

July 2, 2014 - Like Gold? Then Buy Silver

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Jim Cook, president of Investment Rarities, Inc., asked me to write about silver versus gold as he felt many new readers of his own newsletter would benefit. I submitted the following to him which I thought might also be of interest to subscribers. Afterwards, I'll cover some new developments.

Over the past decade or so, I've noticed a developing trend in the world of precious metals. Admittedly, while it is impossible for me to document this on a scientific basis, ten or fifteen years ago, most commentators when speaking about gold, specifically meant gold and nothing else. Nowadays, when precious metals commentators speak about gold, more and more they also include silver as part of the discussion. There's a good reason for that □ on just about every level of comparison, silver is superior to gold as a long term investment. Further, I believe the trend of recognizing the investment merits of silver is just beginning.

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As is fitting for two metals that span 5000 years of civilization, there are many remarkable similarities between gold and silver. Both are precious metals that are relatively rare. Each is considered universal in that they are recognized by virtually everyone on earth above the age of reason. For thousands of years each has been highly valued and served as money and in jewelry and artifacts. To this day, many hold gold and silver as insurance against currency and financial distress since each can be held as an asset without counterparty risk; neither is anyone else's liability. That's not something that can be said about most assets. One would be hard pressed to find two more similar elements that spanned the course of human history than gold and silver.

But it is the differences between gold and silver that make the compelling case for favoring silver over gold as an investment. Aside from color, the biggest visible difference is the price of each □ the price of gold is more than 60 times the price of silver. For centuries, gold has always been more expensive than silver, ranging from being 16 times more expensive when world governments set the price of each for monetary purposes, to the last hundred years when markets set the price at anywhere from gold being 12 times more expensive than silver to 100 times more expensive.

One fascinating aspect to relative price relationships is that the longer a certain

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relationship exists, the more self-fulfilling and entrenched it becomes. Stated differently and particularly as concerns comparable investment assets, the longer a price relationship persists, the more accepted as normal it becomes. Because the price of gold has always been many times the price of silver, the world's investors have necessarily come to conclude and hold certain beliefs. Through a sort of collective common sense and after hundreds and thousands of years, one firm world belief would be that there is much more silver in the world and currently being produced than there is gold. Collective logic, forged over millennia, would conclude, moreover, that there was likely 60 times or more silver in the world than gold given the current silver/gold price ratio.

I would suggest that the world collective opinion about there being more silver than gold is absolutely wrong. This was true at one time, but not any longer. I would further suggest that as the erroneous collective world opinion about the actual rarity and scarcity of silver becomes known there will be a massive upward adjustment in the price of silver.

In no way am I intending to be disrespectful of the collective opinion of the world's citizens, but everyone looks at the price first and then forms an opinion on value afterwards. The seven billion people on earth spend their days involved in uncountable various activities and not in analyzing the silver market

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or its price relationship to gold. If they had the time and assuming they had any interest, they might look at the price occasionally and not much more. Look at it from a different angle □ how many professional silver analysts (doing it for a living) are there in the world □ a couple of hundred tops? When you think of it, analyzing silver must be one of the least populated occupations in the world.

My point is that because so few are analyzing silver closely that increases the possibility that the world collective opinion about it is wrong. How can you see something if you don't look? I contend there are some easy to demonstrate facts that prove silver is massively undervalued compared to gold because it is so much rarer than the world perceives.

This is largely a story set on a rich historical tapestry. For many centuries, up until a hundred years ago, both gold and silver served the same purposes, namely, they were taken out of the ground and used as money and coinage, jewelry, art objects and utensils. Because silver had been mined at a rate 6 to 10 times greater than gold's production, the world accumulated much more silver than gold. As of 1940, there were at least 10 billion ounces of silver in the world compared to 2 billion ounces of gold.

At this point, world collective opinion was correct in valuing gold at 60 times the price of silver because gold was rarer than silver. But something developed over the past 100 years that would turn the relative rarity between gold and silver on its head. That "something" was the discovery that silver was an incredibly useful material in ways never before imagined. Starting around the turn of the 1900's, because silver possessed so many unique and superior physical and chemical properties compared to other materials, it began to be consumed in ways never contemplated before the 1900's.

Because silver is the best conductor of electricity, the best transfer agent for heat, the most reflective of light, the best general biocide and with chemical properties that enabled photography among many other modern applications, it came to be consumed in prodigious quantities. Silver industrial consumption was so great that production could not keep pace with soaring demand. This over-consumption made it necessary that the many billions of silver ounces in world inventories be added to current mine and recycling supply to balance the voracious industrial consumption. From 1940 thru 2006, close to 9 billion ounces of silver were taken from existing inventories to supplement mine production, depleting those inventories to one billion ounces, a reduction of 90%.

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Since 1940, world gold inventories (in all forms) have grown from 2 billion ounces to 5.5 billion ounces, just as world inventories of silver bullion (in 1000 oz bar form) have fallen to a little over one billion oz. Gold has many special properties, but mainly because of its price, it is not consumed industrially anywhere near the level of silver industrial consumption. This enabled gold inventories to grow, where silver inventories shrunk. So, over the course of little more than half a century, silver went from being 5 times more plentiful in terms of world inventories, to gold being 5 times more plentiful than silver. Gold went from being rarer than silver back then to silver being more rare than gold today. The punchline is that the relative price of each has remained unchanged at 60 to 1.

For a variety of reasons, world collective opinion has failed to recognize the dramatic turnabout in relative gold/silver world inventories. If I had to pick one prime reason, it would be that silver is much more manipulated in price than gold; but the reason is not as important as the historical facts, which I urge you investigate on your own. The important point is that if I have portrayed the historical facts correctly, as I believe I have done, it is the price of silver relative to gold that is wrong. The inventory situation is what it is and can't change quickly; the price can. This sets up an investment opportunity of unusual proportions □ seeing something before the collective world opinion catches on.

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Some may say, "OK, the historical record would show that there has been a remarkable turnabout in relative gold and silver world inventories with no adjustment in relative price; but what about current mine production? Doesn't the world still mine 8 times more silver than gold?" Yes, it is true that annual gold mine production is around 100 million oz, while annual silver mine production is around 800 million oz. But it could be a big mistake to stop there and not dig just a little deeper, because this is not an apples versus apples comparison.

I would contend that one needs to look a bit deeper and to compare current mine production of gold and silver, not on a total ounce basis, but on an ounces available for investment basis. Just as silver's remarkable transformation into being a vital raw material that has been industrially consumed for the past 100 years caused the turnabout in relative gold and silver world inventories; silver's industrial consumption has radically altered mine production comparisons with gold. Simply put, so much new silver mine production is already earmarked and spoken for by industrial consumption and other fabrication needs, that only a small percentage (10%) of current silver mine production is available for investment.

This contrasts sharply with the situation in gold, where because there is so little

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industrial consumption, just about all new gold production is available for jewelry and investment demand. When adding recycling supply to current annual mine production in gold and silver and then subtracting industrial and other fabrication demand, by my calculations there are about the same 100 million ounces available for investment in both gold and silver. The lynchpin of my argument is that the silver being used industrially and in other fabrication demands must be subtracted from total current production in order to make a valid comparison with gold.

That few even mention that one must subtract silver industrial and total fabrication consumption from total production before comparing it to gold production seems to me to be another collective world oversight. This is rooted in the fact that silver doesn't have as much of an institutional sponsorship as gold has. Imagine, if you can, that 90% of total gold production was consumed industrially and in other fabrication demand, leaving only 10% of production left over and available for pure investment. The World Gold Council, along with every other organization promoting gold, would be broadcasting this circumstance from the rooftops non-stop. Yet there is no organization pointing out that only 10% of total silver production is available for investment.

While the same 100 million ounces of metal is, effectively, available for

investment in both gold and silver annually, because of the great price difference, that translates into a markedly different comparison on a dollar basis. 100 million oz of gold equals \$130 billion, while 100 million oz of silver equals \$2 billion. These are the dollar amounts required to be expended by the world's investors in order to absorb the new gold and silver produced annually. Not only is it, obviously, easier for the world to come up with \$2 billion than \$130 billion, it is also easier for the world to come up with more than the \$2 billion required in silver to strongly propel silver prices higher. That's the key to precious metals prices □ investment demand. That silver requires such a small amount of investment dollars to ignite prices to the upside compared to gold is the key difference between the two metals.

Putting a dollar value to gold and silver world inventories paints an even more dramatic picture. Gold's 5.5 billion ounces of total above ground supply gives it a total dollar value of over \$7 trillion. Silver's 1.3 billion oz of world bullion inventory comes to around \$25 billion. Yes, I am deliberately comparing total gold above ground with only silver bullion (in 1000 oz bars) because this will be the form of silver demanded by industrial consumers and large investors when the truth about silver reaches a sufficient number of investors. Even if you add in silver in coinage and other hard to retrieve forms, only a billion more silver ounces or so would be added to the equation. What's the difference between comparing \$7 trillion to either \$25 or \$50 billion?

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At the core of my analysis is that because silver morphed into an industrial consumption mode over the past hundred years, in addition to decimating world inventories and taking up such a large percentage of current production, it also sets the stage for a physical supply shortage. Because of silver's dual role of industrial material and investment asset, it seems certain to me that at some point silver users and investors will clash and rush to buy when supply gets tight enough. There has never been a commodity shortage that hasn't sent prices soaring. Gold, not having a strong industrial demand component, seems unlikely to experience the shortage looming in silver. Gold can go higher for any number of reasons, but not due to strong industrial demand.

Aside from world inventories and true net production amounts available for investment, there are other differences between gold and silver. For instance, the world's central banks own one billion ounces of gold, worth \$1.3 trillion versus zero holdings of silver. Sure, these central banks may buy more gold, but they are also in a position to sell as well. In silver, while they may buy, they sure as shooting won't and can't sell. Stated differently, in a runaway gold market, the central banks would be in position to cool things off if they decided to release gold. In silver, since there is no silver held by the world's governments, there is no silver water in the fire trucks to cool off a runaway market.

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The biggest difference of all between gold and silver is that gold is much more widely followed and analyzed than silver. This makes sense from how much of each exists and is produced in terms of dollar amounts available for investment. It seems logical to me that if either one were to be misjudged or overlooked, it would be the one least considered - silver. Therefore, silver seems poised to vastly outperform gold on a long term basis. I challenge you to investigate the facts and decide for yourself.

The standout feature since the weekly review on Saturday continues to be the pattern of deposits and withdrawals in the two big precious metals ETFs, GLD in gold and SLV in silver. Over the past couple of days, gold has been deposited into GLD, as should be the case given the rally in gold prices; while the opposite has occurred in SLV, where another notable withdrawal (2 million oz) was reported Monday. Such a disparity cries out for an explanation, particularly since GLD and SLV hold the largest publicly-owned stockpiles of gold and silver in the world.

You'll remember, of course, that 2013 was the most significant year for deposits/withdrawals in GLD and SLV. As gold prices fell more than \$400 from

the start of 2013, around 40% of the total metal holdings in GLD came to be liquidated and withdrawn, as GLD investors did what investors typically do in a dramatic decline following a decade of advances (sell).

While I'm convinced that the historic gold price decline of 2013 was primarily the result of a downward price manipulation on the COMEX and in which JPMorgan played the pivotal role, that doesn't change the story as far as investors selling GLD and metal departing the trust. By year end, GLD holdings had stabilized and have now risen a bit on the recent price rally. Price manipulation aside, the withdrawal/deposit pattern in GLD seemed to follow the logical script □ withdrawals on price declines and deposits on price increases.

However, in SLV, the logical script wasn't followed in 2013 and is not being followed very recently. Despite an even larger price decline in silver than experienced in gold, no net withdrawal occurred in SLV in 2013. I feel there probably was liquidation in SLV, but that selling was absorbed by new buying as metal changed hands and a good chunk ended up being owned by JPMorgan. Further, JPM was able to evade SEC reporting requirements which would have revealed its ownership by methodically converting shares into metal (where ownership reporting doesn't exist).

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As was the case in 2013, the metal holdings in SLV seem to be out of step with recent price action; only this time, instead of metal coming into the trust as a result of what should be the same net buying as has occurred in GLD, there have been notable withdrawals, more than 10 million oz. over the past month. As a result, it is reasonable to conclude that the short position in SLV may have increased in the next report due July 10 (if the DTCC reports accurately).

Regardless of what the next short report indicates for SLV, the withdrawals of metal where there "should" have been deposits may be very significant if they represent the tightness in silver that I have advanced recently. Along with the continued turnover of COMEX silver warehouse inventories, if the withdrawals in SLV are linked to overall physical silver tightness, these are signs that should not be ignored. While I continue to contemplate why the raptors sold so aggressively and let the technical funds off so easy, I have always considered the inevitable silver shortage as the ultimate key price factor.

This morning I heard the sad news about Jamie Dimon, CEO of JPMorgan, having to undergo treatment for a serious medical problem. As you may know, I have sent Mr. Dimon every single article I have published over the past five years,

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more than 500 in all, since almost all of them mention JPMorgan. Not to do so wouldn't seem right to me. I've never sent an email to Mr. Dimon returned as undeliverable, although every member of the board of directors along with JPM's general counsel quickly blocked my emails to them. I don't know if he or anyone at the bank reads my articles, but I would like to extend my sincere wishes for a full recovery. The business of silver and manipulated markets and the living of life can be completely different at times and there's no room in my life for personal ill will towards anyone.

As a housekeeping note, I do plan on publishing a weekly review on Saturday, even though the COT (and Bank Participation) Report will be delayed until Monday afternoon, due to the Independence Day Holiday. I also plan on some COT comments late Monday. I've received a number of comments about email alerts not being sent when new articles are published. This has been a recurring problem and I've asked our tech people to look into. I do try to adhere to a twice weekly schedule on Wednesdays and Saturdays, so if it's past 3:30 PM NY Time on those days you might want to log on even if you haven't gotten an email alert. (Monday's article will be later than 3:30, since that's the time the report is published.)

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Silver - \$21.25

Gold - \$1330