Silver Opportunity Still Available

By Theodore Butler
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Back in October, I wrote an article entitled "The Real Gold/Silver Ratio Part II." In that article, **http://www.investmentrarities.com/10-24-06.html**, I introduced some new data concerning the relative total market capitalization of above ground gold, compared to silver, over the past 100 years. The purpose of the article was to demonstrate that the gold/silver price ratio was inadequate to fully convey the profound changes between these two precious metals.

I concluded that, due to the extreme rarity of above ground silver bullion compared to gold, silver would almost certainly outperform gold as an investment in the long term. As regular readers know, I have made that point often, starting with my very first article for IRI.

Why do I persist in suggesting a switch from gold to silver? It's a sensitive issue. Gold holders are devout believers in its merits. I also understand I can be criticized for appearing to badmouth gold. That's why so few ever raise the issue of substituting silver for gold ownership. I do for several reasons.

I consider myself to be an analyst. I study and weigh all the available data. I am not suggesting selling gold and calling it a day. I am suggesting a switch from gold to silver. A switch is a simultaneous purchase and sale. It doesn't mean I think gold is going to go down in value. It means that I think silver is going up more than gold is going to go up; much more.

Recently, I have been surprised by an unanimity of opinion among gold analysts that silver will outperform gold. However, there is never a suggestion to switch gold into silver to capture that out performance. I don't understand that. To me, the whole purpose of investment is to be positioned in what you think will go up the most. My suggestion of a switch from gold to silver is meant for those who predominantly own gold and don't have the available funds to buy silver. There's no need to sell gold in order to buy silver if you have the cash available to buy silver, or if you have other assets that can be sold.

If you think I'm appealing to a narrow potential audience, the facts argue otherwise. The total dollar value of the 5 billion ounces of above ground gold today is close to $3.5 trillion. The one billion ounces of above ground silver bullion have a value of $14 billion. There is 250 times more gold in dollar terms, than silver. That's trillions versus billions. Very few grasp the significance of this dollar imbalance. As time evolves, more will become aware of this mismatch and, as I will explain, it has profound implications for the price of silver.

Another reason I advocate switching from gold to silver is that it still makes sense at current prices. The gold owner has an advantage in switching now because we still have a low risk, high return opportunity. That's because gold and silver have generally moved in tandem over the past few years. Silver has mildly outperformed gold. From the dead lows, gold is up 2.75 times in price, while silver is up 3.5 times. Silver has not run away from gold. But it's just a matter of time until it does, in my opinion, based upon the available facts. Then it will be regret for those who didn't make the switch. Six months have passed since I wrote the article referenced above. At that time, silver was around $12 and gold near $600, or a 50 to one ratio.

Currently, the ratio is still near 50 to one, with gold near $700 and silver near $14. Therefore, the switch can be made at the same price ratio.

Gold is primarily an investment item whose above ground stock accumulates over time, whereas silver is primarily an industrial commodity whose available inventories have been largely disappearing. It is this inventory depletion that accounts for there being more gold in the world than silver. There's a low physical amount of silver compared to the amount of gold. There's a high price of gold compared to silver. That creates a difference in value of 250 times. Gold, with greater above ground supply, is valued 250 times more than silver with a smaller supply, and that silver is continuously being used up. These facts are still not widely known.

Gold and silver are uniquely embedded in the world's history and culture. These metals predate civilization and transcend governments, religions and borders. Almost without exception, what can be said about gold can be said of silver. They are both historical and universal forms of money, stores of value, hedges against depreciating paper currencies and assets that are no one else's liability. The differences between gold and silver are almost universally unknown. In the last century, silver was demonetized and dishoarded by the world's governments. That dishoarded silver was industrially consumed or put into a form that made it no longer available. That epic dishoarding and consumption completely up-ended the world's historical balance of how much above ground silver there was compared to gold.

Silver comes out of the ground in an amount roughly 8 times greater than gold. This has been true for hundreds and thousands of years. Because of this, there used to be many times more above ground silver in to world than gold. But that is not the case any longer. Starting in the middle of the last century, we have been industrially consuming the world's silver inventories. This has caused the reversal of the relative size of world gold and silver stocks.

Based upon the current price of each, it appears that the world believes there is still many times more silver above ground than gold. Certainly, the world doesn't believe there is less above ground silver than gold. Perhaps one in a million, or one in ten million, of the world's 6.5 billion inhabitants know silver is rarer than gold. I think it is reasonable to assume that many more will come to learn this truth in the years ahead, with an enormous impact on price. Rarity is a very basic concept that all people intuitively understand.

The main difference between gold and silver is that you can never have a shortage in gold because it is not industrially consumed. The price of gold can go higher, of course, but not because of a shortage. Silver, precisely because it is an industrial commodity (in addition to being an investment item), must go into a shortage, considering the disappearing inventories. That's what creates the opportunity in switching from gold to silver. Such a switch has the benefit of low risk, since it's highly unlikely silver will decline more than gold. It is much more likely that silver will greatly outperform gold, as the world wakes up to these facts. There are signs emerging that a few are beginning to grasp that reality.

Run Silent, Run Deep

New data suggest that a silent investment run may be developing in silver, by deep-pocket institutional investors. Statistics from the US publicly traded Exchange Traded Funds (ETFs) suggest a disproportionate amount of buying in the silver ETF (SLV) relative to buying in the gold ETFs (GLD and IAU).

We are nearing the one-year anniversary of the silver ETF. In that time, 136 million ounces of silver, worth almost $2 billion, have been purchased by the trust. Certainly this is much more silver than any observer predicted, including me. Currently, there are almost 17.5 million ounces, worth $12 billion, in the combined GLD and IAU ETFs. (I am limiting my comparisons to the US ETFs to reduce the variables. Although there are other gold ETFs oversees, the two US versions hold 90%+ of total gold ETF assets).

Therefore, the dollar amount of gold in the combined ETFs is only a little over 6 times the dollar amount of silver held in the (lone) silver ETF. I say "only" because there is 250 times more gold, in dollar terms, than silver in total above ground totals. One would think there would be much more money in the gold ETFs than just 6 times what is in the silver ETF. And if you normalize for the shorter time of existence for the silver ETF compared to the gold ETFs, the comparisons are more dramatic.

One year after the introduction of the big gold ETF, GLD (Nov 2004 to Nov 2005), and including the IAU (Jan 2005 to Nov 2005), these two gold ETFs held a combined 7.7 million ounces of gold, then worth $3.8 billion. Therefore, at the one year anniversary of the respective silver and gold ETFs, there was only 2 times as much gold, in terms of dollar amount, than there was in the silver ETF.

My conclusion from this data is that a disproportionate amount of institutional buying has taken place in the silver ETF relative to the buying in the gold ETFs. Two possible explanations come to mind to account for this disproportionate silver buying. One, some well-informed institutional investors have decided to establish a disciplined position in silver. I use "disciplined" because the buying has been systematic and even. The second explanation has to do with pure index-fund type buying to achieve the proper weightings of silver in the popular commodity indices. This type of buying is also even and systematic. Either explanation would fit with a silent developing "run" on silver by deep pockets.

The buying in the silver ETF, even as disproportionately large as it is compared to gold, does not have the feel of "hot" institutional money. The big "mo-mo" (momentum) hedge fund buying that chases price performance has yet to appear in silver. I think it’s a safe bet to say that it will arrive some day.

The important point is that big institutional money is flowing into silver on a disproportionate basis, as the statistics indicate. It is only a matter of time before this buying causes a disproportionate impact on the price of silver. For me, it’s never been a case of gold not being a good investment, but a case of silver being far superior. If you fit the profile of someone who can take advantage of this opportunity, please don’t let it pass by. Don’t wait for the mo-mo guys to buy first.