Think Twice Before Opening a Gold or Silver IRA
Here's what the precious metals ads don't say

By Kevin McKean
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For anyone worried about financial security in retirement, those ads touting gold and silver IRAs on conservative-leaning cable TV channels and from digital news outlets can sound pretty persuasive.

Take the Rosland Capital commercial where actor William Devane gets caught in a downpour while golfing. “Some things you just can’t control,” says Devane, “like runaway inflation or unstable governments printing money as worthless as wet scorecards. But you can control whether or not you let the money in your retirement lose its value.”

Then there’s the one from Lear Capital — like Rosland Capital’s, running on Fox News Channel — that asks the ear-catching question: “Would you like to own an asset that has the potential for a 60 percent increase or more?” Hard to say “No” to that.

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— Christopher Jones, Financial Engines

You’ll find similar promotions on right-leaning websites, such as the ad in an email from Newsmax that says “your retirement account is in serious danger” or the one in a Breitbart.com email saying: “Warning: Economists Expect an 80% Stock Market Crash to Strike in 2017.”

What the Gold or Silver IRA Ads Say

These ads and others like them often include an appeal to put your retirement savings into a precious metals Individual Retirement Account (IRA) either to make your money safer or help it grow faster. There's generally no minimum investment and the advertiser shows you how to open the account and roll your existing IRA or 401(k) into it. The company then helps you convert that cash into precious metals by selling you gold or silver coins or bullion bars.
The advertisers’ preference for conservative media may be due to the fact that their ads tend to play on fears of financial collapse. The world is a dangerous place, they may say. Excessive national debt, inflation or even global upheaval could hammer the value of stocks, bonds and cash. So protect your money by putting it into hard assets that can survive a crisis — or, as Devane puts it, “an IRA backed by gold and silver, not by paper and promises.”

“They [the ads] are hitting every behavioral hot button to undermine people’s confidence in the asset management world,” says Christopher Jones, chief investment officer for Financial Engines, an asset allocation firm. “They’re trying to frighten people into thinking that the money they have in the bank is just a shadow that could be wiped out on a whim.”

The focus on retirement accounts makes sense because that’s where so many older Americans have their assets.

“So they are both preying on fear and going where the money is,” says Allan Roth, founder of the fee-only financial advisory firm Wealth Logic, of Colorado Springs, Colo. (We asked Rosland Capital and Lear Capital to comment for this story, but neither agreed to an interview.)

But are precious metal IRAs really a smart choice? Next Avenue talked to retirement and investment experts and found many reasons to be cautious — including high costs, relative volatility and a mixed investment record.

**IRAs With a Golden Glow?**

While most IRAs invest in conventional assets like stocks or mutual funds, the tax code also permits special “self-directed” or “alternative-asset” IRAs that can hold physical silver or gold. But not all precious metals are allowed. In fact, the law names specific gold, silver and platinum coins that qualify — like the American Gold Eagle — and defines purity standards for gold, silver, platinum or palladium bars in such accounts. Other coins and jewelry are forbidden.

The tax code also says the gold or silver must be held by an IRS-approved custodian or trustee, though some gold IRA marketers claim there’s a loophole in this law (more about this later).

But the evidence is mixed on whether owning gold can really keep your savings safe.

For starters, while gold can provide some insurance against inflation, just how much depends on your timing and patience.

“Gold does tend to hold its value in the long-term, but it is also volatile —roughly as volatile as stocks — so you may need decades to ride out its ups and downs,” says Campbell Harvey, the J. Paul Sticht Professor of Finance at Duke University’s Fuqua School of Business. “So gold would be at the bottom of the list [as an investment choice] for people who are retired or close to retirement.”
From 1981 through 2000, for example, when inflation nearly doubled, gold went more or less sideways.

Then in this century, the metal really took off. It rose by more than 500 percent from January 2000 (when it traded at around $280 per ounce) to a high of roughly $1,900 in August 2011, while inflation climbed only 34 percent. Since then, however, gold has fallen by about a third in value, to around $1,270 an ounce in mid-June, while inflation edged up 8 percent.

That big run-up during the early 2000s — which silver shared — is still helping precious metals salespeople paint dreams of lustrous gains. The Lear Capital TV ad, for example, says that, “if silver just returns to half of its all-time high, it would be a 60 percent increase.” Fair enough. But if it sagged to around twice its recent low, you would suffer a very painful 50 percent loss.

Caution: Possible Price Bumps Ahead

That’s why even investors who generally favor gold, such as Russ Koesterich, a portfolio manager for the BlackRock Global Allocation Fund, advise you to treat precious metals with the same caution you would any other physical asset, such as real estate. Over time, property tends to rise in value. But in a down market, like the 2008 recession, people can lose their shirts — and homes — to plummeting prices.

“The problem with gold,” says Koesterich, “is that there’s no logical reason why this shiny metal should be a store of value — except that everyone has sort of agreed for thousands of years that it is.” That’s why you still see investors flock to gold in a crisis, as they did one day in mid-May when the Dow Jones Industrial Average plunged 372 points in a single day, while gold prices spiked by nearly 2 percent.

Where is gold headed? Investment pros offer no consensus.

Koesterich says a modest amount of gold in a portfolio (say, 3 to 5 percent) might help provide diversification if other assets slump. But Harvey and former commodities trader Claude Erb argue that gold’s big gain during the 2000s left the metal hugely overvalued compared to historical norms. In a paper published last year, they calculated that if gold returned to its “fair value” compared to inflation over the next 10 years, it would lose about 4.4 percent a year.

“You can go out and buy a Treasury Inflation-Protected Security, or TIPS, that will give you the same return with a lot less volatility,” Erb points out. (A TIPS is a type of U.S. Treasury bond whose principal is guaranteed to increase with inflation.)

The TIPS comparison brings up one key difference between precious metals and other investments: they have no income stream, such as the interest on a bond or dividends from a stock, to cushion their price swings.

The Hidden Costs of a Gold or Silver IRA
What’s more, precious metals have significant purchase and holding costs that stocks and bonds don’t share.

For starters, there are base fees and storage costs. At Rosland Capital, you’ll pay a one-time $50 fee to open an account and around $225 a year to store and insure your holdings at a secure depository in northern Delaware.

The precious metal IRA sellers may waive these annual fees for a year or two to entice new customers. But they make that money back on an even more significant cost: the “spread,” or gap between the wholesale price the company pays to acquire the metal and the retail price it charges you as a buyer.

Lear Capital, for example, recently offered an IRA Bonus Program that picked up $500 of fees for customers who bought at least $50,000 in silver or gold. But the company’s Transaction Agreement said the spread on coins and bullion sold to IRA customers “generally” ranged between 17 and 33 percent. So if the spread were 17 percent, a customer who opened a $50,000 IRA would pay $8,500 for the spread — and receive only $41,500 in wholesale-value gold — which left plenty of margin for Lear to recoup that $500 bonus.

Then there is the potential problem of cashing out.

If you sell the gold or silver to a third-party dealer, you could lose money on another spread, because dealers typically want to pay less than what they think they can get for the metal on the open market.

To help customers avoid that threat, some IRA companies will buy back your gold at, say, the then-prevailing wholesale price. Even so, thanks to the initial spread our hypothetical investor paid to open her $50,000 IRA, she would need gold prices to rise by over 20 percent just to break even. Compare that to the cost of a conventional IRA, where opening and closing an account is often free and transactions may cost just $8 per trade.

Can You Keep Gold at Home?

Proponents of gold IRAs argue that these costs are worth the peace of mind of protection from a possible financial apocalypse. But suppose disaster really does strike. How would you redeem your gold if it’s sitting in a depository halfway across the country?

To address that concern, a few alternative IRA advisers point to a wrinkle in the tax code that they say could let you store your precious metals nearby — such as in a local bank safe deposit box or at home. Essentially, the company helps you set up what’s called a limited liability company (LLC) and place that company into a self-directed IRA. The LLC then buys the gold and chooses where to store it.

The drawback to this strategy is that it appears to run counter to the wishes of the Internal Revenue Service (IRS).
Next Avenue asked the agency about these ads and was told, “The IRS cannot comment on claims made by any particular IRA promoter, but the agency warns taxpayers to be wary of anyone claiming that gold held in your IRA can be stored at home or in a safety deposit box.”

Among other problems, the IRS says, taxpayers who do so run the risk of engaging in a prohibited transaction. Then, they could owe income tax on the entire IRA balance, plus a tax penalty if they are younger than 59½.

A Less Costly Way to Own Gold

Tax issues aside, financial experts say there is a much more cost-effective way to add gold to your retirement portfolio: invest in an Exchange-Traded Fund (ETF) that tracks the price of the metal. These funds — like SPDR Gold Shares, iShares Gold Trust, ETFS Physical Swiss Gold Shares and others — are essentially trusts that own vast quantities of gold bullion. SPDR Gold, for example, has nearly $34 billion in gold bars tucked in a giant underground vault in London where workers in titanium-toed shoes drive the stuff around on forklifts.

The advantage of gold ETFs is that you can buy and sell shares like a stock and hold them in a conventional IRA or 401(k); no special account is needed.

There’s no minimum investment except the cost of a single share, which recently ranged from around $5 to roughly $120, depending on the ETF. And because the funds purchase and store gold in bulk, their operating expenses are comparatively low. SPDR Gold’s annual costs are capped at 4/10 of a percent of holdings per year, for example, or somewhere between the cost of an index fund and an actively managed fund. “So we are able to bring the cost-efficiency of the wholesale market to individual investors,” says George Milling-Stanley, head of gold strategy at State Street Global Advisors, the marketing agent for SPDR Gold.

If you do choose to buy gold, whether through an ETF or otherwise, one caution experts offer is this: Don’t jump in hoping for a huge gain.

“The biggest investing mistake I ever made was to take my college graduation money back in 1980 and buy gold,” says Roth. He still owns those 10 Canadian Gold Maple Leaf coins. They’re worth about $12,500 today — or over $300,000 less than if he’d put the money into Vanguard’s S&P 500 index fund instead.

“But I’d also argue that it was the best investment I ever made,” Roth adds, “because it taught me I wasn’t as smart as I thought it was. I was sure gold was going to $2,000 an ounce. And that’s one of the key signs you are making an investing mistake, when you’re sure of something. The real world is more uncertain than that.”

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