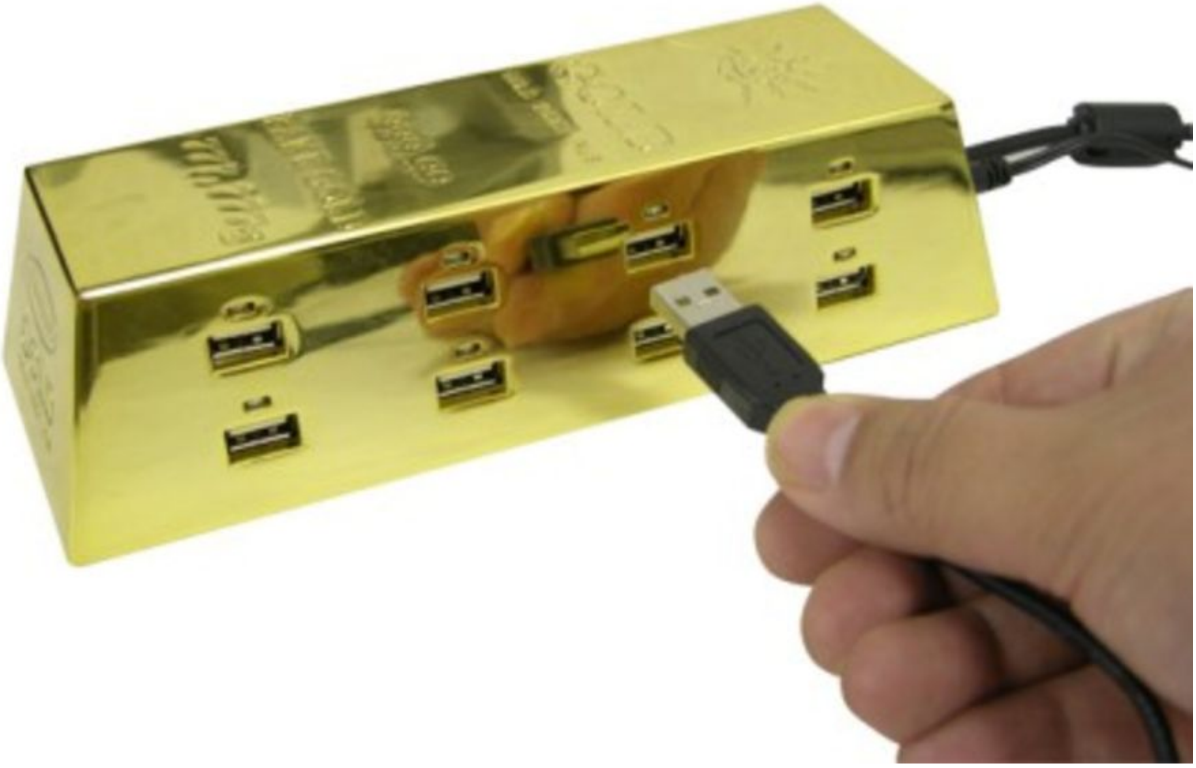

# Stay away from "virtual gold"!

For short term speculation on the gold price, ‘virtual’ gold make sense, so I don’t write the following methods off completely. Before the financial crisis really started biting, I used to recommend these strategies to my clients who wanted to invest in gold. Now I don’t any longer. In fact I believe they are positively dangerous, and doubly so because they are slickly marketed as ‘safe haven’ solutions.

I’m referring here principally to four ‘virtual’ ways of investing in gold:

- ETFs (Exchange Traded Funds): Most of you will be familiar with ETFs. You can buy them through regular online brokerage accounts. Funds like GLD and others allow you to buy gold (kind of) and keep it in your brokerage account as if it were a stock – which, legally speaking, it is. You are actually buying stocks in a company that invests in gold. ETFs track the quoted spot gold price.

- Digital Gold: Here I'm talking about systems like BullionVault.com, e-gold, and GoldMoney that are not stock-exchange based, but allow you to create accounts on their system that function, to vastly over-simplify, rather like bank savings accounts but denominated in gold rather than fiat currency. Got that? You can deposit and withdraw at current rates. The Gold itself doesn't move – it stays put in a vault somewhere. You simply transfer beneficial ownership of it by buying and selling online. It's a smart system for making small value online payments.
- Gold Accounts: Some banks, mainly in Switzerland, offer these accounts to their clients. Gold is kept in the bank vaults, but accounted for on behalf of individual owners who are the account holders. Gold may be either allocated (you own specific bars in the vault) or unallocated/pooled – which means you own a certain number of ounces of the gold in the vault, but all the gold in the pool is interchangeable.Another similar option is the Perth Mint Certificate Program, a hugely successful system whereby the government of Western Australia will hold your gold in their vaults, issuing a certificate in return which entitles you to the gold and which can be bought or sold at spot price (plus brokerage fees of course).
- Gold Mining Stocks: many bankers will try to convince you to invest in shares in gold mining companies. Here, you are not buying directly in gold, but logically the value of these shares basically goes up and down more or less with the price of gold. It's a good way of gaining exposure to the profits and losses of the gold industry. And as gold carries on upwards, this industry will certainly become more and more profitable.

Now let me say clearly again that there is nothing necessarily wrong with any of these four systems, or any similar 'virtual' gold systems. If you want to play the markets and benefit from short term hikes in the official spot price of gold, any of these systems work. I’ve used them all in the past for my own personal funds and may do so again in the future. Out of all four, the ETFs are definitely easiest if you already have a brokerage account.

There are two major, and I mean really major, problems with all these options, however:

- The first problem is that you do not directly own the gold. They all rely on the banking system. Which, when you think about, kind of defeats the whole rationale for owning gold that we outlined in the previous chapter.
- In the case of ETFs, for example, you are actually buying shares in a company that owns gold. Those shares are managed by a Custodian – Barclays iShares in the case of GLD, the biggest ETF. Those shares are then registered in the name of a nominee, then allocated to your brokerage account. What you have is not gold at all – just electrons and promises!

Right there in the example above are at least three financial institutions that could fail and affect your investment. In reality, the chain of ownership is even more complicated than that and may well involve many third party contractors and the like in various jurisdictions. If just *one* of those entities goes down, and gets bailed out, you will probably get your assets back after some time, though that is by no means sure. You might, for example, find your gold suddenly gets frozen in USD for a few months just at the wrong time. That is exactly what happened to many account holders in e-gold when the US government froze the system, had the gold sold and the accounting kept in USD.

More worrying however, is that in the event of a complete systemic meltdown, you will be left with nothing except those electrons and promises from a bankrupt financial system. So if you are looking at gold as a safe haven, your protection against a possible collapse of the financial system, you quite obviously don’t want to hold your gold through ETFs that rely on that same unstable financial system.

There is the risk of government seizure…. making Private Ownership of Gold illegal.

Private ownership of gold in the past has been illegal in certain countries, most notably the USA in the years following the last Great Depression. In the future some of the more oppressive high-tax regimes (not naming names) may well resort to this tactic again, in a desperate attempt to prop up the value of their fiat currencies. It would enable them to buy up a lot of gold at bargain prices (the ‘official’ exchange rate) as people rush to sell it in desperation before the deadline date of lawful ownership.

Any gold you own through bank and brokerage type setups will be completely visible to governments, and is already subject to reporting requirements imposed in the name of the war on money laundering. You are likely even required to report it yourself.

The only solution is to hold real gold yourself, hide it somewhere secure, and tell no-one about it. There’s no way that electrons and promises from the cartel can serve as adequate substitutes for the base metal itself. Keep physical gold bullion – not necessarily at home, but in places that are not exposed to the financial system. I’ll outline some of these in the next chapter.