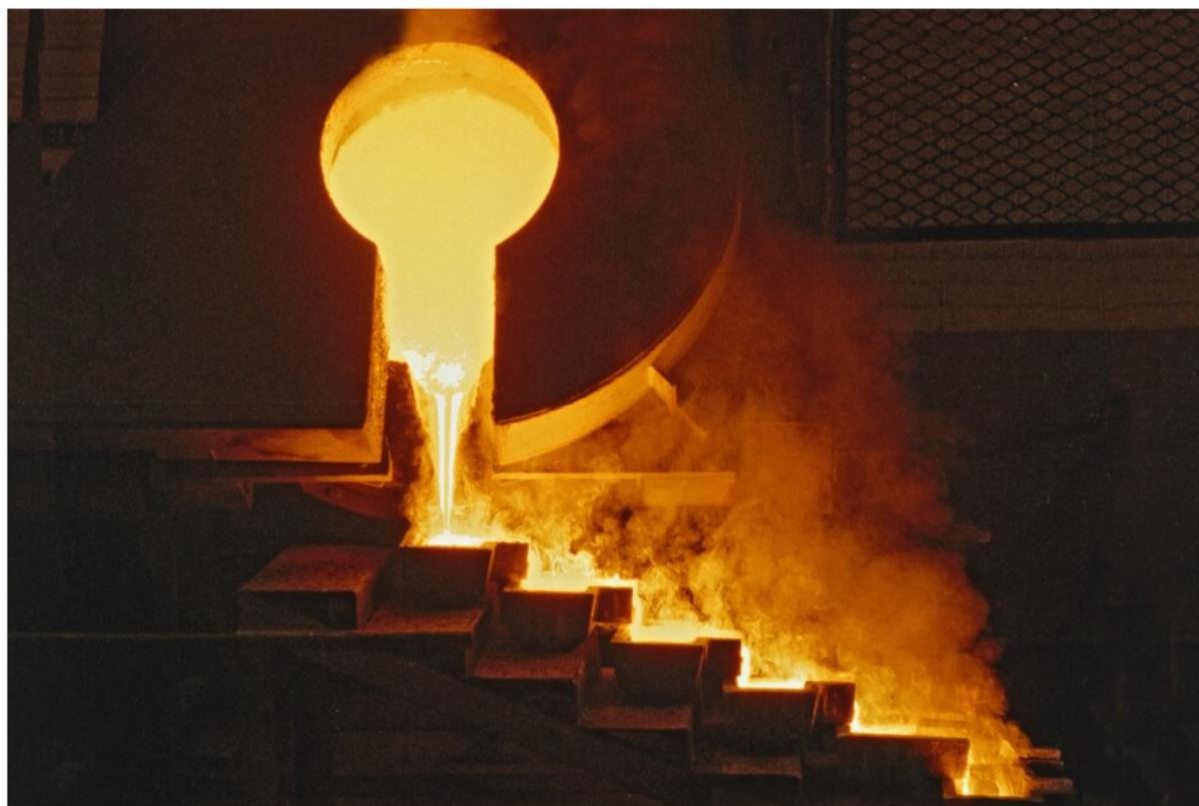


Gold Is a Safe-Haven Investment, But It's Not Foolproof. 10 Crucial Facts to Know Before You Invest

Gold can be a valuable diversifier, but don't buy it without doing your homework.

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By Matt Whittaker



Before investing in gold, keep in mind that prices can be volatile and you'll likely pay a premium for physical gold.

Gold can be considered a safe-haven investment because it often behaves differently than stocks, bonds or currencies.

When the stock market is doing poorly because of economic uncertainty or [worries about geopolitical events](#), people often buy gold because it has a reputation as a long-term store of value.

But before you dive into gold investments, you need to understand the pros and cons of the precious metal in general and the advantages and disadvantages of the different ways of investing in gold.

Also, experts say to have a clear goal in mind.

"Gold can play an important role in a portfolio, but it is not foolproof," says Michael Unger, vice president of investments and planning at Coral Gables Trust. "New investors should think carefully about why they want to own gold. Is it for inflation protection, [diversification](#), safety or simply speculation?"

Brett Elliott, director of marketing at American Precious Metals Exchange, says investors often choose physical bullion for a buy-and-hold strategy because they don't have to pay an expense ratio or storage fees if they're storing it at home.

Those looking to make a quick profit with gold often turn to products with low spreads and high liquidity, such as digital gold products that let them buy and sell gold bullion stored in vaults, Elliott says.

"Before your first gold buy, decide what kind of exposure you actually want, whether that's physical metal, mining stocks, [exchange-traded funds](#) or futures, because the risks, costs and taxes are all very different," says Rich Jacoby, CEO at GoldenCrest Metals.

If you don't have any gold but are thinking of taking the plunge, here are 10 key points for you to consider:

- [Gold can move differently than you'd expect.](#)
- [Gold prices are volatile.](#)
- [Gold stocks aren't the same as physical gold.](#)
- [Gold futures are especially risky.](#)
- [Physical gold is more than just bars.](#)
- [You will pay a premium when you buy physical gold.](#)
- [You need a safe place to store physical gold.](#)
- [Physical gold is taxed at the collectibles rate.](#)
- [Gold can be allocated or unallocated.](#)
- [There's an "opportunity cost" with holding gold.](#)

Gold Can Move Differently Than You'd Expect

While gold is considered a safe-haven investment, it can decline in value during the beginning of an equities sell-off if people need to sell the precious metal to make money to meet margin calls in declining equities positions.

Gold also has roles that are different than as a safe haven. For example, it can falter when the dollar rises or when people buy bonds, which can happen at the same time as a risk event that might otherwise boost gold.

And with all the factors that affect currencies and bonds, those markets might move in certain ways while gold prices remain generally unaffected.

Gold Prices Are Volatile

[Commodities](#) in general are notoriously volatile. Oil or copper prices, for instance, are especially prone to ups and downs because their end uses are tightly tied to the ebbs and flows of the global economy.

While gold generally follows different leads, lending to its reputation as a portfolio diversifier, it is still subject to volatility.

"Gold has experienced a notable rally, but investors should be mindful of its inherent volatility," Unger says. "While it can serve as a hedge during periods of uncertainty, it does not consistently [outperform](#) other asset classes. Think of it as portfolio insurance, sufficient to provide a safeguard, yet balanced enough to preserve your overall strategy."

Unger advocates moderation, saying that allocating 1% to 5% of a diversified portfolio to gold can offer stability without introducing undue risk.

Gold Stocks Aren't the Same as Physical Gold

One of the main ways people invest in gold is through stocks of companies that mine it, such as the world's largest producer, Newmont Corp. (ticker: [NEM](#)), or No. 2 gold miner Barrick Mining Corp. ([B](#)).

While [mining company](#) share prices are certainly influenced by the ups and downs of gold prices, they are also subject to other factors, such as bad management decisions or social unrest in the many countries where they operate.

In contrast to many small mining companies that are exploring for gold and are very risky, larger gold miners can offer lower-risk investments.

"Gold mining companies with competent management teams that are actually mining gold, not exploring for gold or developing a mine, are almost uniformly profitable," says Thomas Winmill, portfolio manager at Midas Funds. "Most mines today were brought online with profitability assumptions made years ago using much lower gold prices."

A way to diversify risk is through holding mutual funds or exchange-traded funds, or ETFs, that allow investors to hold multiple mining companies under a single ticker symbol. These funds provide instant corporate diversification and save investors money over buying all the stocks individually.

[Gold-backed ETFs](#), such as SPDR Gold Shares ([GLD](#)), offer a hybrid between investing in a stock and investing in physical gold. These funds are traded on an exchange like any other ETF, but instead of owning stocks, they are backed by bullion held in vaults. Because of that, they track the spot price of gold more closely than stocks.

Gold Futures Are Especially Risky

Investors can also consider gold [futures](#) and options, but they aren't investments that you can simply set and forget. They require constant maintenance and an understanding of margin and rolling over contracts. Plus, you'll have to get special permission from your broker to trade them.

"Futures represent the highest risk of all," says Eric Roach, partner and co-founder of Summit Metals. "Because you do not actually own the underlying asset and often deploy massive amounts of leverage, the risks skyrocket. Be warned."

Physical Gold Is More Than Just Bars

Investors who want to buy physical gold can turn to online bullion dealers, pawn shops, some banks and individuals.

Physical gold is often called bullion, a term that encompasses bars, coins and rounds, but not jewelry. Rounds are coin-like pieces of metal made by private mints that don't have value as currency.

Gold coins from government mints generally do have a face value. You could in theory use an American Gold Eagle to buy something up to the coin's \$50 face value. But that would be foolish, as the ounce of gold the coin contains is now worth over \$3,400.

Coins also have a collectible value based on their rarity, which can help insulate their value from downturns in the spot price of gold but can also mean you pay a tidy premium over the spot price of the metal.

You Will Pay a Premium When You Buy Physical Gold

Gold coins generally carry more of a premium than gold bars, which don't have the same collectible value, but bars can still cost well over the spot price. You can buy bars in many different sizes, but in general, the bigger they are, the lower the markup.

The largest commercially produced gold bars, at 400 ounces apiece, are the cheapest because you're buying the gold in bulk. But the more you veer from common-sized bars and widely available coins, the more liquidity risk increases. In other words, it might be harder to sell if you need the money quickly.

You Need a Safe Place to Store Physical Gold

If you don't want to store gold at home, you'll have to pay a third party like a bank or specialty facility. If you do want to keep it at your house, you'll likely want a good safe, and you may want to insure it.

"Appropriate storage is an important consideration for physical gold and is often overlooked," says Paul Williams, managing director at Solomon Global. "Verifying the authenticity of the items is also vital."

One way to help make sure gold products are authentic is to use established and reputable dealers who will have authenticated the items before selling, Williams says. Another level of trust can come from buying products made by national mints such as The Royal Mint and the United States Mint or gold bars from globally recognized refiners such as PAMP or Metalor, he says.

If you want to have a [gold individual retirement account, or IRA](#), the Internal Revenue Service requires you to keep your gold with a government-approved depository. Technically, you could apply to be a non-bank trustee or custodian to keep the gold at your house, but the massive hassle likely wouldn't be worth it.

Physical Gold Is Taxed at the Collectibles Rate

Speaking of tax rules, the IRS considers physical gold to be a collectible. Under those rules, profit on collectibles held for less than a year get taxed as regular income. But if you hold the gold for more than one year, you can face tax up to 28%, which is more than the maximum long-term capital gains tax of 20%.

The same rules apply to gold-backed ETFs that are structured as trusts, such as GLD, as the IRS also considers those investments to be collectibles.

Gold Can Be Allocated or Unallocated

Investors can hold gold in allocated or unallocated accounts at [banks](#) and other depositories.

Allocated gold is the property of the owner. It's just stored by the depository. You put in a gold bar, and you get the exact same gold bar out. It's like a sophisticated safe-deposit box.

On the other hand, there are unallocated gold accounts. In these accounts, investors don't actually own any gold. Buying a certain amount in this type of account is a deposit that the financial institution can then loan out, similar to regular cash deposits. Unallocated accounts are cheaper, but they're not insured by the Federal Deposit Insurance Corp.

There's another reason to do your homework and choose a reputable business if you're going to go the unallocated route with gold certificates: Gold certificates are vulnerable to [scams](#). Watch out for relatively new sellers offering gold certificates during times of

financial uncertainty. With paper gold, there's a chance that an unscrupulous company could sell the same gold multiple times.

There's an 'Opportunity Cost' With Holding Gold

You can think of [opportunity cost](#) as what you have to forgo with one thing to own another. If you only have a certain amount of money to invest, you have to choose between putting that into gold or equities or something else.

Each has costs and benefits, but physical gold and gold futures don't pay interest or dividends.

"Investors must weigh the current enthusiasm for gold against its long-run limitations," says Christopher Gannatti, global head of research at WisdomTree. "Gold may shine in certain environments: monetary debasement, geopolitical upheaval, [inflation spikes](#)."

"However, the key question for the strategic, long-term investor is what gets displaced," Gannatti continues. "Historically, taking dollars away from equities, arguably the highest real-returning asset class ever recorded, has been costly when measured over decades."

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