Gold Exposed: Spot Gold versus Gold Futures

Investing in Gold can be a daunting task, especially for the new trader. What I’ve created is a simple guide to help anyone considering trading Gold. I was just like you when I got started, especially, when I was trading spot/physical gold. I kept asking myself, what are Gold futures? Once I figured out Gold futures, I couldn’t believe how cost effective and liquid they were. While it is just my opinion, I was quite pleased. I have now successfully managed the delivery of Gold and Silver from the vaults as part of the delivery process for futures contracts for my clients and handled hundreds of millions of dollars in trading activity. If you are currently trading spot/physical Gold, the following information will be of great value to you. I consider myself a Gold insider and believe my knowledge will help you become a more efficient and successful investor.

Potential Advantages of Trading Futures Gold Futures vs. Spot

There are many potential advantages of trading Gold futures versus spot (Cash):

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<thead>
<tr>
<th>GOLD FUTURES</th>
<th>SPOT GOLD</th>
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<tr>
<td>Gold futures are cleared via a centralized exchange with standardized contracts and complete fiduciary transparency. With centralized markets, investors have access nearly 24hrs a day.</td>
<td>Spot Gold traded by independent dealers with varying types of grades and quantities. Trading hours are limited to the hours of operation for the dealer.</td>
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<td>Centralized exchanges are regulated by the Commodity Futures Trading Commission (C.F.T.C.) and the National Futures Association (N.F.A.).</td>
<td>Spot gold is completely unregulated. Spot gold dealers set their own prices and policies. In some cases, these prices may not reflect current world gold prices.</td>
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<td>Investors are provided with daily statements, and access to live trading software with real-time quotes so monitoring of their positions and balances is transparent and accurate.</td>
<td>Gold dealers typically supply monthly statements and may lack the true transparency needed by today’s investors.</td>
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<td>All brokers are Series 3 licensed with the CFTC and members of the NFA.</td>
<td>Gold dealers are not required to be licensed in any way.</td>
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<td>Investors pay a commission to buy and sell gold futures.</td>
<td>In addition to a commission, gold dealers typically charge for storage and insurance.</td>
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<td>Investor funds are segregated from those of the broker and the exchange.</td>
<td>Purchasers of gold send funds directly to the gold dealer with no financial safeguards as to the safety of funds invested.</td>
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Spreads Explained
The spread is the difference between the bid and ask price; or what someone is willing to buy and sell the precious metal for on the spot market. The spread is perhaps a way for spot dealers to disguise commission as hidden fees, which in turn produces revenues for them. This is contrary to the transparent nature of the futures markets and unlike the futures market this fee is NOT typically disclosed.

Example
10oz of spot Gold at today’s price equals $17,500, and if you are paying a 3% spread; this spread (transaction) is costing you $525 as a hidden fee. If you ask your gold dealer to sell you 10oz of gold and the purchase price is quoted to you as $1,750/oz, the actual purchase price would be about $1,697.50/oz which is $52.50 below the price you were charged. Basically you’re losing $52.50 per oz from the start or $525 in “spread charges.” Not your ideal way to start an investment. In addition, some dealers will offer to store the gold for you and charge you fees plus insurance costs. They may also tack on additional commissions and transaction fees.

For the same transaction in the futures markets, the commission would be approximately $50-$80 and this charge is disclosed to you before your purchase.

Margins Explained
Using margin to trade can be like a down payment for a house; this is when you put 20% down, and then you finance the remaining balance. It’s a way of controlling more, using less of your own personal money. However, trading using margin can be a double edge sword. It can work against or for you depending how it’s structured. One of the most common mistakes I see made is using minimum margin to control the maximum amount of gold with the least amount of money. However, in Gold Futures, you can structure it to any ratio you like and even pay off the balance and then take delivery without the high costs associated with the spot/physical.

PLEASE SEE DANIELS TRADING’S DISCLOSURE ON LEVERAGE AND MARGIN AT THE END OF THIS PROMOTIONAL MATERIAL.

Example
Minimum margin or money needed to trade E-micro Gold (10oz) $1,148, Mini Gold (33.3oz) $5,738, Full Size (100oz) $11,475

Hint: Futures accounts require no interest payment on outstanding balances. That alone is an excellent reason to look at gold futures!

For your entire financial portfolio I suggest you should have 20% to 30% exposure.
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Three Gold Futures Contracts Sizes to Choose From

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<td>Contract Sizes (troy oz.)</td>
<td>10oz</td>
<td>33.3oz</td>
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Gold Futures Market Hours

Gold Futures open every Sunday evening at 6:00 PM EST, then closes every day at 5:15 PM EST, then re-opens at 6:00 PM. Sunday – Friday it’s closed for only 45 min. each day between 5:15 PM EST – 6:00 PM EST, almost a 24 hour trading day!

Hint: Trading Spot/Physical Gold you are typically limited to the companies’ hours you’re dealing with and typically unable to trade at night.

Gold Futures Tic Value

Depending on the movement of the market, each tic upward or downward in the market represents how much you will either make or lose. For example, in gold futures, each tic .1 will either gain or lose the amount listed below:

E-micro: $1.00  Mini Gold: $3.32  Full Size Gold: $10.00

Example

If Gold Futures is trading at $1700.0 and market moves to 1700.3 you would be up $3.00 in the E-micro, Mini Gold would be $9.96, & for Full Size Gold $30.00 (before commissions).
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Hint: You can also trade Gold Futures with your IRA retirement accounts!

Recap

So what I’ve reviewed are the very basics of Gold Futures vs. Spot Physical, and as you can see there are significant differences. Gold Futures can be intimidating just as it was for me when I started! However, if you practice, get the hang of it, and watch the markets closely, then you may find that you know more than the average person trading Gold. We have discussed the Spreads, Margins, Market Hours, Tic Values, and of course the many pitfalls people make in the spot/physical markets. I hope this helps and if you need personal advice, please feel free to contact me directly toll-free at 1-866-276-1475.
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 Authored by Drew Rathgeber, Senior Trader at Daniels Trading - Chicago

Drew began his commodity career at Monex, one of the nation’s largest physical precious metals dealers in 2003. His passion for understanding the fundamentals of today’s economy gave him the foundation to ultimately make the transition to the futures side of the business with a futures and options broker position at Trade Center, LLC in 2007. In 2011, Daniels Trading acquired Trade Center, which has provided Drew with a host of new products to serve his clients with.

THE RISK OF LOSS IN TRADING COMMODITY FUTURES AND OPTIONS CONTRACTS CAN BE SUBSTANTIAL. THERE IS A HIGH DEGREE OF LEVERAGE IN FUTURES TRADING BECAUSE OF SMALL MARGIN REQUIREMENTS. THIS LEVERAGE CAN WORK AGAINST YOU AS WELL AS FOR YOU AND CAN LEAD TO LARGE LOSSES AS WELL AS LARGE GAINS.