

Silver Investment

Investment has been a core element of the silver market since its very beginning. For thousands of years investors stored a portion of their wealth in this white metal via such vehicles as ornamentals and jewelry. Silver investment has also been facilitated through a variety of monetary systems. In fact many historians believe this metal was used in the oldest form of coinage.

With silver as money, investors have been able to use physical coins as means to store their wealth. From the drachmas used by the ancient Greeks to the famous Spanish pieces of eight, silver coins are an integral part of this metal's *precious* lineage.

Silver was even a part of the United States' monetary system through 1965. Up until this time silver coins were in circulation and you could redeem \$1 Silver Certificates with the federal government in exchange for physical silver. At Zeal we've long recommended that investors hold bags of 90% junk silver as a foundational physical PM investment. These bags are loaded with pre-1965 quarters and dimes, which were made from 90% silver and 10% copper.

But with the worldwide demonetization of silver, industrial demand along with investment and speculation activities have become the drivers of silver's price movements. In the last century or so the world has shifted away from a long period where governments were silver's main buyers and brokers.

On the industrial side of things the middle of the 20th century brought about technological innovations that radically altered silver's landscape. Silver went from a metal that was mainly used in the production of things precious to a metal that would see the majority of its consumption come from industrial applications.

With silver's ductile/malleable nature and the fact that it has the highest electrical conductivity of all metals, its industrial uses have become indispensable. Silver's use in such things as electronics, mirrors, batteries, photography and countless other products has greatly boosted its utility in things non-precious.

But amidst this industrial silver revolution, investment and speculation is not to be forgotten. In fact since the late 1960s it is this contingent of the silver trade that has had the most influence on silver's market price. Even though industrial consumption has been growing at a sharp rate, its silver demand has been predictable for the most part. The supply chain (mining, scrap, and government sales) can usually come close to balancing demand. But silver investment and speculation is the wildcard.

And silver's changing dynamics are not limited to the technology seen on the industrial side, but extend to the financial markets. Provocatively silver investment is not just a physical possession thing anymore. As the financial

markets have grown more sophisticated, synthetic investment has gained a growing influence on the silver scene. The futures and ETF markets in particular have had major impacts.

The evolution of the silver futures markets has allowed speculators to game the price movements of this metal. And silver historians are well aware of the occasions where the futures markets converge with the physical markets. Back in 1979/1980 some notorious speculators took delivery on a large chunk of silver when their futures contracts expired. And this had a staggering impact on the price of silver.

But the futures markets are not a formidable measure of *investment*. In reality, aside from the hedging utility of these markets, futures are simply a playground for highly-sophisticated and risk-tolerant speculators. When it comes to measurable investment the best place to start in understanding its role in the silver trade today is the data published in the World Silver Survey. This survey is a detailed study that is performed annually by PM-mining consultancy [GFMS](#).

GFMS does a fine job tracking global silver supply and demand. Its “fundamental” picture of the silver market scrubs fabrication demand with mine and scrap supply to determine a balance of trade. And according to GFMS the silver market was running a supply deficit for many years leading up to 2007 when the markets shifted to a “fundamental” surplus.

Well since fabrication demand and mine/scrap supply never equal out, GFMS fills the gap by plugging in net government sales, producer hedging or de-hedging, and then uses simple math to determine an *implied* net investment or disinvestment. This last category is just a calculation that brings supply and demand to an equilibrium after all other factors are taken into account, and what I will focus on today. A table that shows silver’s balance of trade for the last 10 years can be viewed on the [Silver Institute’s website](#).

For example, from the late 1980s through 2000 the standard supply chain was falling short of meeting growing fabrication demand. But since the consumers were getting their silver from somewhere, it is assumed that this gap was filled by investors selling their silver into the market. To formally balance the silver trade GFMS labels this gap as implied net *disinvestment*.

But since 2000 total fabrication demand has fallen (demand in industrial applications were on the rise but demand for photography and silverware were falling at a faster rate) while mine supply has been rising. And when government sales are included in supply, there has actually been a supply surplus. This is where silver investment really comes into play. This excess supply is shunted into what GFMS tags implied net investment.

So with the silver supply growing, fabrication demand down, yet the price of silver still *climbing*, it is obvious that investment demand is the impetus for silver's impressive secular bull market since 2003. And I believe a big factor in silver's recent success and a big proponent for continually growing investment demand is the iShares Silver Trust (SLV), the world's largest silver ETF.

Like [GLD for gold](#), SLV has had a tremendous impact on silver investment. This ETF has given stock investors an easy and cheap way to obtain exposure to silver. And because of its popularity, SLV's accumulation of physical silver has had a dramatic effect on silver's true fundamentals.

Here's how SLV works. Like any other ETF, it is designed to track the price of its underlying asset. In order to do so its custodians must actively manage its capital inflows and outflows. And since SLV is backed by physical bullion this fund is actively buying or selling the metal to balance demand and supply. If it didn't act to balance the flow of capital, the fund would risk decoupling from the price of silver either to the upside or downside.

If the demand for SLV shares is outpacing their supply, the custodians must issue new shares and then use this capital to buy more physical silver. Inversely if supply is outpacing demand, there is more selling than buying, the custodians must liquidate enough physical silver to pay for the shares that are being sold back to them.

A unique characteristic of SLV is it allows us to actively monitor stock investor interest in silver since its custodian discloses its bullion holdings on a daily basis. And we can view the expansion or contraction of these holdings in strategic context to show silver's popularity on the investment front. The corresponding trend is easy to visualize when the data is plotted in chart format.



As you can see there has been outsized demand for this ETF. Since its inception in 2006 stock investors have piled into SLV and grown it to become one of the world's largest ETFs. From the hefty buying upon its highly-anticipated IPO through current, SLV's holdings have grown to incredible heights.

And by overlaying the price of silver on this chart another unique SLV trait sticks out. You will notice that the movements of SLV's holdings are generally independent of silver's price action in the futures markets. And this is illustrated right from inception. Shortly after SLV went live silver's powerful 2006 upleg came to an end. And in the subsequent sharp correction and then long consolidation into 2008 you'd have thought investor interest in this metal would have taken the same path.

But SLV's resilience showed the moxie of the stock-market silver investor. Investment in this precious metal during this consolidation period would not wane. Not only did SLV's holdings grow to 121m ounces by the end of 2006, only 8 months after inception, they grew by an additional 48m ounces in 2007.

And with 2008 starting out with a bang for the price of silver, it is no surprise that SLV's holdings continued to rise. But SLV's actions from June 2008 on are really striking. After it tested \$20 again, silver tanked in the summer of 2008 and then fell even farther amidst the stock panic. Its price was sliced in half in less than 6 months. But what did SLV's bullion holdings do over this same period of time? They grew! While they did level out a bit during the grips of panic, 2008 saw overall SLV bullion holdings grow by 50m ounces.

The consistent bullion growth within this ETF has really highlighted the growing impact and importance of silver investment. And SLV's celebrity is not retreating behind the curtain. From their low point after the small panic decline, SLV's holdings have grown by 32% to current and it continues to break records. So far in 2009 SLV has added *over 60m ounces* of silver to its holdings!

With SLV alone showing substantial silver investment throughout its existence, we can view GFMS's supply-and-demand study from a different angle. While supply has indeed exceeded fabrication demand, it has only exceeded it so much as to allow for implied net investment of 67m, 25m, and 50m ounces in 2006, 2007, and 2008 respectively. But with *SLV alone* showing investment demand of 121m, 48m, and 50m ounces over this same period of time, I view silver's fundamentals a bit differently.

With SLV formally publishing its silver holdings, not all investment (outside of coins) is implied. If we scrub SLV's silver holdings up against GFMS's implied net investment over the last 3 years, there is actually a *supply deficit of 77m ounces*. And this is a conservative figure. This 77m-ounce shortage is only taking into account SLV. Not only are there other avenues of investment not captured here, but the Swiss- and UK-based silver ETFs have accumulated at least 60m ounces of silver in their own vaults in the last 3 years.

Ultimately SLV has been a huge boon to the silver market. It is an excellent conduit to funnel stock-market capital into silver and it has given this metal exposure to a whole new class of investors. While the physical possession of silver bullion is the optimal way to invest, the large majority of investors buying SLV would not likely have invested in the metal otherwise.

For a variety of reasons (dealer premiums, storage hassles, security, etc...) most mainstream retail investors are not likely to seek out physical silver. SLV is a great alternative for these nontraditional investors. But not only does SLV offer the retail stock investor an opportunity to own this metal, it opens up silver investment to institutional investors.

Most pension, mutual, and hedge funds are not able to trade futures or physically own commodities. But since SLV trades like a stock, these funds are now able to own silver and gain even better diversification in their portfolios. And with the growth seen in coins and medals (according to GFMS up 123% in the last 10 years and 63% YoY in 2008) it is not likely that SLV is taking away too much from the physical market.

It will be interesting to see if SLV can continue its amazing growth trend. But I don't see why it cannot. SLV's market cap is only \$4.2b compared to the S&P 500's \$8400.0b. With the states of the global economy and flagging fiat currencies that are being [inflated into oblivion](#), investors are beginning to realize the importance of diversification into hard assets, particularly precious metals.

Even if 5% of stock-market capital was shifted into PM holdings via ETFs, there is a lot of room to run for SLV.

But while SLV is a fantastic medium for stock investors to gain exposure to silver's price movements, the more risk-tolerant investors can seek leverage to this metal via the mining stocks. The mining industry has really had to respond to fast-growing silver demand over the years. In the first half of the 20th century global mine production was relatively flat, but in the second half it has had to greatly increase. According to the US Geological Survey world mine production is up 229% since 1950.

And with government stockpiles dwindling there is less of a cushion for these miners. In years past most miners sold their silver directly to the government. As there was market demand for silver, governments would pull from their stockpiles and sell it to consumers. But with the universal demonetization of silver most governments stopped buying silver. And over the years government central banks have liquidated their silver holdings to raise cash, thus supplementing mine and scrap supply to meet demand.

According to GFMS net government sales are way down, a third of what they were 10 years ago. In 2008 this supply channel was responsible for only 3.5% of total supply. And it will likely continue to fade as GFMS estimates there are only about 70m ounces in total government stockpiles remaining.

This effect is seen via mine production's growing portion of total supply. In 1999 mine production was responsible for 67% of total supply while in 2008 it was responsible for 77%. With silver miners now selling their product directly to market and it being a larger portion of the supply chain, silver stocks are more meaningful now than ever before.

Interestingly if you want to gain leveraged exposure to silver via silver stocks, there is a limited pool to choose from thanks to silver's byproduct nature. Only about a quarter of the annual mined supply comes from mines in which silver is the primary source of revenue. And only 14% of mined silver comes from mining companies that consider silver their primary metal. In my essay last week I discussed [silver's byproduct nature](#) in detail.

I also discussed how incredibly small the silver stock sector is when you exclude the non-primary silver mining companies. In our research to uncover the entire universe of primary silver stocks we found *less than 100*. This research fed our newest [research report](#), and when we were done going through all these stocks we narrowed them down to our favorite dozen.

If you are looking for high-potential silver stocks that are well-positioned to capitalize on silver's ongoing bull market, please consider [purchasing this report](#). The Zeal-12 range from juniors that are advancing the world's next generation of

silver mines to elite senior producers already well-leveraged to amplify this metal's fortunes. Each of these companies is comprehensively profiled in this fascinating 33-page report.

The bottom line is silver investment has become the driving force behind silver's secular bull. A greater number of investors are realizing the importance of diversifying away from the general markets and the dollar. And one of the tools that has greatly helped market silver to the investing public is the Silver Trust ETF. SLV alone is responsible for a large portion of silver investment growth and continues to draw in stock-market capital.

To gain leveraged exposure to this shiny white metal investors can tap the stocks of the mining companies that bring it to market. Though the miners that consider silver their primary metal are a little harder to come by, there are still plenty to choose from. Those stocks that are well-positioned to leverage silver's gains will greatly reward investors over the course of this bull.

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So how can you profit from this information? We publish an acclaimed monthly newsletter, [Zeal Intelligence](#), that details exactly what we are doing in terms of actual stock and options trading based on all the lessons we have learned in our market research as well as provides in-depth market analysis and commentary. Please consider joining us each month at ... www.zeallc.com/subscribe.htm

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