Portfolio Diversification with Gold

Mike Garofalo, President,
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An APMEX Company

APMEX®

Investments You Hold™

Introduction of APMEX

- One of the world's leading precious metals dealers, with customers in over 60 countries
- One of only 13 worldwide "Authorized Purchasers" United States Mint Products; direct purchasing from most major sovereign mints of the world.
- Exclusive arrangements with Brinks Global to provide secure storage through subsidiary Citadel Global Depository Services, Inc.

Introduction of APMEX

- Exclusive, co-branded offering with eBay USA & eBay Germany
- Operations:
  - Over 5,000 products on site/in stock
    - Ready for immediate delivery
  - Over 500,000 packages delivered during 2013
- Transparent Buy & Sell Prices
  - A plus rating with the BBB
  - 98% customer satisfaction

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Reasons Why People Buy Gold

- Wealth Protection
  - Portfolio diversification – risk mitigation
  - Insurance policy –reduce volatility
- Wealth accumulation
  - More so with silver than gold
- Currency collapse
  - Those sure it is going to happen
  - Those who think it will not happen but just in case
- Collector
- New customer –general discomfort with government, financial institutions & big business

Portfolio Diversification with Gold
Today's Discussion

- Gold is an Alternative Investment – Wealth Protection
  - Oil, Real Estate & Gold trade in the trillions each day
  - Examine their recent non -correlation comparisons
- Forms of gold ownership
  - Detailed comparison of physical vs. ETF
- Inherent risks for gold investors
- Who should or should not consider gold
- World Economic Forum 2014 Global Risks
  - If gold mitigates risks, then what risks
- IRS Tax rules for gold
- World Gold Council 2013 Annual Report

Wealth Protection Strategy

Gold is an Alternative Asset

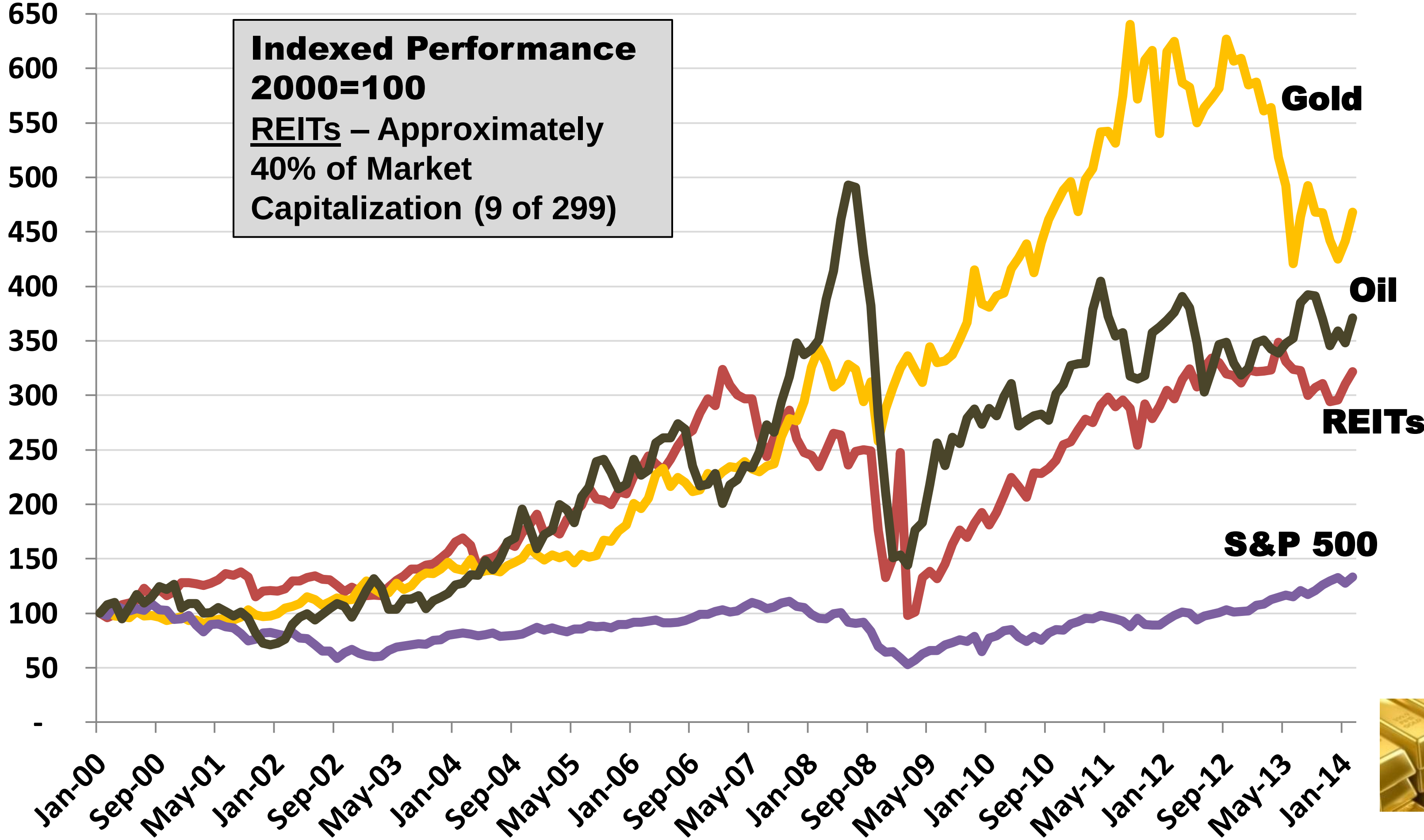
Alternative Investments

- Everything but stocks, bonds or cash
- Hedge funds, managed futures, real estate, commodities (oil), derivatives and precious metals (gold)
- Often have high minimums & high fees
- Low correlation to standard assets provide portfolio diversification
- Generally have 5-20% allocations

Gold is an Alternative Asset Class

- Markowitz's Modern Portfolio Theory held true for many years with just stocks, bonds & cash
  - Began to break down during inflationary times of the 1980's
  - 2007-09 clearly showed the three asset model did not hold up – alternatives became necessary for portfolio diversification
- Alternative assets provide diversification - reduce volatility – provide risk management
  - Preferred alternatives are highly liquid and non-correlated
  - Gold is highly liquid, non-correlated, and easy to explain and understand.
  - Let's take a look at non-correlation compared to real estate & oil

Gold as an Alternative Asset



Source: Federal Reserve Bank of St. Louis, marketwatch.com, London Bullion Market Association

Correlation Coefficients Comparisons

Correlation	2000-2014 (Feb)
S&P 500 - REIT	0.66
S&P 500 - Gold	0.36
S&P 500 - Oil	0.51

Correlation Coefficients Comparisons

Correlation	2000-2014 (Feb)	May 07-Feb 2014
S&P 500 - REIT	0.66	0.83
S&P 500 - Gold	0.36	0.27
S&P 500 - Oil	0.51	0.61

What Forms of Gold Ownership

Compare ETF to Physical

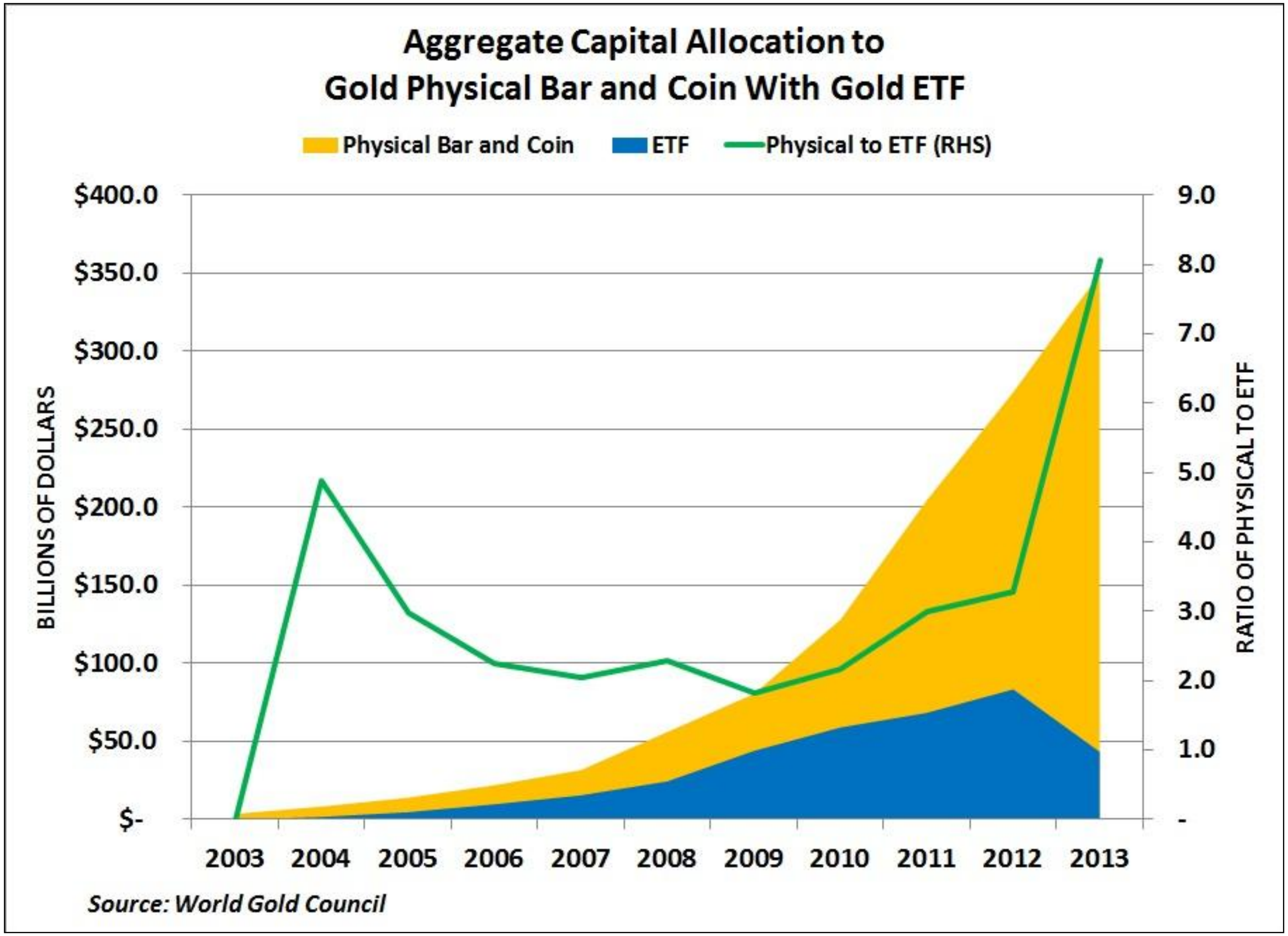
4 Ways to Invest in Gold

- Physical Gold (Bullion – Numismatic)
  - Physical gold bullion will have the highest correlation to gold spot price (Bullion value = to metal content)
    - Coins, bars or rounds - 3 year or more investment horizon
      - Yes, coins are most often bullion
    - Numismatic = metal content plus "collectability"
- Gold "ETFs"
    - High correlation to gold spot price
    - Preferred for trading in and out of the market
- Mining companies
    - Leveraged bet for higher risk/reward
    - Bet on company management, geopolitical conditions, labor costs, supply & demand… in addition to gold spot price
- Gold options & futures
    - Speculative bets for the experienced trader

ETF or Physical

- Gold ETFs recently celebrated a tenth anniversary
  - According to the World Gold Council, at the end of 2013, ETFs represent $43 billion in aggregate investment for the last 10 years
  - At the end of 2013, physical gold represented $350 billion (more than 8:1 over ETFs) in aggregate investment for the last 10 years

Aggregate Capital Allocation-
Gold ETF and Physical Bar and Coin



World Gold Council 2013 Annual Report Physical Demand Up – ETF Demand Down

- Large liquidation of “ETFs” by institutional investors provided the source of physical gold
- Physical sales were up, while ETFs were net sellers of gold
- “ETFs” liquidations caused the sale of 400 ounce gold bars to refineries in Europe, Dubai & Asia
- Refineries converted the gold bars into smaller coins and bars for consumers largely in the East
  - Physical demand was up in USA as well

Comparison: Gold ETFs vs. Physical Bar and Coin

Investment Attributes of Gold	Physical Gold	Physical Gold and Gold ETFs	Gold ETFs
Easily passed down to the next generation	•		
Hedge against inflation		•	
Portfolio balance, non-correlated asset		•	
Tangible asset with recognized intrinsic value	•		
Hedge against loss of purchasing power		•	
Potential for capital appreciation		•	
Asset value available for portfolio leverage			•
Quick liquidity to offset other portfolio losses			•
Tangible asset, just in case something happens	•		

Risks of Investing in Gold

All Investments Carry Risks

- Gold can fluctuate in price just like any other asset
  - 2013 as case in point
- Changes in political or economic climate may have a direct impact upon the price of gold through
  - Currency Devaluations
  - Central Bank Purchases
  - Trade Imbalances
  - Oil Flow Restrictions
  - Armed Conflict and other geopolitical tensions
- Natural disasters
- Black swan events

All Investments Carry Risks

- Gold carries an opportunity cost in that it does not pay interest or dividends
- Physical gold requires storage (potentially a cost) and can be viewed as a security risk
- Collectible gold products carry supply & demand risks outside of their gold content
- Not all precious metal dealers are equal; due diligence should be completed on several dealers before selection(price, availability, transparency, selection, qualifications).
  - AML & KYC Compliance - Counterfeit detection

Portfolio Diversification with Gold: Who Should or Should Not Invest

Who Should Not Consider Physical Gold

- Investors with a short term view
  - Short term wealth accumulation –playing the market
- Investor age can be a factor
  - Is there a need for a long term view?
  - Is there a need for easy transfer of wealth?
  - Is there a need for multi-generational transfer of wealth?
- Investors who need a stream of dividend or interest income
- Investors who do not need to consider investment asset diversification

Who Should Consider Physical Gold

- Investors with a long term view of at least 2-5 years
- Investors who need portfolio diversification through investments non-correlated to stocks
- Investors looking for an easy transfer of wealth
  - Immediate or multi-generational
- Investors who are concerned about
  - U.S. Debt (Global debt – it is not just the U.S.)
  - Inflationary pressures in the U.S. and around the world due to "easy" monetary policies
  - World political instability/geopolitical tensions
  - Currency devaluations –race to the bottom
    - Ray Dalio, founder Bridgewater Capital, maintains 5% gold allocation
  - Government – Financial Institutions – Big Business

World Economic Forum
2014 Global Risk Report

From the Founder of World Economic Forum

"Our lives are changing at an unprecedented pace. Transformational shifts in our economic, environmental, geopolitical, societal and technical systems offer unparalleled opportunities, but the interconnections amongst them also imply systemic risks". This report aims to enhance our understanding of how a comprehensive set of global risks is evolving and how their interactions can lead to unexpected and often systemic impacts." **-** Klaus Schwab, Founder

World Economic Forum 2014 Global Risks

- 31 global risks selected by over 700 leaders & decision makers from WEF stakeholder community
- Ranked by level of concern, likelihood, potential impact and interconnectivity with other risk factors
- A global risk is defined as an occurrence that causes significant negative impact for several countries and industries over a time period of up to 10 years.

31 Global Risks by Category

- **Geopolitical risks:**
  - Global governance failure
  - Political collapse of a nation of geopolitical importance
  - Large scale terrorists attacks
  - Weapons of mass destruction
  - Violent inter-state conflict with regional consequences
  - Nationalization of resources
- **Societal risks:**
  - Political and societal instability
  - Mismanaged urbanization
  - Income disparity
  - Food crisis

31 Global Risks by Category

- **Technological risks:**
  - Escalation of large scale cyber attacks
  - Massive incidents of data fraud/theft
  - Breakdown of critical information networks and infrastructure

- **Economic risks:**
  - Fiscal crisis in key economies
  - Oil price shock to the global economy
  - Decline of the importance of the US dollar as a major currency
  - Liquidity crisis
  - Failure of a major financial institution or mechanism
  - Structurally high unemployment or under employment

31 Global Risks by Category

- **Environmental risks:**
  - Greater incidents of extreme weather events
  - Greater incidents of natural disasters such as earthquakes, volcanoes and geomagnetic storms
  - Greater incidents on manmade disasters such as nuclear accidents and oil spills
  - Water crisis
  - Climate change

TOP 10 Global Risks 2014
High Interconnectivity = Domino Effect

1. Fiscal crisis in key economies
2. Structurally high unemployment and under employment
3. Water crisis
4. Severe income disparity
5. Failure of climate change mitigation and adaptation
6. Greater incidents of extreme weather events

TOP 10 Global Risks 2014
High Interconnectivity = Domino Effect

7. Global governance failures
8. Food crisis
9. Failure of a major financial institution/mechanism
10. Profound political and social instability

Portfolio Diversification with Gold: Current Tax Implications

The Tax Man Cometh

- Gold purchased by the investor is not required to be reported to any government agency
  - Cash transactions of $10,000 or more are reported on Form 8300
  - Bank wires, personal or business checks are not consider cash transactions, as these funds have been cleared by the issuing bank
- Only certain foreign gold coins in quantities of 25 ounces or more or gold bars in quantities of 32.15 ounces or more may be subject to 1099 B reporting
  - Only the sell side of the transaction is noted on the 1099B – cost basis unknown & undeclared

The Tax Man Cometh

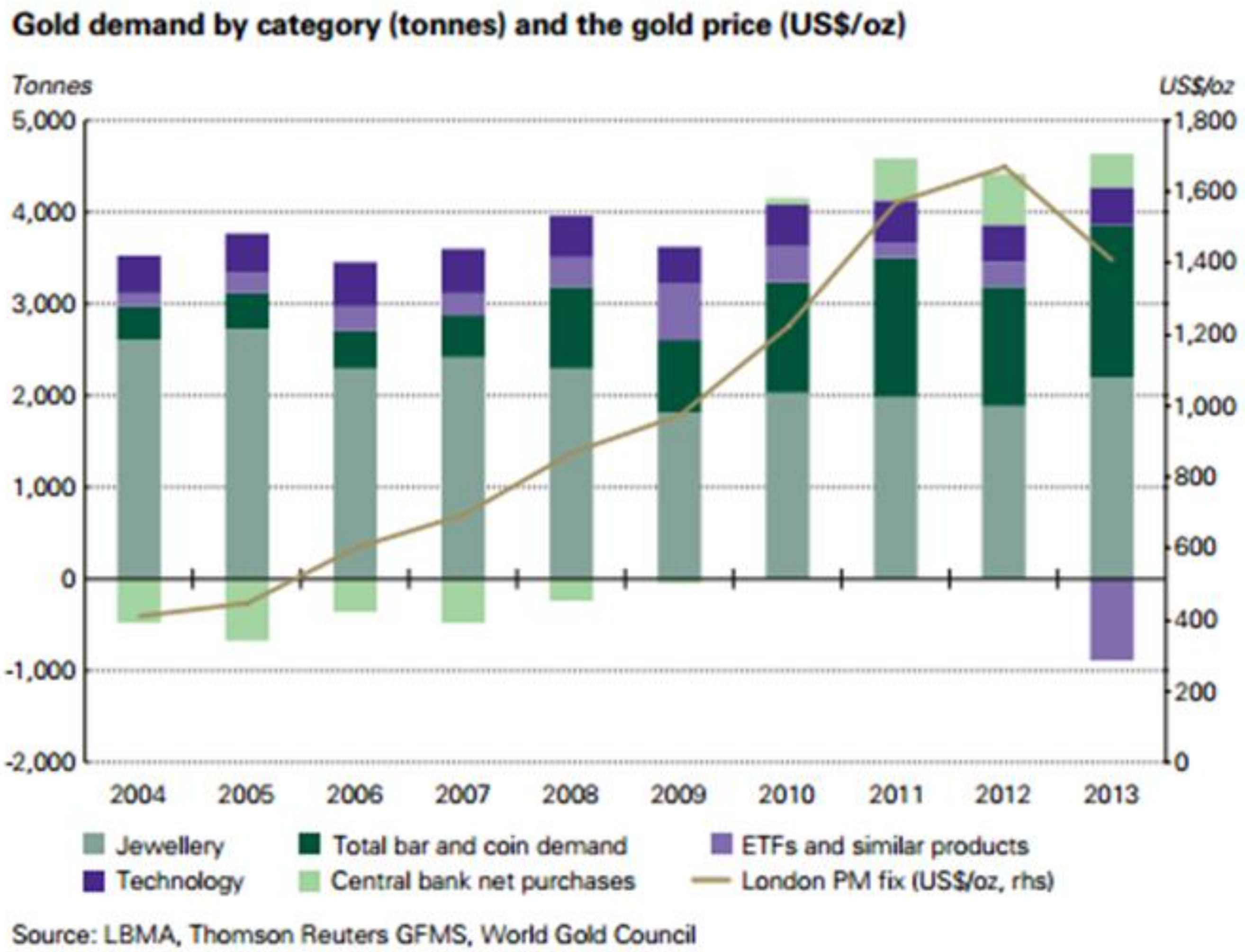
- Investors are required to self-report any capital gains to the IRS
  - IRS considers both bullion & numismatic gold as a collectable
  - If held less than a year then 28%; more than one year, the individual is taxed at their marginal tax rate up to 28%
  - Those in a higher income bracket are only subject to 28%
- Gold ETFs are taxed under the same rules as Physical Gold

World Gold Council
2013 Review

Gold Demand Down 15% in 2013

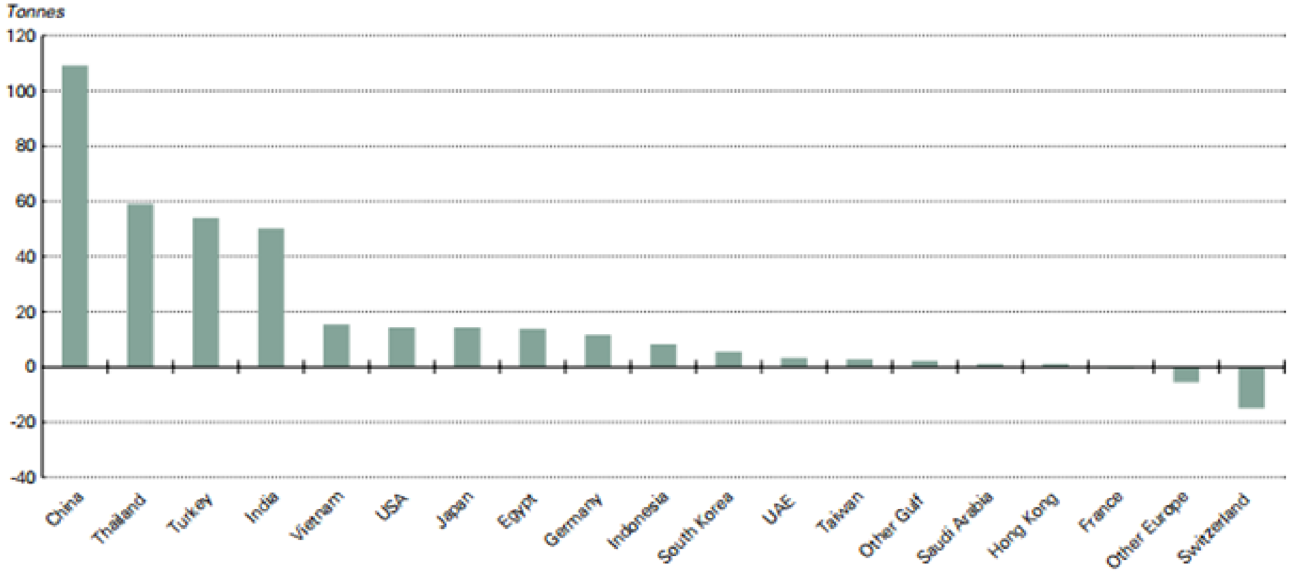
- Physical demand up 21%
  - Falling prices triggered high demand for the long term view
- Central Bank demand down 32%, but still net buyers
  - 12 straight quarters of net purchasing
  - Still bought above 5-year moving average
- ETFs experienced significant outflows
- Sharp drop in gold prices clearly differentiated the mindset between the owners of ETFs vs. the physical
  - Physical more about consumers
  - ETFs more about Institutions

Gold Demand by Category



Year-on-year change in coin & bar demand

Chart 7: Year-on-year change in bar and coin demand by country (tonnes)

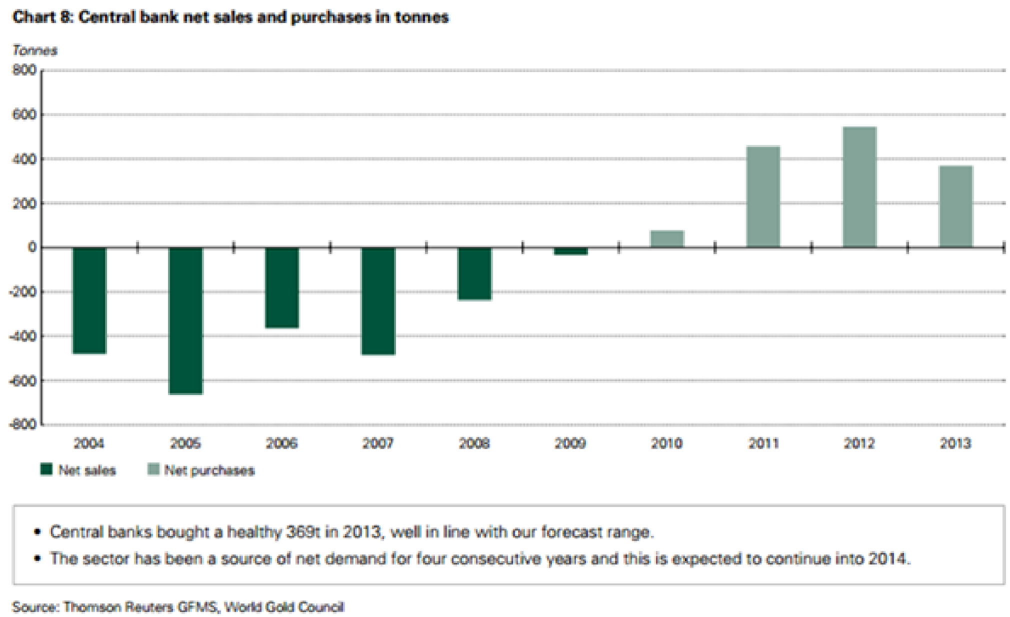


- Record bar and coin demand reflects widespread growth.
- Europe is the outlier, although demand here remains well within its elevated post-crisis range.

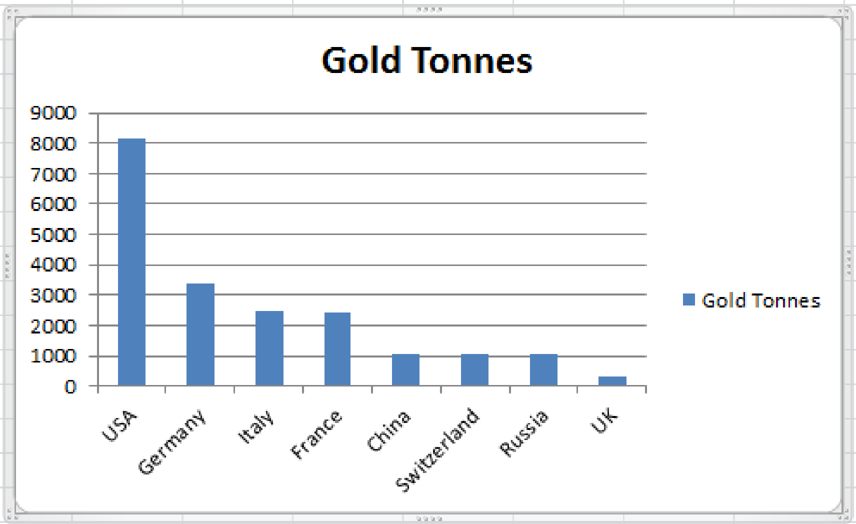
Source: Thomson Reuters GFMS, World Gold Council

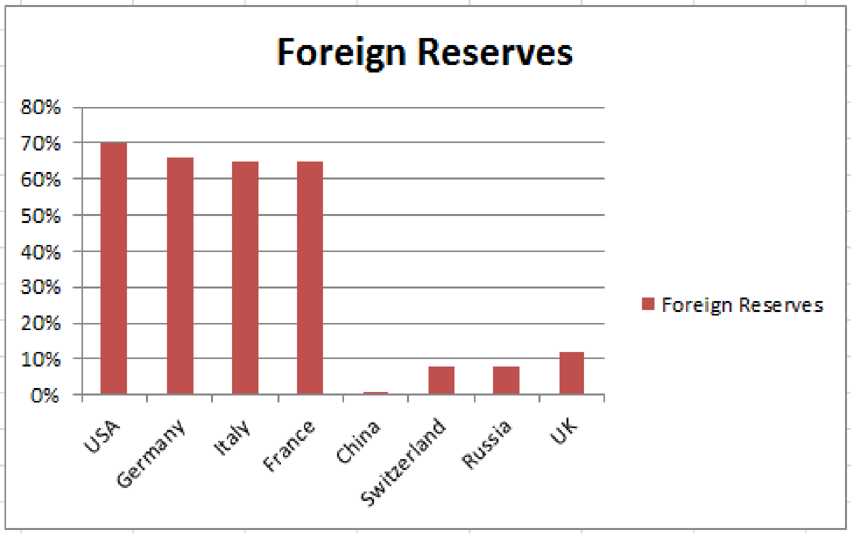
Central Bank Purchases

- In Q3 of 2009, Central Banks became net buyers of gold for the first time in over two decades
- Through 2013, Central Banks have been net buyers for 12 straight quarters
- The same Central Banks began buying gold at about the same time they all began printing money



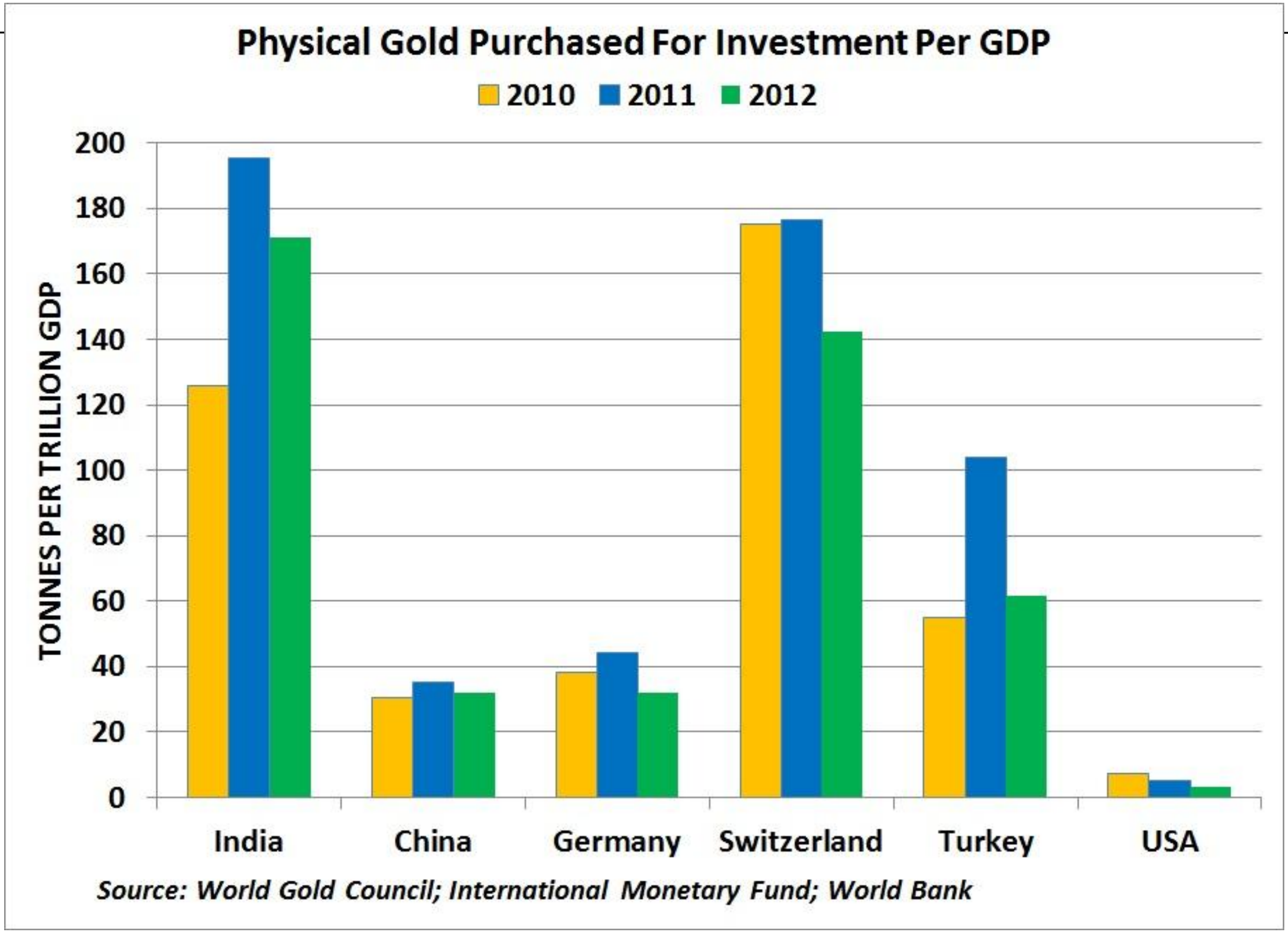
Central Banks
Ownership & % Foreign Reserve Currency





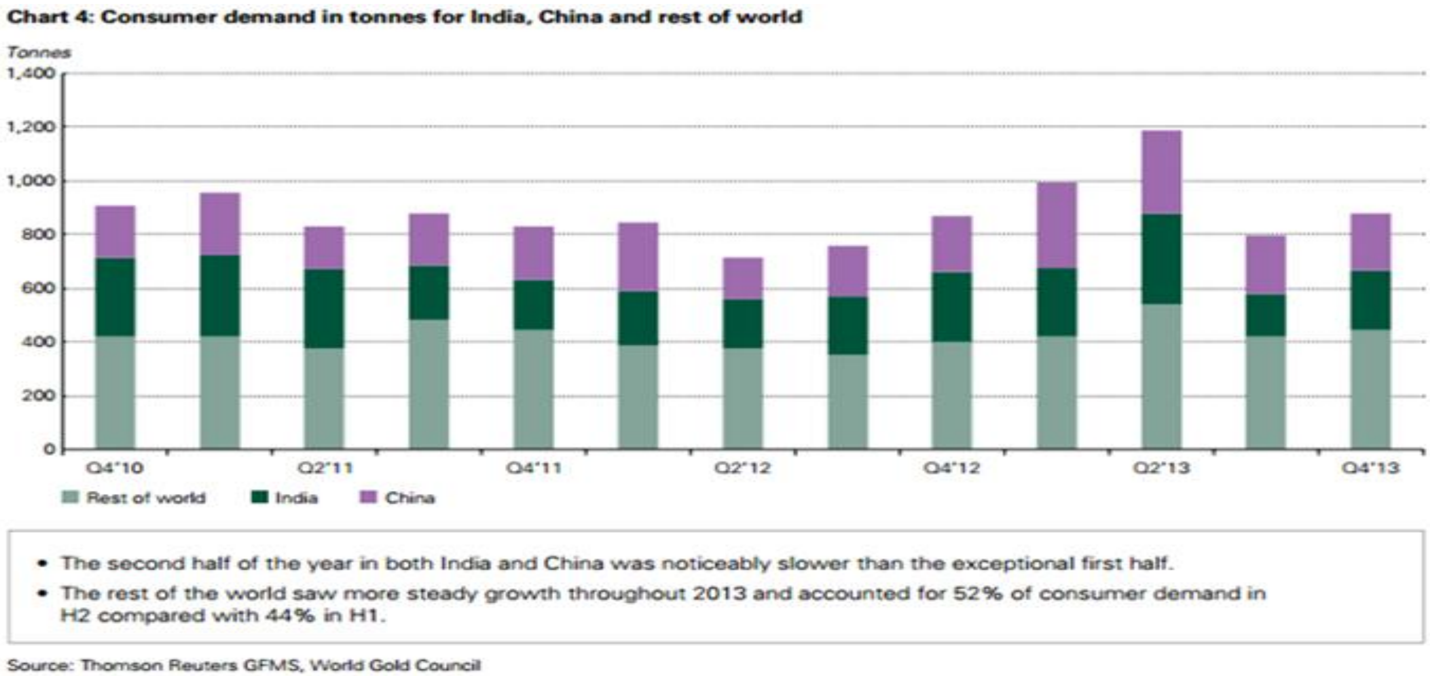
- The US owns the most Gold and it represents 70% of their foreign reserve currency – most western nations above 50%
- China ranks number 6 for Gold ownership, but it only represents 3% if their foreign reserve currency
  - $40 trillion in foreign reserves – 1% = $40 billion
  - China has not officially reported Gold holdings since 2009

Gold vs. GDP


Physical Gold Purchased For Investment Per GDP
2010
2011
2012
TONNES PER TRILLION GDP
200
180
160
140
120
100
80
60
40
20
0
India
China
Germany
Switzerland
Turkey
USA
Source: World Gold Council; International Monetary Fund; World Bank

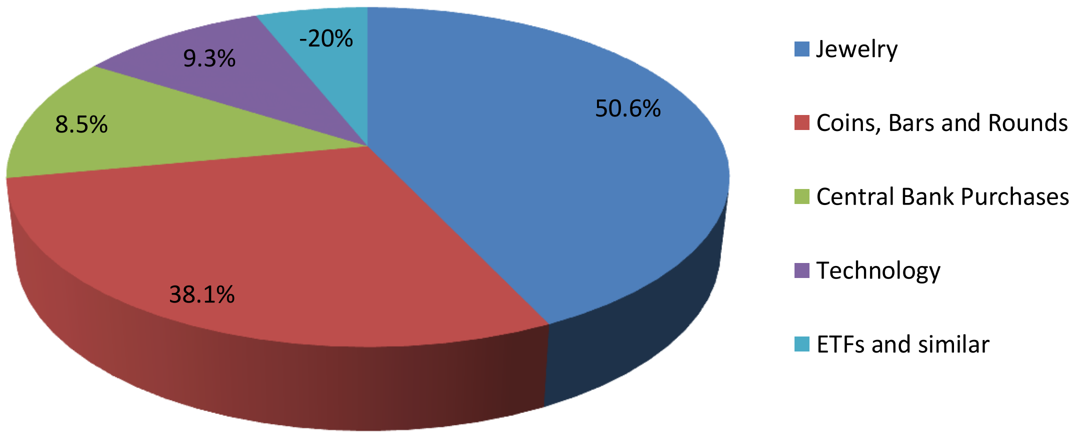
India & China
Over 50% of the World's Gold Purchases

- February 2014, China overtook India and became the world's largest consumer of gold
- Gold jewelry the most popular form especially in India



Forms of Precious Metals Demand

- In 2013, according to statistics from the World Gold Council, the sources of demand for gold were as follows:
  - Please note that Jewelry is by far the most popular gold product at over 50%
    - Driven by demand India, China and other counties of the Far East
  - Coin & bar demand is second at 38%
  - Technology is less than 10%
  - ETFs were net sellers of gold in 2013



Key Takeaways & Considerations

- Gold is an alternative investment that is highly liquid, non-correlated & easy to understand and communicate to clients
  - Easy to get in & easy to get out
- Physical gold is appropriate for the long term view and is favored by consumers
- ETFs better accommodate short term trading and is favored by Institutions, hedge finds and traders.
- Gold is not a one-size fits all solution. There are reasons not to own gold.
- Gold prices tend to rise on the bad news and go down on the good news
- Global risks are more easily recognized with today's ease of communication. The interconnectivity and potential domino affect is of much greater concern than any single risk

Key Takeaways & Considerations

- Central banks have been net buyers of gold for 12 straight quarters
- China continues to display a voracious appetite for gold
  - Looking to be a major world currency backed by gold
- India & China buy over 50% of the gold
- In 2013 coin and bars sales to consumers spiked on falling gold prices
  - In 2013 gold was non correlated to stocks
- ETFs outflows from Institutions and hedge funds increased as a result of the falling prices

Final Thoughts

- Kevin O Leary Interview
  - Gold provides stability - it is like an insurance policy
  - 5% allocation works for me ($300 M) but 10% would make sense
  - Rebalance quarterly – do not care about gold price
  - ETFs to rebalance – Physical to hug

- "Gold and silver are money. Everything else is credit" – J.P. Morgan

For further information and questions, please contact Mike Garofalo at 1-888-518-7596 or michael.garofalo@cgdsi.com

Thank You

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