Several years ago, I spoke with a woman at a dinner party who asked me what I thought about pork bellies. I responded that I had no strong opinion about pork bellies. She then asked me what I thought about the Deutschmarks. Again, I had little to offer. Finally, she asked me what I thought about cocoa. And with conviction I told her, I do enjoy cocoa. Slightly annoyed, the woman stated that our host had apparently misinformed her that I was a finance professor. I explained that while I was indeed a finance professor, I didn't actively follow commodity markets. And I asked her about her own interest in commodities. She told me that she had recently taken a weekend course in how to trade commodities and was now doing so on a daily basis. I pointed out that commodity trading is risky. And she replied that the course had taught her strategies for trading for a profit and that so far she'd only put $5,000 into her commodities trading account.

If things went well she was considering investing all of her savings and possibly quitting her job. The woman was a doctor. She really was. I told her that I hoped that she lost some of her $5000 quickly. Of course, she wasn't very happy with this remark. And so I explained that the vast majority of individual investors who trade commodities end up losing money. And my guess was that the two likeliest outcomes for her were either to lose a little money quickly and quit or get lucky at the beginning, risk more of her savings, and then lose a lot of money. Hence I hoped that she lost early rather than later.

I don't believe that options, futures, commodities, which are often traded as futures, or gold are appropriate investments for most people's retirement accounts. And I don't plan to spend much time talking about these investments in this course. Briefly, options are contracts between two parties, in which one party sells the other party the right to buy or sell something, such as 100 shares of a particular stock, at a pre-determined price, by a specified date. The buyer of the option is under no obligation to exercise this option. Some options are simple some complicated. Futures contracts are agreements in which one party promises to buy, and the other private party promises to sell, a specified security, such as a stock, or a commodity, such as oil, on a future date, in a specified location, and for a price agreed on now. The contracts are bought and sold on commodities exchanges. The buyer and the seller deal with exchange, not with each other.

Commodities include agricultural products, such as corn, soybeans, sugar, and coffee. And natural resources, such as oil, natural gas, copper, aluminum, silver, and gold. Commodities are usually, though not always, traded as futures contracts. For example, you could buy or sell a futures contract for 5,000 bushels. That's about 136 metric tons of number two, soft, red, winter wheat, for delivery in Chicago, next December. Most future contracts are closed by purchasing an offsetting contract. While the contract is open, the buyer and seller receive money from, or pay money to, the commodities exchange, reflecting their daily losses and gains as the future price changes.

Options and futures are what economists call zero-sum games. For every winner, there is a loser. If the buyer of an option gains $1, the seller loses $1, and vice versa. Actually the gains don't quite add up to
the losses because there are some transactions costs involved, but these tend to be low. Zero-sum investments can actually make both parties better off by reducing unwanted uncertainty. For example, suppose it's spring and a farmer doesn't know what price he's going to get for his wheat in the fall. And meanwhile the owner of a flour mill is worried that the price of wheat in the fall will be higher than expected. The farmer could sell a wheat futures contract and the mill owner could buy a wheat futures contract for a price agreed upon today. Thus both the farmer and the mill owner could reduce their risk of a bad outcome. Of course, the farmer would no longer profit from high prices next fall and the mill owner would no longer benefit from low prices. Chances are though, you don't have a wheat crop or an oil field that you need to hedge in the futures market.

Most individual investors who trade commodities are simply speculating. And they are speculating in markets in which there are as many dollars lost as won and most of the other traders are professionals. You know, it's just wildly overconfident to assume that as a part time do it yourself investor you will on average beat highly trained professionals who have more experience and far more resources. Do you have a plane to fly over Iowa and take pictures of the pending corn crop? I know a commodities trader who does. Commodity sales, especially sales of gold, are often accompanied by stories, such as that the Federal Reserve is running out of gold. Or that inflation is just around the corner. But in the long run, stories don't win. Expertise and research does. People who spend their days analyzing commodity supply and demand consistently make money. While individuals who speculate in commodities lose. And it's naive to assume that skilled professional traders won't charge you the full value of their skill, and probably then some, to invest your money in commodities through a commodities fund or fund of funds.

So what about gold? Gold doesn't belong in the portfolio of the average US investor. Gold doesn't produce anything. You know, it's not a company providing services or goods. It isn't farmland providing food. And with the possible exception, of this, gold isn't a building providing shelter. Gold's price gyrates highly with shifts in investor sentiment. Like art, gold can be beautiful. So buy it for its beauty. My wife gave me this gold wedding ring and this gold earring. I like them both a lot. But I'm not counting on them to support me in retirement.

Don't buy gold as an investment. You know, this advice wouldn't necessarily apply to someone living in a politically or economically unstable country, who faced a real risk of currency collapse, and was unable to obtain or safeguard foreign securities or currency. While such a person would face the same sentiment risk as others when buying gold, this risk could be less than the risk of currency collapse. But the US dollar isn't about to collapse. Of course, somewhere down the line, the dollar could be weakened by inflation. But you can buy investments that offer better protection against inflation than gold. For example, treasury inflation protected securities, often referred to as TIPS.

Please understand, I'm not claiming that gold is not going to go up some day. It will probably go up. It will probably go down. When and by how much? I have no idea. I don't have a crystal ball. What I'm saying is that gold and other commodities, as well as futures and options, are not appropriate investments for most people's retirement accounts. Around the time I met the doctor who wanted to be a do it yourself commodities trader I saw this ad. The ad reads, prefers to do it alone. Independent, confident, you're ready to trade futures on the internet. You don't need a broker's help. You want it all. Speed, convenience, control. Well perhaps this confident young woman could become a professional commodity futures trader. The most successful commodities trader I know is a woman named Renee
Haugerud, who began her career trading agricultural commodities, back in my home state of Minnesota. But learning to trade commodities futures professionally takes a lot of time and hard work. If the young woman in this ad plans to trade futures in her spare time, she better have a lot of spare cash.