Customer Advisory: Understand Risks and Markets before Reacting to Internet Hype

The Commodity Futures Trading Commission advises the public to thoroughly research and fully understand how commodity futures markets, physical markets, and securities markets differ—as well as the risks associated with speculative trading—before acting on tips or other information communicated via social media.

Recently, posts on online message boards and social media platforms have been cited as contributing to increased volatility in markets for certain commodities. Large numbers of individual speculators—traders who try to profit from short-term trades—rushed into commodity-backed exchange traded products, physical commodities such as gold and silver, commodity futures, and options contributing to brief but dramatic price swings.

Unfortunately, those who came late, held on too long, or didn't fully understand what they were doing, may have lost big. For every post about "taking it to the moon," there are many more posts about individuals losing some or all of their money.

Speculative short-term trading is always risky, but mixing it with unfamiliar products and markets, leverage, and advice from anonymous individuals is a recipe for disaster.

What to Consider

Before jumping into any trade that involves commodity futures or physical commodities like precious metals, here are some things to consider:

1. Only trade with "risk capital." This is money you can afford to lose, not the cash used for basic necessities, savings to cover emergencies, or long-term needs like retirement. Also, research has shown that after commissions the majority of individual speculators lose money.[1]

2. Experience in one market may not transfer to success in others. Markets are not all the same. Learning the differences between securities markets, futures markets, options markets, and physical markets can help you avoid costly mistakes. For example, you cannot "buy the dip" in futures markets when a spot price of a commodity looks like a bargain. Futures contracts convey the right to buy or sell an asset at some point in the future. They do not convey ownership in the asset itself. Contracts are also time-limited and cannot be held indefinitely waiting for prices to rebound.

3. Commodity-backed exchange traded products (ETPs) are sold on stock exchanges but can own physical commodities such as gold or silver, be wholly backed by derivatives, or hold a combination of assets. The ETPs' underlying holdings and trading strategies will determine how they respond to changes in the markets and the economy. It is important to know exactly what is in a commodity ETP, and how its trading strategy can be affected by market forces. Always ensure that you receive or have direct access to timely prospectuses and other disclosure documents, and read them carefully. Take your time, do your research, and ask questions.

4. It's better to develop your own trading plan targeted to your particular situation and risk tolerance than to follow others. As the saying goes, plan the trade and trade the plan. Having a plan will

[1] Canoles, W. Bruce, Sarahelen Thompson, Scott Irwin, and Virginia Grace France. "An Analysis of the Profiles and Motivations of Habitual Commodity Speculators." *Journal of Futures Markets* 18, no. 7 (1998): 765-801.

help take some of the emotion out of trading and help avoid common biases, like selling winners too soon or holding losers too long.

5. Consider the information's source. Professional advisors and brokers are regulated and have limits on what they can recommend online. The individuals behind online tips and information may not have significant relevant knowledge or experience or they may be newcomers themselves. Some may already be holding the asset they are trying to pump or have ulterior motives. Similarly, don't pay for signals or online programs that promise winning trades. There are no silver bullets and programs based on past performance cannot guarantee future results.

6. Although investing in physical precious metals is commonly considered to be a safe way to ride out volatile markets or economic uncertainty, it is not risk-free. Spot prices—the cash price for immediate delivery—can be volatile, and the transaction costs for bullion can be high. Dealers set their own spreads. The spread is the difference between the price dealers will sell you a specific coin or ingot and the price they would buy it back from you. These spreads can often be 10 percent or more, which means the value of your investment must climb more than 10 percent for you to break even, let alone cover taxes, storage costs, and possibly insurance. Always compare dealers' prices including spreads on specific coins or ingots, as well as fees and other charges.

7. If you would like to learn to trade, there are many free or low-cost resources available online. But be careful, as there are also a lot of fraudsters using get-rich-quick promises to sell classes, seminars, books, and programs. Start with your broker to see if it offers a market simulator that uses live market data. Use it to develop trading strategies and practice before risking real money. The exchanges and some industry groups also offer educational information (see box below). To learn more about how to protect yourself in markets regulated by the CFTC, visit **cftc.gov/LearnAndProtect.**

Sources to Help You Learn More about Futures and Options Trading

Before you pay for classes or training software, you may find that it is useful to tap into free resources to learn how markets and trading really work. The more you learn from a variety of sources, the better situated you will be to identify misinformation and avoid scams.

Although not exhaustive, the list below offers some potential resources to help you get started.

- CME Institute (**cmegroup.com/education.html**) includes free online courses and tools for practicing trades.
- Futures Fundamentals (**futuresfundamentals.org**) includes articles and videos on how futures markets work and how to trade.
- Intercontinental Exchange (**theice.com/support/education**) offers in-person and online courses covering a range of derivatives market topics.
- The Institute for Financial Markets (**theifm.org**) offers a collection of resources, including a printed guide to derivatives markets, available for purchase.
- Options Industry Council (**optionseducation.org**) hosts free webinars and courses geared to different knowledge levels, along with educational videos, podcasts, and articles.
- Your local library may offer free educational sessions on trading and investing, as well as books on trading strategies.