

June 3, 2010 – Known Facts and Simple Math

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In this article I'm not going to try to convince you of the investment merits of precious metals. I assume you already own gold or silver, or are strongly considering such an investment, either for the first time or to add to existing holdings. Certainly, there is no shortage of analysis extolling the advantages of gold and silver investments. Instead I will attempt to convince you to buy silver instead of gold.

This may suggest to some that I am knocking gold. Nothing could be further from the truth. Gold is one of the few assets that can be expected to preserve purchasing power in the future. It would not surprise me in the least were gold to increase in price. It's an asset that is no one else's liability. In a world where everyone else's liabilities are coming into question, gold would seem to offer refuge. Current investment flows confirm that gold is being sought by many. It's hard to argue with the growing number of leading analysts and successful investors who have embraced gold. The case for investing in gold is compelling.

However, I am suggesting that silver will outperform gold. Some easy to comprehend numbers suggest silver will be a better investment. My objective is for you and for me to make the most on our investment capital with the least risk. We want to make the most and conversely, lose the least. The risk/reward metric will be especially relevant when comparing silver and gold performance in the future. As an example, I expect that if gold were to increase to \$1500, that silver would double to \$36 an ounce. If I'm correct, an investment of \$10,000 in either would grow to \$12,500 in gold and \$20,000 for silver.

If instead, the price of each fell from current levels, I would expect silver to fall less than gold. I expect an investor will make more in silver than in gold from here on out. What is the simple math that I base this on? It has to do with comparing silver and gold in physical ounces and dollar amounts.

According to the World Gold Council there are thought to be five billion ounces of gold in existence, of which 40%, or two billion ounces, are in bars and bullion coins. This two billion ounce estimate, if anything may be low and the amount of gold bullion may be closer to three billion ounces. However, using the two billion ounce amount means that total dollar value of all the gold bullion in the world equals \$2.4 trillion.

There is no good estimate for how much total silver exists in the world in all forms. That's because so much of the world's silver previously existed in the form of silverware, government stockpiles and coinage. Starting 65 years ago, billions of ounces of this ~~silver was used up by industrial and photographic applications so today there are no~~

good estimates of how much silver remains. This remaining silver is not considered bullion and is extremely dispersed. If higher prices do motivate owners to sell and have their silver melted into bullion, such a mass liquidation will be observable, as occurred in 1980. In the meantime, the amount of actual silver bullion remaining in the world is thought to be no more than one billion ounces, according to most reliable sources. At the current price of \$18, the total dollar value of all the silver bullion in the world equals \$18 billion.

You have two numbers, \$2.4 trillion (\$2,400 billion) for gold and \$18 billion for silver. By division, you can calculate that the dollar value of gold bullion in the world is 133 times larger than the value of silver bullion. Stated differently, the value of the world's silver bullion is only .75% (3/4 of one percent) of the value of the world's gold bullion. If the amount of gold bullion available for investment is 133 times larger than all the silver bullion available for investment, one would think there would be an investment flow into gold approaching 133 times the flow into silver.

What are the actual relative investment flows going into gold and silver? The actual number is around six times. Let me state this clearly. Even though the dollar value of the world's gold bullion is 133 times greater than the dollar value of the world's silver bullion, the dollar value of gold investment flows has been only six times the dollar value of silver investment flows. In some apples-to-apples comparison, such as U.S. Mint Eagle bullion coins sales, the dollar amount spent on gold is only three times the dollar amount spent on silver. If there is not 133 times more money going into gold than into silver, why is the dollar amount of gold 133 times greater than the dollar amount of silver? Is it just investor perception?

One likely explanation is that we mine and produce more silver than gold. While that's technically true, that explanation only serves to prove my point. We mine annually about nine times more silver than gold in physical ounces, and seven and one-half times more gold than silver in dollar terms, but that's a far cry from 133 times. Relative production, either in ounces or dollar terms would suggest gold should be priced roughly eight times the price of silver, not more than 60 times, as is the case currently.

How much of gold or silver annual production is actually available for investment is misunderstood, in my opinion. Virtually all of gold's annual production of 100 million ounces (mine plus recycling) is available for investment purposes (bullion, coins and investment jewelry). That's because very little gold production is used for industrial purposes (less than 10%). At current prices, net investment flows need to run close to \$120 billion annually to absorb the new and recycled gold being produced. Many would argue, with no disagreement from me, that \$120 billion is nothing in a world where fiat money is being created in much larger amounts.

In silver, mine production and scrap recycling totals about 850 million ounces a year. But industrial, photographic, silverware, jewelry and other applications absorb roughly 750 million ounces of the 850 million ounce total production. This reflects the nature of silver and its wide variety of uses. After silver consumption is subtracted from total production, 100 million ounces is left for bullion investment. At current prices, these 100 million ounces are worth \$1.8 billion. Let's keep it simple and round that up to \$2 billion.

Let's analyze and compare these two new numbers, \$120 billion of new gold available for investment annually versus \$2 billion of new silver. Simple division shows that 60 times more new gold needs to be absorbed as investment than silver in dollar value. Or stated differently, annually there is only 1.6% as much new silver available for investment as there is new gold.

What I'm attempting to convey is how little silver exists or is being produced in dollar terms compared to gold. I'm willing to accept that many hold a personal preference for holding gold. But I doubt that many with that preference have sat down and calculated that there exists 133 times more gold than silver in bullion terms. Or that 60 times more gold than silver is available annually for investment in dollar terms.

The great disconnect here between the dollar value comparisons of gold and silver boils down to one simple explanation— the price of silver is wrong and wrong by a wide margin. Even if the price of silver was to double or triple overnight with gold remaining the same, the great disparity would still remain. I agree with the notion that gold prices may go higher. But that's not the same as suggesting that the gold price is completely wrong. It's different in silver. The price is completely wrong. And silver's mispricing exists for a very specific reason — because silver is manipulated in price.

When you get down to it, only something like a manipulated price could explain the disparities between gold and silver. Let's face it, we are talking about two very similar items known and valued by man for 5000 years. For most of that time, there was much more silver production than there was gold. Over those 5000 years the price of gold reflected its rarity compared to silver. It was priced 16 times higher. Due to industrial consumption over the past 100 years, the world now has less silver than gold.

Instead of the new rarity of silver compared to gold being reflected in the price, the

opposite has occurred. As silver continues to become rarer relative to gold, the dollar value of gold climbed over silver. If someone has a logical explanation for that, I have yet to hear it.

The only plausible explanation is that the price of silver is artificially depressed. Remarkably, there is specific credible evidence of a silver manipulation in the existence of a concentrated short position held on the world's largest silver market (the COMEX), by the largest silver trader, JPMorgan. The primary commodities regulator, the CFTC, is currently investigating allegations of this silver manipulation and thousands of public comments were just received concerning the COMEX silver manipulation. So far, the CFTC, JPMorgan, and the COMEX have yet to respond to growing allegations of the silver crime in progress. In time, they surely will be forced to respond.

In the interim, the severe undervaluation of silver presents one of the most attractive investment opportunities in history. This is a theme on which I have expounded for more than ten years. During that time, the price of silver has climbed dramatically, richly rewarding silver investors. Yet, in many ways, silver is more compelling than ever before. This is particularly true for gold investors. Since the price of gold has more than kept pace with silver over the past decade, gold investors have not missed anything by not owning silver. But past performance does not guarantee future returns. The next ten years will likely be much different than the last ten years.

There is a question that existing and prospective gold investors should consider. Given that current investment flows in gold are only six times silver investment flows; do you think the dollar value of gold bullion will continue to be 133 times greater than silver bullion over the next ten years? That doesn't imply that gold need go down in price, but it does imply that silver must go up in price. If you seek the best returns possible with the least amount of risk, silver fits the bill. A review of the facts and some simple number crunching should convince you of silver's coming outperformance.

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