

Silver versus Gold, with silver updates

In August of 2004, when Silver was \$6 and Gold was \$380 I wrote the 4 reasons for liking silver more than gold.

- Supply and demand -

Mine production could not satisfy physical demands of either gold or silver. However, I like silver better because most official sectors, such as the US government, have run out of silver. Only governments do nutty things like selling a valuable asset to suppress its price. I trust the private enterprises holding silver stockpiles to be logical (i.e. profit-seeking) participants in the silver market. If Mr. David Morgan were right that China provided most of the silver to fulfill the demand for the last few years, then the silver picture would just get more bullish. I expect China in a year or two will be a net silver importer (if it has not already), just like soybeans, copper, steel, and any other commodity you can think of.

- Commercial position -

Every short position has to be covered. The silver commercials at times are net short an entire year of silver mine production. The situation for gold is much less severe. If any COMEX market has a chance of blowing up, silver is it.

- Consumed vs Stored -

There is a lot of gold above ground to go around. But for silver, once it goes into that laptop or fridge, it is gone. Silver has a chance to repeat what palladium did in 2000 (when it raced from \$350/oz to over \$1,000/oz in 12 months).

- Speculative/public interests -

Thanks to Ted Butler, David Morgan, and Gata, I think a number of people with \$billions are watching silver. Tech funds are not all that stupid. Now that they have been burned a few times, they will figure out a way to beat the commercial shorts. And the way to do it is quite easy as Buffet did it in 1997: accumulate the physical and make it known after the fact.

Back in 2004, silver bears pointed to three things:

- Unknown quantity of existing stockpiles -

They say there is a lot of Indian silver to go around. Well, obviously not at \$5/oz or the US government will not have run out of silver last year. The least we can say is that existing silver owners expect to release their inventories at a price above \$5/oz.

- Silver is bulky -

That has to be the lamest excuse. Storage fee amounts to no more than 2% a year. In 1998, I did not hear mutual fund investors complain about the 5% front sales load when they received double-digit returns.

- Silver is an industrial metal and not an investment-

Well for me, anything that goes up in price is a good investment. In the past month, silver handily outperformed gold, platinum, and palladium. That sounds like a good investment to me.

I continue to hear arguments on gold vs silver. Most of them are personal opinions. Some analysts pointed to how much more silver is produced over gold (600 million oz vs 80 million oz). Well by that logic, palladium with 4-million-oz of annual production, should be trading at well over USD \$1000/oz+.

Other analysts pointed out some historic data and concluded that gold will outperform silver. I let the market do the talking. Both silver and silver shares have performed better than gold and gold shares this year. There is a gold equivalent of SSRI and it is called VGZ and it sells at 1/10 of SSRI's market capitalization. This shows how much premium silver shares command in the market over their gold counterparts. In today's world, where paper money far out-supplied any metal at current prices, fundamental physical supply and demand of the metal itself is really irrelevant. *Simply put, people will be voting with their papers.*

The scenario will go like this - a \$1 billion hedge fund makes \$200 million from gold futures, reads about silver, decides to put \$100million in silver and instantly bumps the silver price by \$2/oz. Others read the tapes and follow - the bull becomes a self-fulfilling prophecy. Coupled with that, apparently no-one can go to the physical market and dump 100 million oz of silver to cool the fire makes silver a no-risk bet.

Update: Today

- Stated government sale has not decreased-

Official Government sales according to the world silver survey have not decreased since 2004.

World Silver Supply and Demand

(in millions of ounces)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Supply										
Mine Production	520.0	542.1	556.8	590.9	606.2	593.8	600.7	622.2	645.7	646.1
Net Government Sales	--	33.5	97.2	60.3	63.0	59.2	88.7	61.9	65.9	77.7
Old Silver Scrap	169.3	193.9	181.6	180.7	182.7	187.5	184.0	181.5	186.4	188.0
Producer Hedging	68.1	6.5	--	--	18.9	--	--	9.6	27.6	--
Implied Net Disinvestment	78.9	45.2	42.0	83.5	--	8.3	--	--	--	--
Total Supply	836.3	821.2	877.5	915.4	870.8	848.7	873.4	875.2	925.6	911.8

Demand										
Fabrication										
Industrial Applications	319.5	313.2	336.1	371.3	332.4	336.5	346.8	364.2	405.8	430.0
Photography	217.4	225.4	227.9	218.3	213.1	204.3	192.9	181.0	162.1	145.8
Jewelry	150.6	140.6	159.8	170.6	174.3	168.9	179.2	174.8	173.8	165.8
Silverware	117.7	114.2	108.6	95.6	105.2	82.6	83.0	66.2	66.6	59.1
Coins & Medals	30.4	27.8	29.1	32.1	30.5	31.6	35.6	42.4	40.0	39.8
Total Fabrication	835.6	821.2	861.5	888.0	855.4	823.9	837.4	828.6	848.3	840.5
Net Government Purchases	0.7	--	--	--	--	--	--	--	--	--
Producer De-Hedging	--	--	16.0	27.4	--	24.8	20.9	--	--	6.8
Implied Net Investment	--	--	--	--	15.4	--	15.0	46.6	77.2	64.5
Total Demand	836.3	821.2	877.5	915.4	870.8	848.7	873.4	875.2	925.6	911.8

Silver Price (London US\$/oz)	4.897	5.544	5.220	4.951	4.370	4.599	4.879	6.658	7.312	11.549
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SOURCE: World Silver Survey 2007

In 2004, silver's established firm bottom around the same time the US Treasury ran out of silver may be a pure coincidence. Or maybe:

1. Other governments demanded a better price for their silver than the US government causing the silver price to rise despite persistence government sales.
2. The well advertised fact of the depleting US treasury silver inventory might have triggered more net implied investment demand, up from 15 million oz in 2003 to over 70 million oz in 2005.

- *Commercials short position is bigger than ever*

Commercials piled on 100,000+ short contracts in 2004, now it is at 140,000+. That is 500 million oz before vs 700 million now. How does one explain more shorts with a rising silver price? Perhaps the day of reckoning of massive short covering is to come? Or perhaps there is no real correlation between silver shorts and the silver price?

- *Implied Net Investment Demand Grew*

While net investment demand grew in 2005 and 2006, it still accounted for less than 10% of total physical demand. One should take such figure from World Silver Survey with a grain of salt. As no one truly knows how much physical silver changed hand privately.

Conclusion

In today's world, where paper money far out-supplies of any metal at current prices, fundamental

physical supply and demand of the metal itself is really irrelevant. Simply put, *people will be voting with their papers.*

The case applies to silver, gold, grain, oil, and any commodity. After all, how can one blame the tripling of wheat prices in the past 12 months on China? Did all of 1.3 billion Chinese changed their diet habit and switched to bread overnight?

People vote with their papers. The Commitment of Traders Report shows today's positions have grown by 20%+ for silver (200 million oz) since 2004. There was a strong investment demand to counter the dealer shorts. 200 million oz is merely \$4 billion with present invest-able dollars, measured at tens of \$trillion (if not over \$100 trillion). Any micro-analysis based on today's silver stats does not carry much significance.

Since August of 2004, Gold has gone up 250% from \$380/oz to \$950/oz, while silver has gone up 300% from \$6 to \$18.5. As the 4 pro-silver reasons I outlined in the article begin to further manifest themselves, the percentage of performance difference to date will be seen as negligible compared to what's to come.

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