Gold Speculator, Investor, Trader, Saver or Gambler ?

I recently had an interesting discussion with a few individuals in the comments section of a subscription site (so can't provide a link) where we argued whether certain members were investing, speculating or trading (based on their strategy) in the precious metals sector.

The word speculator generally has some negative connotations, but I think many in the precious metals space who think they are investing are in fact speculating (myself included, but I've never had any issues with that label).

Here are the five labels I would give to those with capital invested in the precious metals space (more than one may apply to each individual):

Precious Metals Trader

The precious metals trader is someone looking for short term opportunity in the market based on chart and other technical indicators which suggest the future price direction of the metal. They might trade short or long on the metal (betting on the price moving lower or higher). They might have a view on the long term prospects for Gold/Silver, but this doesn't (or at least it shouldn't) affect their short term decisions. This means when the metals are overbought the trader will either sell short or close their long positions (some may follow the rule "Never short a bull market").

Precious Metals Saver

The precious metals saver is a regular buyer of Gold &/or Silver. They buy the metals not to speculate on a rising price, but because they choose to hold their savings in ounces instead of dollars. Precious metal savers will generally not concern themselves with the price when they buy, rather they purchase at regular intervals (e.g. every pay day or once a month) and this is referred to as dollar cost averaging. In some cases they are doing so because they believe it will protect their capital from the effects of inflation or some save in Gold/Silver as they believe a new monetary system is likely in the near future and the savings in precious metals will allow them to safely carry their capital from the current monetary system to the next. The precious metals saver might be considered conservative even if they have heavy exposure to precious metals.

Precious Metals Speculator

The precious metals speculator is someone who is heavily exposed to precious metals with the intention of making spectacular gains as the bull market continues. They would have a solid understanding of the market and ensure the fundamentals support their decision. Their heavy exposure means that if something were to change dramatically in the market without warning this could impact the value of their portfolio substantially, a risk they are aware of and prepared for. Unlike the trader they may be prepared to weather significant price corrections with the intention of riding the longer term trend.

Precious Metals Gambler

The precious metals gambler is probably similar to the speculator in many ways; ultimately they are looking for a significant gain in their portfolio, but in attempting to achieve these gains they make poor decisions which might include: using too much leverage, blindly following the actions of a speculator without understanding reason for their choices or buying without knowing their own limits (for example they might buy high without the necessary patience to weather a long correction & sell out at the bottom).

Precious Metals Investor

The precious metals investor is someone who holds Gold/Silver as part of a balanced portfolio (for example they might hold 25% as per Harry Browne's Permanent Portfolio, with the other 75% held in stocks, cash & bonds, evenly split). They will not be overweight in precious metals and their exposure is likely to be mixed, for example they might hold some physical along with dividend paying Gold & Silver mining stocks. If the goal of the individual is a modest and consistent return over a long period of time (of which the precious metals plays a part) then they are an investor. If they are using precious metals to multiply the value of their portfolio over the short to medium term, then chances are they are a precious metals speculator.

Several of the above labels may overlap at times. For example the precious metals saver might occasionally trade some Silver for Gold (or visa versa) in order to play the Gold:Silver Ratio (GSR), but ultimately their goal would be to stack more ounces using this strategy (just the same as you might swap from one term deposit account to another with a better rate).

To a degree I would consider myself as having worn the first three hats (Trader, Saver & Speculator) at various times over the last five years.

I have a core position in physical Gold which is unlikely to be sold regardless of the prices we reach over the short to medium term. This core position will be held with the expectation we see a new monetary system at some point (perhaps something similar to Freegold, a concept previously covered on the blog or maybe it will be completely different). I would consider this core position as "savings".

At times I have sought to benefit from short term moves in the price of Gold and Silver, including when I sold a portion of my Silver between $38 and $46 in early 2011 when I assumed we were nearing a major peak (but held the majority for continued bull market trend).

Primarily though I consider myself a precious metals speculator. I am heavily geared towards a continued rise in precious metals and it should be obvious to most longer term readers that the vehicles I've used can be inherently risky (for example junior mining stocks & options). My investment capital is positioned heavily (100% more or less) toward the expectation for a continued rise in the precious metals and while I think there is good reason to expect the bull market will continue, if the environment changes quickly and without warning (for example the US starts raising interest rates and tightening monetary policy) then there is the potential for significant loss.

The above descriptions and definitions are mine only. I have no doubt there are some whose opinion would clash with mine and I would encourage you to speak up in the comments below. Also if you think there is a group who hold precious metals but aren't covered by the above labels I would also value your input.

Different investor strategies different investment vehicles

With gold stocks languishing near lows in a desolate sentiment wasteland, investors are wondering why this sector has fallen so deeply out of favor. One theory is capital that would have traditionally flowed into major gold producers has been diverted into the GLD gold ETF instead. Taken to extremes, this logically leads to the conclusion gold stocks will never thrive as long as GLD exists. Is it cannibalizing the miners?

The more investment capital that flows into physical gold, regardless of the vehicle, the higher its price is driven. And the higher gold's price goes, the more investor interest it generates. Everyone loves a winner, and gold's performance has been incredible over the past 8 years since GLD opened up a direct conduit for stock-market capital to flow into physical bullion. And of course higher gold prices help gold stocks.

Gold stocks are not suffering today because GLD is cannibalizing their capital inflows, but simply because sentiment is at an unsustainable ebb. Endless cycles of greed and fear echo through the markets. Prices soar to overbought heights when greed gets excessive, and then correct sharply. Eventually prices plunge to oversold lows and fear grows extreme. And then this cycle begins anew.

So a gold ETF opening up a new conduit for the vast pools of stock-market capital to easily flow into gold would be a great boon for everything gold-related. It would help ease new investors into this secular-bull sector.
In addition to being a gateway drug, a gold ETF provides a quick and easy way for all investors to diversify into gold. Depending on how much capital you run, buying gold coins isn't a cost-effective way to own gold. If you have a $100k portfolio, putting 5% to 10% of your capital in gold coins is relatively easy. But if you are a hedge fund or pension fund managing tens of billions, the coin market is too small, illiquid, and expensive (high premiums over spot).
GLD fills that gap, allowing vast amounts of capital to be quickly and cheaply deployed into physical gold bullion held in trust. That portfolio-diversification mission has always been the primary market for GLD. Because of the necessary management fees to operate this massive ETF, GLD's performance will always lag gold's by 0.4% per year. This is acceptable to most money managers since owning large amounts of gold themselves is prohibitively expensive.

Gold stocks have an entirely different mission and constituency than GLD. Their profits leverage advances in the gold price, leading to gains in gold stocks that multiply gold's own when this sector is back in favor with investors. Instead of lagging gold's gains like GLD has to, gold stocks can amplify them by two times or even more in the right sentiment environment. I never thought GLD and gold stocks directly competed.

Large money managers who want low-risk diversification are not interested in the big additional operational risks gold stocks bear, and investors and speculators who want big gold-sector returns aren't interested in not even matching gold's gains. GLD is great for portfolio diversification, while gold stocks are great for investing in a secular gold bull. They each attract in very different groups of traders controlling separate pools of capital.
With such great differences in their risk-and-return profiles, odds are GLD has cannibalized gold stocks considerably less than most traders assume. While I am a big fan of GLD since it facilitates more capital pouring into gold to amplify its secular bull, I've never owned it nor recommended it. But I have owned and recommended hundreds of

gold stocks over the 8 years since GLD was born. They are very different vehicles for very different traders.

While we've always owned and recommended physical gold as the foundation for every individual investor's portfolio,we don't want to merely track gold's gains, we want to far exceed them. And we have through the contrarian trading of some of the toughest calls in the industry.

And with gold stocks so deeply out of favor again, now is a great time to buy before the next major upleg explodes higher as greed returns.

The bottom line is the gold ETF is not cannibalizing the HUI to any major degree. GLD remains much smaller than the HUI components' market cap, and its holdings grow the most when gold stocks are also enjoying major uplegs. Capital flows into GLD and gold stocks simultaneously when traders are feeling bullish and greedy on gold, and dries up for both when psychology decays to worry and fear.
Both GLD holdings and gold stocks have been consolidating for a couple years now, weathering the fear end of the great sentiment pendulum's arc. But after such a long time being out of favor, greed is due up next in the emotional cycles. And as gold returns to favor itself, gold stocks will rally and new capital will drive up GLD's holdings in parallel. There will be more than enough new investment to float all gold boats higher.